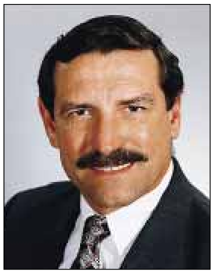
MESSAGE FROM THE ACTING CHIEF FINANCIAL OFFICER



During 1997, I assumed the role of Acting Chief Financial Officer (CFO) of the Patent and Trademark Office (PTO) and the responsibilities for the fiscal management and stewardship of its assets and resources. During this time, the PTO has continued to provide quality products and services to hundreds of thousands of customers all around the world.

As we conclude FY 1997, I am pleased to report that the PTO also continued its financial successes. The Statements of Financial Position reveal that our assets increased 22 percent during FY 1997, rising from $568 million to $694 million. At the same time, our liabilities increased 10 percent, rising from $360 million to $398 million. The Statements of Operations and Changes in Net Position demonstrate a 30 percent return on equity during the year, despite a 61 percent increase in the cumulative amount of revenues withheld. This statement also shows that our revenues climbed to more than $733 million, a more than 18 percent increase from the previous year. However, Congress withheld $54 million of these revenues and restricted their use by the PTO. The amount of customer-paid revenues withheld is scheduled to increase to $92 million in FY 1998.

As we progress into the new fiscal year and closer to the start of the new millennium, we find ourselves managing a multitude of operational changes and financial management reforms. At the same time, we remain committed to providing our customers with the highest level of quality and service. Our financial management organization consists of a solid group of finance, procurement, budget and accounting professionals whose dedication to fiscal accountability and sound management practices is unparalleled. Our financial management organization has made—and continues to make—significant improvements to our financial management, reporting and accounting systems. Most significantly, we continue to re-engineer our resource management processes, which will facilitate our planned transition to a performance-based organization. An important key to this transition is the implementation of the Government Performance and Results Act of 1993 (GPRA).

During FY 1997, we continued to enhance our technological capabilities through various financial management system modifications. Significant accomplishments include deployment of a new revenue accounting system, and upgrades to the property subsystem, the procurement subsystem, and the travel subsystem. In addition, enhancements were planned for the budget formulation and allocation subsystems. We successfully awarded several contracts using the reengineered contracting process known as ReMap/Conops, thus paving the way for it to be our standard method of conducting procurements. We are on course to realizing the goal of a fully integrated financial management system that provides reliable, accurate, timely, and accessible financial information.

As CFO, I am committed to providing effective financial planning, management, and reporting to ensure increased productivity and sustainable economic successes. Our FY 1997 financial statements have demonstrated this commitment by earning an unqualified opinion from the Office of Inspector General for the Department of Commerce. I want to thank our customers, employees, and stakeholders for their continuing support. We look forward to the future with confidence.

E. R. Kazenske

Edward R. Kazenske
Acting Associate Commissioner and
Chief Financial Officer

PATENT AND TRADEMARK OFFICE AT THE CLOSE OF FY 1997

Main Offices: Arlington, Virginia, distributed through 16 buildings and 1,723,465 square feet of space

Other locations: Two storage facilities in Springfield, Virginia; leased storage in Boyers, Pennsylvania

Number of employees: 5,134 full-time equivalent staff

Phone number: 1-800-786-9199

Funding sources: The PTO is funded entirely through user fees

Statutory Authorities:

- 15 U.S.C. 1051-1127 contain provisions of the Trademark Act of 1946 that govern the administration of the trademark registration system.
- 15 U.S.C. 1511 places the PTO under the jurisdiction and supervision of the Department of Commerce.
- 35 U.S.C. contains basic authorities for administering patent law, derived from the Act of July 19, 1952, and subsequent Acts. Revenues from fees are available to the PTO to the extent provided for in appropriations Acts.
- 44 U.S.C. 1337-1338 contain the PTO's authority to print patents, trademarks, and other matters related to the PTO's businesses.

Creating a Patent and Trademark System for the 21st Century   Fiscal Year 1997   A Patent and Trademark Office Review

FINANCIAL REVIEW

The PTO administers U.S. patent and trademark laws, protecting the inventions and ideas of inventors, businesses, and the public. Patent and trademark products serve to bolster domestic and international markets, fuel American business expansion and exports, encourage advancements in technology, and improve the quality of everyday life.

For the past decade, the PTO has been streamlining its operations and incorporating advances in information management technology in its processes. The PTO is determined to make its quality products and services more affordable, and to keep pace with burgeoning demand. The PTO is striving to improve the automated patent and trademark application examination processes by replacing paper applications with electronic submissions. In fact, the prototype of the trademark electronic application is available for review on the PTO's Internet web site. The PTO is also continuing all efforts to increase the speed of patent searches, and to expand accessibility to patent and trademark information.

During FY 1997, the PTO continued its significant technological and developmental efforts. The PTO's FY 1997 cash outlays for new property and equipment—primarily computer hardware and software—totaled $83.4 million, exceeding amounts expended in any previous year. Such investments in new information technologies and advanced communications enable the PTO to provide the flexibility and service that patent and trademark customers demand—ready access to information and the ability to interact electronically with the PTO. Customer demand for high-quality, timely protection of intellectual property rights continues to increase significantly each year. In fact, the PTO's earned fee revenues and reimbursements for FY 1997 reached $733.9 million, an all-time high.

FY 1997 was a notable year, not just at the PTO, but throughout the Federal government, as agencies continued striving to produce audited financial statements in compliance with the requirements of the Chief Financial Officers Act of 1990 (CFO Act), as amended by the Government Management Reform Act of 1994 (GMRA). These two acts have resulted in the promulgation of a body of generally accepted Federal financial accounting and reporting standards that impose numerous financial management requirements upon Federal entities. These include developing cost management and accounting systems, developing integrated financial management and accounting systems, and improving capital asset reporting and accountability. Also, the Government Performance and Results Act of 1993 (GPRA) requires agencies to develop effective strategic plans and performance measures that demand more reliable financial information.

In recent years, the PTO has made significant progress in implementing Federal financial management reforms. For FY 1996, only four out of the 24 departments and major agencies subject to the CFO Act received both unqualified and timely audit opinions. The PTO, a bureau of the Department of Commerce (DOC), also received a timely unqualified opinion for FY 1996. Only 45 percent of Federal agencies required to use the U.S. Standard General Ledger (SGL) do so at the transaction level. The PTO has been SGL compliant at the transaction level since FY 1992. The PTO is also one of 14 agencies which will pilot the Federal Agencies' Centralized Trial-Balance System (FACTS) II, budgetary accounting reporting. Notwithstanding the fact that the PTO is on the forefront of Federal financial management reform, it has also completed numerous substantive initiatives to further improve its operations, ensure operational and financial accountability, provide accurate and reliable financial reporting, and ensure compliance with Federal financial accounting and reporting standards. These initiatives have included: (1) conducting major process re-engineering efforts in the patent area to achieve pendency goals;

(2) developing a new revenue accounting system that enhances the processing of cash receipts and customer deposit account transactions; (3) developing comprehensive procedures for asset management and accountability; (4) strengthening internal controls in all aspects of equipment and software acquisitions and accounting, including implementation of an automated fixed asset subsidiary system and related property management database; and (5) developing cost management methodologies and cost accounting models that can capture and distribute costs associated with the PTO's operations, business units, and specific products.

These initiatives have contributed to enhanced financial accounting and reporting and have substantially improved the PTO's ability to produce meaningful, accurate financial statements annually. Indeed, this is the sixth year the PTO has provided its customers and stakeholders a comprehensive set of financial statements with related footnote disclosures.

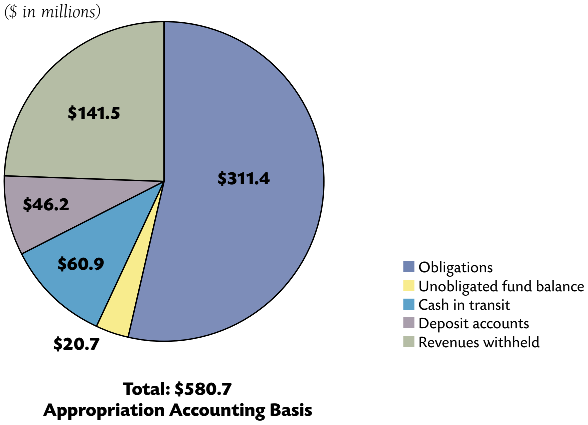
The PTO's FY 1997 financial statements were compiled in accordance with guidance issued by the Office of Management and Budget (OMB) and supplementary guidance provided by the DOC. The DOC Office of Inspector General (OIG) audited the PTO's FY 1997 financial statements. In the OIG's Report on Internal Control Structure, the OIG made recommendations for improving certain internal controls and promoting operating efficiencies. Substantive actions have been initiated by the PTO's management officials to implement these recommendations. As in past years, the PTO was issued an unqualified opinion on its financial statements.

Although the PTO prepares and publishes financial statements on an accrual basis in accordance with the CFO Act requirements, it still operates on the cash basis required by appropriations law. The PTO has no investment authority, no borrowing authority, and no lines of credit. For the PTO to spend a single dollar, it must have already collected that dollar. By the end of the fiscal year, there must be collected fees in the Fund Balance with the U.S. Department of the Treasury (Treasury) account to cover all outstanding obligations and commitments (for goods or services not yet delivered). However, under generally accepted accounting and reporting requirements, these commitments, or outstanding contracts, do not appear on the accrual basis financial statements until the goods or services have been provided, and are only referenced in footnotes to the financial statements.

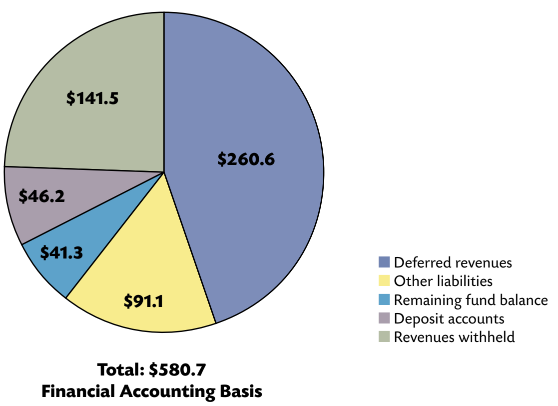
The unobligated balance of total funds available to the PTO amounted to $20.7 million at the end of FY 1997. This is only a small percentage of the PTO's total cash and Fund Balance with Treasury. The nature of the CFO Act financial statements, if interpreted on a cash basis, for an appropriated government entity, may lead the reader to the conclusion that the PTO's cash and Fund Balance with Treasury are funds available for obligation, rather than funds that have previously been obligated and that will be used to liquidate current outstanding contractual commitments. Private enterprises would not have these outstanding obligations and commitments outside of the financial statements and would not keep such large fund balances on hand; rather, fund balances would be invested.

The charts below illustrate the differences between accounting for fund balances on the appropriations accounting basis used in the budgeting process, and the financial accounting basis as reported under the requirements of the CFO Act.

Claims Against Fund Balance with Treasury
($ in millions)



Claims Against Fund Balance with Treasury
($ in millions)

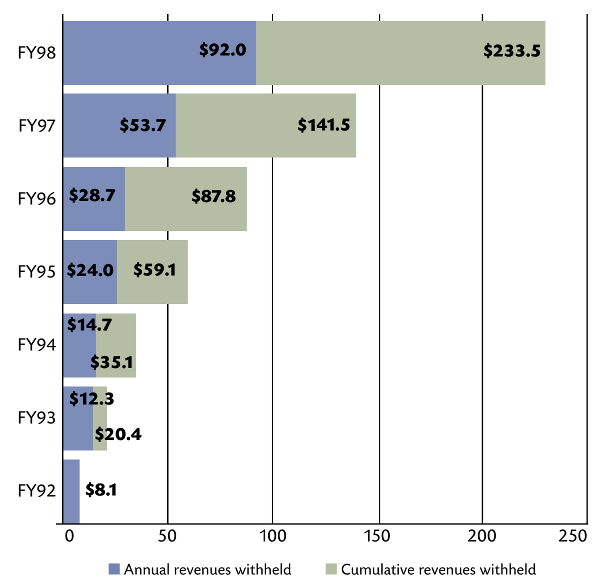


The Omnibus Budget and Reconciliation Act (OBRA) of 1990, as amended in 1993, provided for a 69 percent increase in statutory fees to allow the PTO to become fully funded by its customers through the collection of user fees. This customer fee increase was initially collected by the PTO and placed in a special restricted account at the Treasury. Although the fees were collected by the PTO, the use of the funds was controlled by Congress. Subsequent legislation removed the percentage requirement, requiring the PTO to deposit specified amounts of fees into the special account each year. Budget authority must be appropriated in order for the PTO to use these fees.

Since FY 1992, Congress has continued to withhold increasing amounts of the PTO's customer fees. Initially, the amounts withheld were small compared with the PTO's revenues. They ranged from $8.1 million in FY 1992 to $53.7 million in FY 1997. The PTO was able to absorb these revenue restrictions in its operating budget with controlled adverse effects on its programs. In fact, the annual amount of fees withheld has risen more than 563.0 percent since FY 1992, and the cumulative total of fees collected by, but unavailable to, the PTO as of the end of FY 1997 was $141.5 million. In FY 1998, the customer fees withheld will increase 71.3 percent, from $53.7 million to $92.0 million.

This revenue restriction of $92.0 million can be absorbed only in the operating budget of the PTO. For FY 1998, the cumulative amount of fees withheld will reach $233.5 million, according to current appropriations and apportionment schedules. By law, these restricted revenues are available to the PTO only through the appropriations process.

Trends in Annual and Cumulative Revenues Withheld
($ in millions)



SELECTED ASSET ACCOUNT ANALYSES are presented to assist the reader in understanding the nature of the assets included in the statements of financial position, the current trends, and the extent of the future economic benefit to the PTO. The most significant assets owned and managed by the PTO are cash, Fund Balance with Treasury, and property and equipment.

Cash and Fund Balance with Treasury

User fees are the source of most revenues earned by the PTO. Patent and trademark rights, grants, registrations, and related products and services are sold to the public for fees assessed. As demand for the PTO's products and services has increased, fee collections have continued to climb, with a concurrent increase in workload.

The PTO began the year with a total of $492.4 million in its cash accounts and Fund Balance with Treasury. Of this amount, $288.4 million was set aside for the payment of obligations, $87.8 million was withheld from the PTO as required by the OBRA, $47.7 million represented checks in transit, $41.5 million represented moneys held in trust for the PTO's customers, and $0.9 million was reserved for a rescission of restricted funds. Only $26.1 million—or 5.3 percent—of the PTO's cash accounts and Fund Balance with Treasury was available to meet patent and trademark program needs arising in FY 1997 and future years.

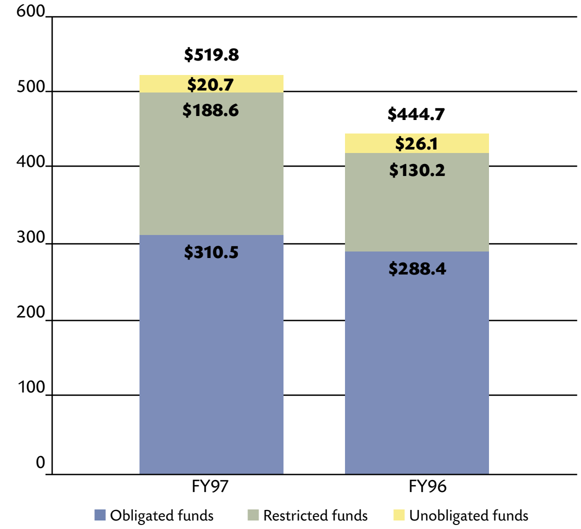
During FY 1997, the PTO generated a net of $171.6 million in cash from patent and trademark fees and other sources, as indicated by the net cash provided by operating activities in the statements of cash flows. This represents a $37.1 million increase over the $134.5 million in net cash provided by operating activities for FY 1996. As indicated by the net cash used in investing activities in the statements of cash flows, $83.4 million of the $171.6 million generated from operating activities was used solely for the purchases of new property and equipment, principally automation technology. This amount represents an increase of $34.4 million over the $49.0 million net cash used in investing activities for FY 1996. Total cash provided during FY 1997 by both operating activities and investments in property and equipment was $88.2 million, an increase of 3.2 percent over the $85.5 million provided during FY 1996.

The PTO ended FY 1997 with a total of $580.7 million in its cash accounts and Fund Balance with Treasury, a 17.9 percent increase from the $492.4 million balance at the end of FY 1996. Of this FY 1997 year-end amount, $310.5 million was set aside for the payment of obligations, $141.5 million was withheld from the PTO as required by the OBRA, $60.9 million represented checks in transit, $46.2 million represented moneys held in trust for the PTO's customers, and $0.9 million was reserved for a rescission of restricted funds. Only $20.7 million—or 3.6 percent—of the PTO's ending cash accounts and Fund Balance with Treasury is available to meet patent and trademark program needs arising in FY 1998 and future years.

While the PTO operates as a fully customer fee-funded operation, it remains a U.S. Government entity subject to Federal appropriations law and is not authorized to freely invest its cash and fund balances. The PTO's Fund Balance with Treasury includes amounts set aside for the payment of outstanding obligations and restricted funds for the customer deposit accounts, nonentity funds, and revenues withheld by Congress.

The following chart indicates the portions of the Fund Balance with Treasury that represent obligated funds, unobligated funds, and restricted funds.

Fund Balance with Treasury
($ in millions)

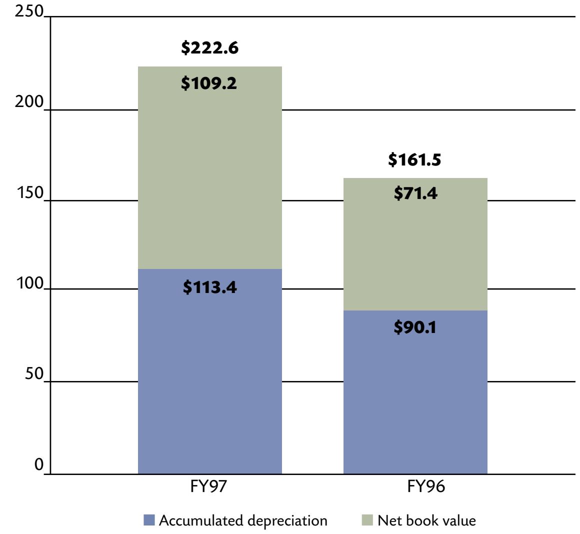


Property and Equipment
The PTO's property and equipment (P&E) include hardware, software, and office furniture and equipment. The PTO's investment in automation technology has increased substantially in recent years, as many processes transform from paper-based to electronic systems, as old equipment is replaced with newer technology, and as operating and application software are purchased and upgraded to keep pace with equipment capabilities and emerging technology. Significant automated data processing (ADP) equipment acquisitions, software purchases, and software development activities were made or were continued throughout FY 1997.

One of the PTO's largest automation efforts is the Automated Patent System (APS). Although a portion of the costs associated with the APS is expensed as incurred, other costs, such as software design and development as well as purchased hardware and software, are capitalized and depreciated over the useful life of the system.

At the end of FY 1997, the PTO's P&E are stated at a net book value of $109.2 million, which represents the original acquisition value of $222.6 million less accumulated depreciation of $113.4 million. Annual depreciation of P&E provides for the economic distribution of the cost of using these assets over time. The net book value increase of 52.9 percent from the FY 1996 net P&E balance of $71.4 million is the result of continued purchases of APS equipment and software (such as storage devices, routers, printers, and examiner workstations), purchases of other ADP equipment and software (such as personal computers, equipment upgrades, and network upgrades), and purchases of office furniture and fixtures.

Property and Equipment
($ in millions)



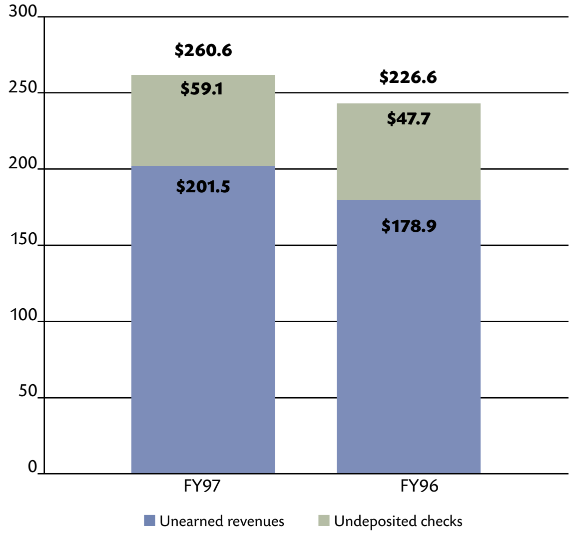
SELECTED LIABILITY ACCOUNT ANALYSES are provided to assist the reader in understanding the nature of liabilities included in the statements of financial position. Liabilities are classified into two categories: governmental liabilities and intragovernmental liabilities. Most PTO liabilities result from deferred revenues, that is, fees received for services requested, but not fully earned, and undeposited checks at year-end. Other significant PTO liabilities include customer deposit accounts and accounts payable.

Deferred Revenues

Deferred revenues represent fees received for services requested, but not fully earned, and undeposited checks at year-end. The PTO's deferred revenue calculation distinguishes between fees collected and income realized as application files pass through the various examination/processing stages. During FY 1997, the PTO continued to enhance its financial and operational systems with the implementation of the Revenue Accounting and Management (RAM) system and greater use of the Patent Application and Location Monitoring (PALM) and the Trademark Reporting and Monitoring (TRAM) systems. While the RAM system records the receipt of fees for which the PTO renders services, the PALM and TRAM systems track the progression of application files from office to office. Reports generated from each system, as well as other documentation, provide the bases for matching revenues with the expense of processing those files and for identifying checks to be deposited at year-end.

Deferred Revenues

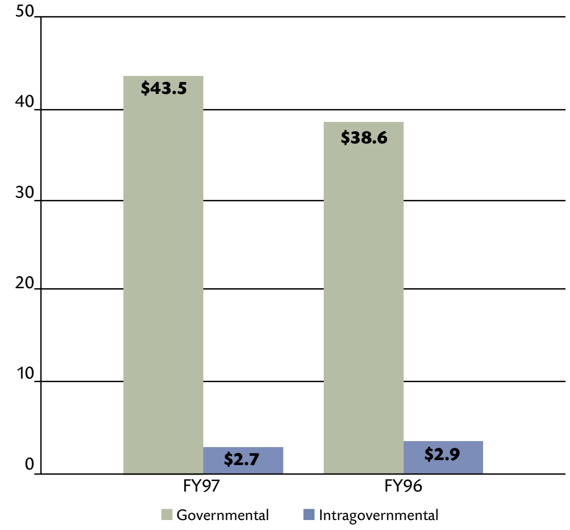
($ in millions)



Total deferred revenues at the end of FY 1997 were $260.6 million, an increase of 15.0 percent from the FY 1996 balance of $226.6 million. This increase in deferred revenue is consistent with both the increase in fees processed during FY 1997 and the increase in demand for patents and trademarks. During FY 1997, the PTO received 220,773 utility, plant and reissue (UPR) patent applications and 16,272 design applications. The UPR application filings workload increased by 15.5 percent from the previous year and design applications increased by 7.3 percent. As for trademarks, during FY 1997, the PTO received 224,355 trademark applications, an increase of 11.8 percent from the previous year's filing level of 200,640.

Deposit Account Liability

($ in millions)



Customer Deposit Accounts

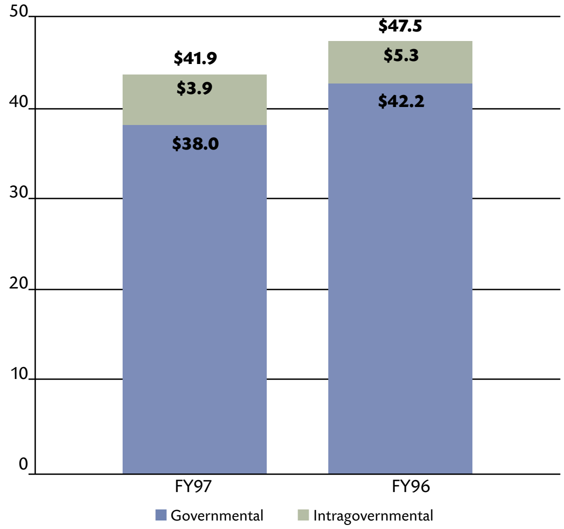
Customer deposit accounts are maintained by the PTO as a service to its customers. The associated liability results from moneys paid to the PTO in anticipation of a future demand for services. Upon receipt of a service request from a customer maintaining a deposit account, the PTO deducts the appropriate fee from the respective account. At the end of FY 1997, the liability was $46.2 million, an increase of 11.3 percent over the FY 1996 balance of $41.5 million. As discussed in the preceding paragraph, the increase in customer deposit accounts is also consistent with the overall increase in demand for patents and trademarks.

Accounts Payable

The PTO's accounts payable balances include Federal and non-Federal accounts payable for goods and services received for which the PTO has not yet made payment. At the end of FY 1997, payments owed to other Federal agencies (intragovernmental) totaled $3.9 million, a $1.4 million decrease from the $5.3 million owed at the end of FY 1996. In addition, $38.0 million was owed to non-Federal entities (governmental), a $4.2 million decrease from the $42.2 million owed at the end of FY 1996. The decrease in accounts payable is the result of the PTO's continuing efforts to comply with the Prompt Payment Act of 1982, as well as an increase in the volume of vendor payments processed during the fourth quarter of FY 1997.

Accounts Payable

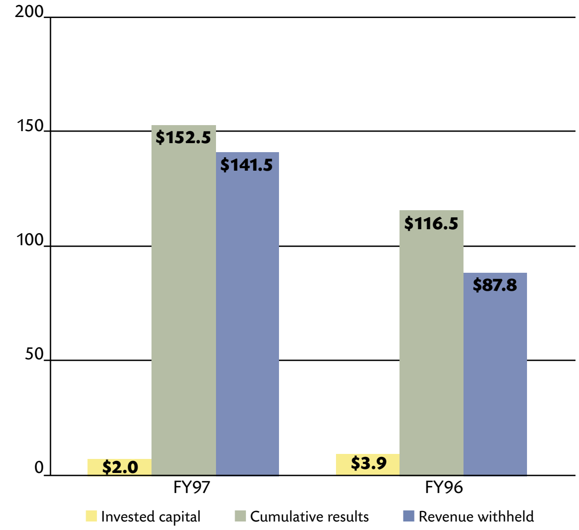
($ in millions)



NET POSITION is reported by the PTO in three components: invested capital, cumulative results of operations, and revenues withheld. In the aggregate, the various components of the net position section in the statements of financial position are also referred to as "equity." Equity is the residual interest in the assets of the entity that remains after deducting liabilities. The total net position increase of $87.8 million from FY 1996 to FY 1997 includes $53.7 million that is not available for use because the PTO has not been granted the authority by Congress.

Equity Accounts

($ in millions)



Invested Capital

Invested capital is the net book value of capitalized fixed assets that were purchased with appropriations from general taxpayer revenue. Because the PTO is no longer funded from an annual appropriation from general taxpayer revenue, the balance in the invested capital account (an appropriated fund account) will decrease each year by the amount of depreciation associated with the respective capitalized assets, eventually going to zero. At the end of FY 1997, the balance in this account was $2.0 million, a decrease of 48.7 percent from the balance of $3.9 million as of the end of FY 1996.

Cumulative Results of Operations

The cumulative results of operations (CRO) represents the cumulative unrestricted net operating gain recognized by the PTO since its inception. CRO increases or decreases each year by the excess of revenues and financing sources over total expenses, in the statements of operations and changes in net position. However, in practice, not all of that amount is allocated to the CRO. Instead, a portion of the amount is diverted each year into a restricted revenues withheld account at Treasury. These fee collections are used by Congress to offset increased spending in other Federal programs, which reduces the PTO's budget authority and restricts its ability to spend all of its customers' fees to accomplish patent and trademark program work.

At the end of FY 1997, the PTO's CRO was $152.5 million. Thus, of the total assets presented in the PTO's statements of financial position, a portion of the government's interest consists of net P&E, as there are no outstanding liens against any of these assets. Net P&E appears on the statements of financial position in the amount of $109.2 million. However, $2.0 million of this was purchased with appropriated funds classified as invested capital, leaving $107.2 million in CRO. The accounts receivable of $4.0 million also represent a portion of the CRO. The remaining balance of $41.3 million is the PTO's interest in the Fund Balances. However, this $41.3 million interest is a financial accounting basis amount that does not reflect the impact of $258.6 million in unpaid undelivered orders (goods and services ordered, but not yet received) on the appropriation accounting basis. The PTO's current interest in the Fund Balances will be used to liquidate a portion of the current commitments the PTO possesses in these unpaid undelivered orders, and future funding requirements will have to be earned to liquidate the remainder of its unpaid undelivered orders and to meet its liabilities, both funded and unfunded, at September 30, 1997.

Revenues Withheld

Revenues withheld is segregated as a portion of the equity balance because of restrictions associated with the availability of the customer-paid fees. Although these fees were earned, additional action by Congress is required to make these balances available for use by the PTO.

During FY 1997, the PTO collected and deposited $115.0 million in customer fees into the special restricted account. Congress provided budget authority for the PTO to spend $61.3 million, with $53.7 million remaining in the restricted Treasury account. Although the cumulative amount of the withheld fees appears on the statements of financial position, it is a restricted account and the PTO has not been given the authority to use the funds. Revenues withheld reached $141.5 million at the end of FY 1997, an increase of 61.2 percent over the FY 1996 balance of $87.8 million.

SELECTED REVENUES AND EXPENSES are discussed below to assist the reader in understanding the PTO's statements of operations.

Revenues and Financing Sources

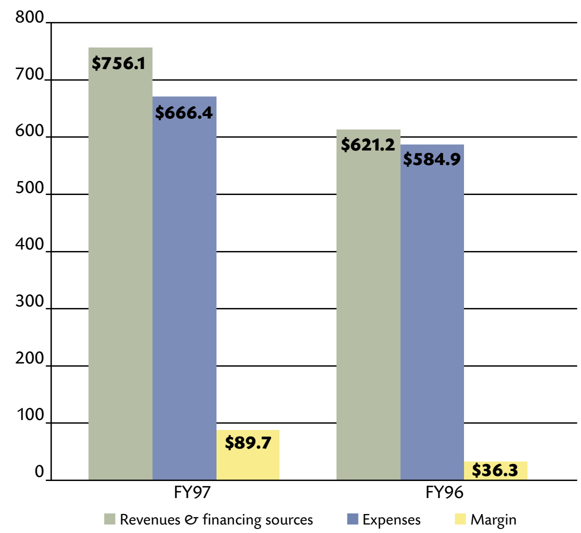
The PTO's fee collections have continued to climb as demand for the PTO's products and services has increased. Customers pay user fees when they order products and services. The current patent fee structure allows for lower initial fees that are supplemented by income from other sources, such as maintenance fees, to cover the full cost of the patent examination and issuance process as well as other PTO operations (e.g., patent documentation and quality review). Total earned income (financial accounting basis) from fee collections (patents, trademarks, and reimbursements) in FY 1997 was $733.9 million, an increase of 18.6 percent from FY 1996 fee income of $618.9 million. Maintenance fees accounted for $252.3 million of the FY 1997 collections. Patent maintenance fees are collected over the life of the patent from owners of those patents. If maintenance fees are not remitted at each of the three stages, patent protection expires. Since the maintenance fees are the largest category of fee income, fluctuations in rates of renewal can significantly affect revenues. Renewal rates are currently: 80.3 percent at the first stage (at the end of the third year after a patent is issued); 55.8 percent at the second stage (at the end of the seventh year after a patent is issued); and 35.4 percent at the third stage (at the end of the eleventh year after a patent is issued).

The PTO's revenues and financing sources are primarily derived from the sale of goods and services. For FY 1997 an additional $1.9 million was from appropriated capital used during the year, and $20.3 million was from an imputed financing source primarily resulting from the PTO's recognition of its share of the cost to the Federal government of providing pension and post-retirement health and life insurance benefits to all eligible employees.

The chart below illustrates the PTO's revenues, expenses, and margin for FY 1997 and FY 1996.

Revenues, Expenses and Margin

($ in millions)



Expenses

The PTO's total expenses for FY 1997 amounted to $666.4 million, of which program or operating expenses accounted for $619.9 million. This is a 12.0 percent increase in operating expenses from FY 1996, primarily the result of increases in personal services and benefits and contractual services. As the PTO is a service provider, personnel costs are its largest expense. In FY 1997, personal services and benefits were $353.0 million, an increase over the $330.8 million in FY 1996. The increase in personnel costs reflects government-wide salary increases and increases in overtime requirements. In addition, expenses for contractual services increased in FY 1997 by $9.4 million. The increase in contractual services is consistent with the PTO's need to procure outside support services to accommodate increased workload. Although personnel costs rose during FY 1997, personal services and benefits represented 56.9 percent of total operating expenses, a decrease from 59.7 percent of total operating expenses in FY 1996. The decrease in personnel costs as a percentage of total operating expenses reflects the overall increase in other operating expenses. In addition to increases in components of operating expenses, depreciation expense rose $14.9 million. This is due to an increase in capital investments during FY 1997 and FY 1996.

SIGNIFICANT ACTIONS, ACCOMPLISHMENTS, AND RESULTS

Financial Management: Quantitative indicators, as prescribed by the OMB, monitor improvements in financial management. The following chart depicts the goals or target performance established by OMB for FY 1997 and the performance of the PTO during that period.

Significant Actions, Accomplishments and Results		
Measure	**Target Performance**	**PTO Performance**
Percent of Timely Vendor Payments	95%	98%
Percent of Payroll by Electronic Transfer	90%	97%
Percent of "Treasury Agency Locations" Fully Reconciled	95%	100%
Timely Posting of Inter-agency Charges	30 days	31 days
Timely Reports to Central Agencies	95%	100%
Timely Travel Payments Average Processing Time	15 days	1 day
Audit Opinion on FY 1997 Financial Statements	Unqualified	Unqualified
Material Weaknesses FY 1997 Reported by OIG	None	None

Financial Systems: At the beginning of FY 1992, the PTO implemented the Federal Financial System (FFS) and assumed responsibility for all accounting records. Software and hardware support for the core system are supplied via a cross-servicing arrangement with the U.S. Geological Survey of the Department of the Interior. Improvements during FY 1997 and enhancements planned for FY 1998 to the PTO's financial management systems are described below:

- Completed interim upgrade to the procurement sub-system that had been implemented in FY 1996.
- Defined and reviewed the business workflow requirements and technical architecture for the subsequent major upgrade to the procurement subsystem scheduled for mid-FY 1998.
- Implemented the Revenue and Accounting Management System in June 1997.
- Completed improvements to the travel subsystem, including continued deployment of Travel Manager.
- Deployed the enterprise-wide Data Warehouse for the Financial Subject Area in October 1997.
- Scheduled upgrade of FFS for year 2000 compliance for FY 1998.
- Scheduled implementation of the Program Office Desktop for FY 1998.
- Planned for enhancements to the Budget Formulation Module for preparing budget estimates.
- Identified improvements to enhance the Electronic Commerce capability of the procurement subsystem.

Management Controls: For FY 1997, the PTO provided reasonable assurance of compliance with the provisions of the Federal Managers' Financial Integrity Act. Weaknesses in subsystems previously identified and reported to the DOC were corrected. The weaknesses below were identified by the OIG during its audit of the FY 1996 financial statements. Reported weaknesses and anticipated dates for full correction are indicated in the table that follows.

Management Controls: Federal Managers' Financial Integrity Act	
Section 2 Material Weaknesses	**Anticipated Correction Date**
None	N/A
Section 4 Material Nonconformance	**Anticipated Correction Date**
Procedures for Accounting for Capital Assets Should Be Improved	FY 1998
Preparation, Analysis, and Monitoring of Financial Information Should Be Improved	FY 1998

Limitations of Financial Statements

Pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, the financial statements that follow have been prepared to report the financial position and results of operations of the Patent and Trademark Office. The FY 1997 financial statements consist of the Statements of Financial Position, the Statements of Operations and Changes in Net Position, and the Statements of Cash Flows. The following limitations apply to the preparation of the FY 1997 financial statements:

- The financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515 (b).
- While the statements are prepared from the books and records of the entity in accordance with the formats prescribed by the Office of Management and Budget, the statements are different from the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.
- The statements should be read with the realization that they are for a component of a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

FINANCIAL STATEMENTS

U. S. Department of Commerce Patent and Trademark Office

STATEMENTS OF FINANCIAL POSITION

As of September 30, 1997 and 1996 *(Dollars in Thousands)*	1997	1996 *(Restated)*
ASSETS		
Entity Assets:		
Intragovernmental Assets:		
Fund Balance with Treasury (Note 3)	$518,944	$443,806
Accounts Receivable	3,466	4,088
Governmental Assets:		
Accounts Receivable	549	544
Cash	60,856	47,765
Property and Equipment, Net (Note 4)	109,236	71,409
Total Entity Assets	693,051	567,612
Non-Entity Assets		
Intragovernmental Assets		
Fund Balance with Treasury (Note 3)	871	871
Total Non-Entity Assets	871	871
Total Assets	$693,922	$568,483
LIABILITIES		
Liabilities Covered by Budgetary Resources:		
Intragovernmental Liabilities:		
Accounts Payable	$ 3,871	$ 5,314
Accrued Postemployment Compensation	929	804
Customer Deposit Accounts	2,648	2,915
Other Liability Due to Treasury (Note 3)	871	871
Actuarial Liability (Note 5)	4,033	3,086
Governmental Liabilities:		
Accounts Payable	38,020	42,175
Accrued Payroll and Benefits	25,105	22,955
Accrued Leave	18,290	16,985
Customer Deposit Accounts	43,515	38,564
Deferred Revenues (Note 6)	260,556	226,603
Total Liabilities	397,838	360,272
NET POSITION		
Invested Capital	1,982	3,876
Cumulative Results of Operations	152,573	116,554
Revenues Withheld	141,529	87,781
Total Net Position	296,084	208,211
Total Liabilities and Net Position	$693,922	$568,483

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

U. S. Department of Commerce Patent and Trademark Office

STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION

For the years ended September 30, 1997 and 1996

(Dollars in Thousands)	1997	1996
REVENUES AND FINANCING SOURCES		
Revenues from Sales of Goods and Services		
To the Public	$729,285	$614,702
Intragovernmental	4,574	4,218
Appropriated Capital Used	1,894	2,281
Imputed Financing Sources (Note 8)	20,380	–
Total Revenues and Financing Sources	756,133	621,201
EXPENSES		
Program or Operating Expenses (Note 9)	619,863	553,676
Depreciation and Amortization	45,556	30,658
Change in Actuarial Liability (Note 5)	947	599
Total Expenses	666,366	584,933
Excess of Revenues and Financing Sources Over Total Expenses	$ 89,767	$ 36,268
Net Position, Beginning Balance	$208,211	$174,224
Excess of Revenues and Financing Sources Over Total Expenses	89,767	36,268
Decrease in Invested Capital	(1,894)	(2,281)
Net Position, Ending Balance	$296,084	$208,211

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

U. S. Department of Commerce Patent and Trademark Office

STATEMENTS OF CASH FLOWS (INDIRECT)

For the years ended September 30, 1997 and 1996 *(Dollars in Thousands)*	1997	1996 *(Restated)*
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess of Revenues and Financing Sources Over Total Expenses	$ 89,767	$ 36,268
Adjustments Affecting Cash Flow:		
Appropriated Capital Used	(1,894)	(2,281)
Decrease in Accounts Receivable	617	2,172
Increase/(Decrease) in Accounts Payable	(5,598)	9,679
Increase in Customer Deposits	4,684	5,671
Increase in Deferred Revenues	33,953	53,214
Increase in Accrued Leave and Postemployment Compensation	1,430	1,205
Depreciation and Amortization	45,556	30,658
Increase in Actuarial Liability	947	599
Increase in Accrued Payroll and Benefits	2,150	2,919
(Decrease) in Other Liability Due to Treasury	–	(5,049)
(Decrease) in Capital Lease Liability	–	(625)
Capital Lease Liability Cancellations	–	116
Total Adjustments	81,845	98,278
Net Cash Provided by Operating Activities	171,612	134,546
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of Property and Equipment	(83,383)	(48,977)
Net Cash Provided by Operating and Investing Activities	$ 88,229	$ 85,569
Fund Balances with Treasury and Cash, Beginning	$492,442	$406,873
Net Cash Provided by Operating and Investing Activities	88,229	85,569
Fund Balances with Treasury and Cash, Ending	$580,671	$492,442
Entity Fund Balance with Treasury	$518,944	$443,806
Non-Entity Fund Balance with Treasury	871	871
Entity Cash	60,856	47,765
Fund Balances with Treasury and Cash, Ending	$580,671	$492,442

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

NOTES TO FINANCIAL STATEMENTS

NOTE 1.
Summary of Significant Accounting Policies

Basis of Presentation

As required by the Chief Financial Officers Act of 1990 (CFO Act), the accompanying financial statements present the financial position and results of operations of the Patent and Trademark Office (PTO) of the United States. The books and records of the PTO serve as the source of the information contained herein. These financial statements were prepared in accordance with the guidance specified by the Office of Management and Budget (OMB) in Bulletins 97-01 and 94-01, as well as the accounting policies of the PTO. Therefore, they may differ from other financial reports submitted pursuant to OMB directives for the purpose of monitoring and controlling the use of the PTO's budgetary resources.

Reporting Entity

The 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 the trade-related aspects of intellectual property policy.

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

The financial position and results of operations for these core business activities are presented in the accompanying financial statements and include the accounts for salaries and expense (13X1006), surcharge (revenue withheld) (13X5127), and customer deposits (13X6542) appropriations, which are under the control of the PTO. The PTO has no lending or borrowing authority.

Budgets and Budgetary Accounting

Since the passage of the Omnibus Budget Reconciliation Act of 1990 (OBRA), the PTO programs have been substantially funded by user fees. Since 1990, the appropriated funds from general taxpayer revenues gradually decreased until the PTO became fully fee funded in FY 1993.

Revenue withholding on statutory patent fees was established by the OBRA. Subsequent pieces of legislation removed the reference to a specific surcharge withholding of 69 percent, required the PTO to withhold and deposit exact amounts of revenue, and extended the revenue withholding through the end of FY 1998. These revenues withheld constitute offsetting receipts and are deposited into a restricted account at the U.S. Department of the Treasury (Treasury). The PTO is only authorized to use moneys from this account to the extent appropriated by Congress. Thus, Treasury makes these funds available to the PTO by the issuance of a warrant each month to the extent such funds were authorized for use. The excess moneys not appropriated to the PTO by Congress are not available and are retained in a restricted receipt account by Treasury.

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

Basis of Accounting

Transactions are recorded on the accrual basis of accounting as well as on a budgetary basis. Under the accrual method, revenues are recognized when earned,

Note 1: Summary of Significant Accounting Policies (continued)

and expenses are recognized when a liability is incurred, without regard to the receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds. The accompanying financial statements are presented on the accrual basis of accounting.

Under the authority of the CFO Act, the Federal Accounting Standards Advisory Board (FASAB) was established to recommend Federal accounting standards to the Secretary of the Treasury, the Director of OMB and the Comptroller General, co-principals of the Joint Financial Management Improvement Program (JFMIP). Specific standards agreed upon by the three principals will be issued by the Director of OMB and the Comptroller General. Pending issuance of final accounting standards, FASAB has recommended, and the JFMIP principals have agreed, that agencies adopt for use in preparing financial statements an other comprehensive basis of accounting. The accounting principles and standards applied in preparing these financial statements are in accordance with this other comprehensive basis of accounting and the following hierarchy of accounting principles, as recommended by the FASAB and agreed to by the JFMIP principals:

- Individual standards agreed to and published by the JFMIP principals.
- Requirements contained in the OMB's Form and Content Bulletins in effect for the period covered by the financial statements.
- Accounting standards contained in agency accounting policy, procedures manuals or related guidance.
- 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 standards improve the meaningfulness of the financial statements.

Revenues and Other Financing Sources

The PTO's user fee rates are established by rule and law. Since 1993, the PTO funding has been primarily received through the collection of user fees. Fees that are remitted with initial applications and other services are recorded as revenue when received, with an adjustment at year-end to defer revenues for services that have not yet been performed. Revenues withheld pursuant to the OBRA are also recognized as income by the PTO. Advance payments made by customers for services not yet requested are recorded as liabilities in customer deposit accounts until services are rendered.

A financing source is recognized to the extent of the annual depreciation expense for property and equipment purchased in prior years with funds appropriated from general taxpayer revenues. Also, an imputed financing source is recognized to represent the PTO's share of the cost to the Federal government for providing pension and other post-retirement benefits to eligible PTO employees and for amounts paid from the Treasury Judgment Fund for certain claims assessed to the PTO.

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

Fund Balance with Treasury

Commercial bank accounts are maintained to deposit revenues collected. All moneys maintained in such accounts are transferred to the Federal Reserve Bank on the next business day following the day of deposit. In addition, some customer deposits are wired directly to the Federal Reserve Bank. All banking activity is conducted in accordance with the directives issued

Note 1: Summary of Significant Accounting Policies (continued)

by the Financial Management Service of the Treasury. With the exception of those that are restricted, funds with the Treasury are available to pay current liabilities and to finance duly authorized purchases. All disbursements are processed by the Treasury's Philadelphia Regional Finance Center.

Accounts Receivable

Governmental accounts receivable represent amounts due from non-Federal entities, the majority of which are due from former employees for the reimbursement of education expenses. Intragovernmental accounts receivable represent amounts due from other Federal entities, of which $3,086 thousand and $3,935 thousand in FY 1997 and FY 1996, respectively, are due to a financing agreement entered into during FY 1995 with the DOC to fund the Commerce Administrative Management System.

Cash

The majority of the PTO's cash balance consists of undeposited checks that are the result of fees collected by the PTO that were not processed at the end of the fiscal year due to the lag time between receipt and initial review. All such undeposited cash amounts are considered to be cash equivalents. Immaterial cash balances are also held outside the Treasury and are used as imprest funds to facilitate small purchases, local travel, and emergency salary advances. The cash balances include undeposited checks of $60,841 thousand and $47,750 thousand in FY 1997 and FY 1996, respectively, and an imprest fund of $15 thousand in both years.

Property and Equipment

The buildings in which the PTO operates are leased from private concerns by the General Services Administration (GSA). Long-term leases are negotiated by GSA and appropriate rent charges—intended to approximate commercial rental rates—are levied by GSA and paid by the PTO. The arrangements with GSA are considered operating leases.

Effective for property and equipment acquired during FY 1997, the PTO revised its capitalization policies. These revisions included increasing the capitalization thresholds and refining the bulk purchases policy. These changes are prospective and do not require retroactive application.

Previously, the capitalization threshold for individual purchases was $5 thousand for equipment and other assets, and $25 thousand for automated data processing (ADP) software. Equipment and other assets acquired through a major contract or in connection with the installation of a major system were also capitalized.

The PTO's revised capitalization policies are summarized below:

Property and Equipment Capitalization Policy

Classes of Property and Equipment	Capitalization Threshold Individual Purchases	Capitalization Threshold Bulk Purchases
ADP Equipment	$25 thousand or greater	$500 thousand or greater
Software	$25 thousand or greater	$500 thousand or greater
Software in Progress	$25 thousand or greater	$500 thousand or greater
Furniture	$25 thousand or greater	$ 50 thousand or greater
Equipment	$25 thousand or greater	$500 thousand or greater

Note 1: Summary of Significant Accounting Policies (continued)

The costs for developing custom software are capitalized when incurred for creating the detailed 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 are written off against accumulated depreciation.

Liabilities

The PTO records as liabilities all amounts or other resources that are likely to be paid as the direct result of events that have already occurred. All such liabilities presented for FY 1997 and FY 1996 have been classified as fully funded. No liabilities can be paid by the PTO unless funding is available and authorized by Congress. Also, liabilities of the PTO arising from other than contracts can be abrogated by the government acting in its sovereign capacity.

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 Department of Labor (DOL). DOL bills each agency annually as its claims are paid; however, payment on these bills is deferred two years to allow for funding through the budget process. As of September 30, 1997, the PTO recorded a liability for $891 thousand for claims paid on its behalf during the benefit periods of July 1, 1995 through September 30, 1997. At September 30, 1996, the PTO recorded a liability for $804 thousand for claims paid on its behalf during the benefit periods of July 1, 1994 through September 30, 1996.

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 DOL. DOL bills each agency quarterly as its claims are paid. As of September 30, 1997, the PTO recorded a liability for $38 thousand for claims paid on its behalf for the quarters ended June and September 1997.

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 at the end of each fiscal year to ensure that the balances in the accrued leave accounts reflect current pay rates. Accrued annual leave and compensatory time are reported as covered by budgetary resources for financial statement presentation only. No portion of this liability has been obligated. To the extent current or prior year funding is not available to 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

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

The financial statements of the PTO do not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, which may be applicable to its employees. Such reporting is the responsibility of the Office of Personnel Management. Also, 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 the programs. The PTO does not fund post-retirement benefits such as Federal Employees Health Benefit (FEHB) Program and the Federal Employees Group Life Insurance

Note 1: Summary of Significant Accounting Policies (continued)

(FEGLI) Program. The PTO also is not required to fully fund the CSRS pension liabilities. For FY 1997, the PTO recognized 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 to all eligible PTO employees.

For those employees covered by the CSRS, the PTO makes contributions equivalent to 7 percent of the employee's pay. For those covered by the FERS, the PTO makes contributions equal to approximately 13 percent.

All employees are eligible to contribute to a thrift savings plan. For those employees participating in the FERS, a thrift savings plan is automatically established, and the PTO makes a mandatory 1 percent contribution to this plan. In addition, the PTO makes matching contributions, ranging from 1 to 4 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 CSRS. Employees participating in FERS are covered under the Federal Insurance Contributions Act (FICA) for which the PTO contributes a matching amount to the Social Security Administration.

The PTO's total contributions for CSRS and FERS participants during FY 1997 and FY 1996 were $25,933 thousand and $24,057 thousand, respectively. The PTO's contributions to the Social Security Administration during FY 1997 and FY 1996 were $10,659 thousand and $9,691 thousand, respectively.

As required by the Federal Workforce Restructuring Act of 1994, the PTO contributed 80 dollars per position on the rolls as of March 31, 1996, to the Civil Service Retirement and Disability Fund.

Deferred Revenues

Deferred revenues represent fees that have been received by the PTO for requested services, but will not be earned until the related service is provided. Two types of deferred revenues are recorded. The first results from checks received with a request for a service that were not deposited because of a backlog in receipt processing. The second relates primarily to fees for applications that have been partially processed and issue fees collected for which the patent has not been issued.

Application fees received that have undergone the initial processing phase but have not been reviewed by a patent examiner or trademark attorney are deferred and revenues 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 a 10-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

Certain FY 1996 financial statement amounts were reclassified to conform with the FY 1997 presentation. Also, SFFAS No. 5, "*Accounting for Liabilities of the Federal Government,*" has an effective date for periods beginning after September 30, 1996. In compliance with this new standard, the PTO reported for FY 1997 its share of pension and other post-retirement benefits. Likewise, in compliance with the Interpretation of Federal Financial Accounting Standards No. 2, "*Accounting for Treasury Judgment Fund Transactions,*" the PTO recognized an imputed financing source and corresponding expense to represent amounts paid from the Judgment Fund for certain claims assessed to the PTO. The PTO also disclosed no contingencies for claims and assessments which may be paid from the

Note 1: Summary of Significant Accounting Policies (continued)

Treasury Judgment Fund. Implementation of SFFAS No. 5 did not require retroactive application. Therefore, the PTO's FY 1996 financial statements were not restated to present these comparable balances.

NOTE 2. Restatement of FY 1996 Cash from Undeposited Checks

The PTO restated cash balances from undeposited checks in the Statement of Financial Position at September 30, 1996. The Statement of Cash Flows has also been restated to present the effect of this change. This restatement results from more detailed data that became available during FY 1997 as a result of the deployment of the Revenue and Accounting Management (RAM) system. RAM has the ability to differentiate between fees earned from undeposited checks and fees earned from charging customers' deposit accounts. The conversion to RAM from the system utilized prior to FY 1997 separated the data for the two methods of processing, allowing for a more refined reporting of fees to be processed from undeposited checks as of September 30, 1996. The restatement of undeposited checks at the end of FY 1996 decreased both assets (cash) and liabilities (deferred revenue) by $17,173 thousand. This restatement has no effect on the Statement of Operations and Changes in Net Position, and no effect on the PTO's net position.

NOTE 3. Fund Balance with Treasury

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

(Dollars in Thousands)

	1997			
	Available Funds	Restricted Funds	Total	1996
Appropriated Funds—Obligated	$310,584	$ –	$310,584	$288,489
Appropriated Funds—Unobligated	20,669	–	20,669	26,056
Deposit Accounts	–	46,162	46,162	41,480
Revenues Withheld	–	141,529	141,529	87,781
Entity Funds	331,253	187,691	518,944	443,806
Non-Entity Funds	–	871	871	871
Total Fund Balances	$331,253	$188,562	$519,815	$444,677

Funds amounting to $5,920 thousand had been permanently canceled and rescinded in FY 1995 in accordance with P.L. 103-317 and P.L. 104-19. During FY 1996 a portion of these non-entity funds were returned to the Treasury. The balance of $871 thousand remains in restricted surcharge funds, is not available to the PTO, and is also recognized as an other liability due to Treasury.

NOTE 4.
Property and Equipment

Property and equipment consisted of the following as of September 30, 1997:

Classes of Fixed Assets	Depreciation Method	Service Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
			(Dollars in Thousands)		
ADP Equipment	SL	3-10	$147,633	$ 72,662	$ 74,971
Software	SL	3-11	50,297	30,959	19,338
Software in Progress	–	–	7,975	–	7,975
Furniture	SL	5	9,345	4,510	4,835
Equipment	SL	3-5	7,427	5,310	2,117
Total			$222,677	$113,441	$109,236

Property and equipment consisted of the following as of September 30, 1996:

Classes of Fixed Assets	Depreciation Method	Service Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
			(Dollars in Thousands)		
ADP Equipment	SL	3-10	$106,021	$62,582	$43,439
Software	SL	3-11	36,629	20,538	16,091
Software in Progress	–	–	3,643	–	3,643
Furniture	SL	5	7,786	2,818	4,968
Equipment	SL	3-5	7,444	4,176	3,268
Total			$161,523	$90,114	$71,409

NOTE 5.
Actuarial Liability

The Federal Employees Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits under FECA for the PTO's employees are administered by the DOL and are ultimately paid by the PTO. The DOL generated future workers' compensation (FWC) estimates from an application of actuarial procedures developed to estimate the liability for FECA benefits.

The actuarial liability estimates for FECA benefits include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases.

The liability was determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the OMB's June 10, 1997 economic assumptions for 10-year

Note 5: Actuarial Liability (continued)

Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

1997	1996
6.24% in year 1,	6.21% in year 1,
5.82% in year 2,	5.97% in year 2,
5.60% in year 3,	5.60% in year 3,
5.45% in year 4,	5.32% in year 4,
5.40% in year 5, and thereafter	5.15% in year 5, and 5.10% thereafter

In FY 1997, the FWC actuarial model was revised to include additional features that would provide a more accurate estimation of the FECA FWC liability. Both a wage inflation factor and medical inflation factor were added and applied to the calculation of projected future payments. In addition, the adoption of a discounting formula to recognize the timing of actual compensation payments was incorporated into the model. Also, the number of projected years used by the model was extended from 23 to 37 years. All changes to the FWC actuarial model were treated prospectively.

Based on information provided by the DOL, the DOC determined that the estimated liability of the PTO as of September 30, 1997 and 1996, was $4,033 thousand and $3,086 thousand, respectively.

NOTE 6.
Deferred Revenues

Deferred revenues consisted of the following as of September 30:

(Dollars in Thousands)	1997	1996 *(Restated)*
Undeposited Checks	$ 59,091	$ 47,684
Unearned Fees	201,465	178,919
Total Deferred Revenues	$260,556	$226,603

NOTE 7.
Leases

The operating lease agreements negotiated by the GSA for the PTO's office buildings expire at various dates between FY 1998 and FY 2007. Under existing commitments, the minimum lease payments through FY 2002 are as follows:

Fiscal Year	*(Dollars in Thousands)*
1998	$ 49,894
1999	52,124
2000	53,425
2001	54,757
2002	56,128
Total Future Minimum Lease Payments	$266,328

Rent expense was $45,742 thousand and $41,305 thousand in FY 1997 and FY 1996, respectively.

NOTE 8.
Imputed Financing Sources

For FY 1997, in accordance with SFFAS No. 5, "*Accounting for Liabilities of the Federal Government,*" the PTO recognized 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. In accordance with the Interpretation of Federal Financial Accounting Standards No. 2, "*Accounting for Treasury Judgment Fund Transactions,*" the PTO also recognized an imputed financing source and corresponding expense to represent amounts paid from the Judgment Fund for certain claims assessed to the PTO. The components of the FY 1997 imputed financing sources and corresponding expenses are below:

	(Dollars in Thousands)
CSRS/FERS	$ 8,739
FEHB	11,541
FEGLI	42
Subtotal Pension/ORB	20,322
Judgment Fund	58
Total Imputed Financing Sources	$20,380

NOTE 9.
Program or Operating Expenses

Program or operating expenses consisted of the following for the years ended September 30:

(Dollars in Thousands)	1997	1996
Personal Services and Benefits	$353,004	$330,792
Travel and Transportation	1,591	1,826
Rental, Communication and Utilities	54,096	52,190
Printing and Reproduction	34,210	30,885
Contractual Services	102,556	93,250
Training	5,105	6,346
Maintenance and Repair	18,671	19,139
Supplies and Materials	8,610	8,699
Equipment not Capitalized	8,901	7,357
Insurance Claims and Indemnities	282	31
Other Services	12,515	3,161
Imputed Post-Retirement Expense	20,322	–
Total Program or Operating Expenses	$619,863	$553,676

NOTE 10.
Commitments and Contingencies

Commitments

In addition to the future lease commitments discussed in Note 7, the PTO is committed under obligations for goods and services that have been ordered but not yet received at fiscal year-end. Total unpaid undelivered orders for all of the PTO's activities amounted to $258,616 thousand and $244,110 thousand as of September 30, 1997 and 1996, respectively.

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 adverse to the Federal government. Management expects that it is probable that there will be awards or damages for four labor relations claims, but the amount of the contingent liability cannot be reasonably estimated. Management also expects that it is reasonably possible that approximately $3,105 thousand will be owed for awards or damages involving an additional 53 labor relations claims.

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. Although the ultimate disposition of these proceedings is not presently determinable, management does not expect that any liability or imputed cost that might ensue would be material to the PTO's financial statements.