

*Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996*

INSPECTOR GENERAL'S REPORT ON FINANCIAL STATEMENTS

Mr. Bruce A. Lehman
Assistant Secretary of Commerce and
Commissioner of Patents and Trademarks
Patent and Trademark Office
Washington, D.C.

We have audited the Statements of Financial Position of the Patent and Trademark Office (PTO) as of September 30, 1997 and 1996, and the Statements of Operations and Changes in Net Position, and Cash Flows for the years then ended. These statements are the responsibility of PTO's management. Our responsibility is to express an opinion on these Principal Statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget Bulletin No. 93-06, *Audits of Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

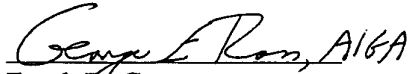
The aforementioned standards also require us to issue reports on PTO's Internal Control Structure and Compliance with Laws and Regulations. We have issued separate reports dated December 29, 1997.

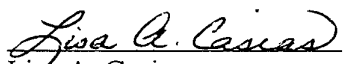
As required by Office of Management and Budget Bulletin No. 94-01, *Form and Content of Agency Financial Statements*, Note 1 to the Principal Statements describes the accounting policies used by PTO to prepare these statements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

***Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996***

In our opinion, the Statements of Financial Position of PTO as of September 30, 1997 and 1996, and the Statements of Operations and Changes in Net Position, and Cash Flows for the years then ended, present fairly, in all material respects, the financial position of PTO as of September 30, 1997 and 1996, and the results of its operations and changes in net position, and cash flows for the years ended September 30, 1997 and 1996, in conformity with the accounting policies described in Note 1.

Our audits were made for the purpose of forming an opinion on the Principal Statements. The information in the other sections of the *Fiscal Year 1997 A Patent and Trademark Office Review* is not a required part of the Principal Statements but is supplementary information required by Office of Management and Budget Bulletin No. 94-01, *Form and Content of Agency Financial Statements*. Such information has not been subjected to the auditing procedures applied in the audit of the Principal Statements and, accordingly, we express no opinion on it.


for Frank DeGeorge
Inspector General


Lisa A. Casias
Deputy Assistant Inspector General for
Financial Statement Audits

December 29, 1997

*Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996*

INSPECTOR GENERAL'S REPORT ON INTERNAL CONTROL STRUCTURE

Mr. Bruce A. Lehman
Assistant Secretary of Commerce and
Commissioner of Patents and Trademarks
Patent and Trademark Office
Washington, D.C.

We have audited the Statement of Financial Position of the Patent and Trademark Office (PTO) as of September 30, 1997, and the Statements of Operations and Changes in Net Position, and Cash Flows for the year then ended, and have issued our report thereon dated December 29, 1997.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget Bulletin No. 93-06, *Audits of Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.

In planning and performing our audit of the financial statements for the year ended September 30, 1997, we considered PTO's internal control structure in order to determine our auditing procedures for the purposes of expressing our opinion on the financial statements and to determine whether the internal control structure meets the objectives identified in the following paragraph. Our consideration included obtaining an understanding of the significant internal control structure policies and procedures and assessing the level of control risk relevant to all significant cycles, classes of transactions, or account balances; and for those significant internal control structure policies and procedures that have been properly designed and placed in operation, performing sufficient tests to assess more fully whether the controls are effective and working as designed.

The management of PTO is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that the Office of Management and Budget, PTO management, or the Inspector General have identified as being significant for which compliance can be objectively measured and evaluated; funds, property, and other assets

*Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996*

are safeguarded against loss from unauthorized use or disposition; transactions are properly recorded and accounted for to permit the preparation of reliable financial reports in accordance with applicable accounting policies and to maintain accountability over the assets; and data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information. Our evaluation of the controls for performance information was limited to controls to ensure the existence and completeness of the information.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06, as amended. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to ensure that the objectives of the internal control structure, as previously defined, are being achieved. We have summarized the reportable conditions below.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited or material to a performance measure or aggregation of related performance measures may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

A letter dated March 20, 1998, transmitting our audit report to PTO, includes the complete Report on Internal Control Structure which discusses each of the control weaknesses in more detail and provides specific recommendations or actions PTO should consider taking.

*Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996*

Controls Surrounding Property Should Be Improved

PTO has not fully addressed the weaknesses surrounding property to properly account for and safeguard its assets. Prior to fiscal year 1997, PTO did not have a property and equipment subsidiary ledger that directly tied to the general ledger. To address this issue, for fiscal year 1997, PTO hired a contractor to upload the Fixed Asset Subsystem (FAS) with all prior year purchases that were still owned and being depreciated by PTO. This subsystem was populated utilizing the spreadsheets from prior fiscal years and now represents the subsidiary ledger that supports the capital asset balances in the general ledger. PTO maintains two property systems: the Office of Finance maintains FAS for capitalized assets, and the Office of Administrative Services uses the National Finance Center Personal Property System (NFC/PPS) to perform annual accountability procedures as required by the Department of Commerce.

In addition, during fiscal year 1997, PTO established a Fixed Asset Management Team to ensure the proper accountability of its assets. This team is composed of members from the Office of Finance, Office of Administrative Services, Office of the Chief Information Officer, Office of the Assistant Commissioner for Patents, and Office of the Assistant Commissioner for Trademarks. The team meets weekly to address current issues related to the ongoing inventory and maintenance of PTO property. In addition, during fiscal year 1997, PTO drafted capitalization policies and accountable property procedures that resulted in more consistent treatment of property throughout PTO. As a result of these focused efforts, we were able to classify the effectiveness of the controls surrounding property as a reportable condition rather than a material weakness as in the fiscal year 1996 and 1995 audits. However, as a result of current audit procedures, we identified several issues relating to capital assets where controls were not sufficient. These issues are summarized below:

Controls Over Property

The Office of Administrative Services is responsible for coordinating an annual inventory of PTO property and updating the NFC/PPS subsidiary property ledger. During the previous and current year audits, we noted several deficiencies in this process. As a result of the deficiencies noted, in fiscal years 1997 and 1996, PTO hired a contractor to perform an inventory of all PTO assets, including accountable property, and to update the tracking system (Services, Technicians, and Assets Tracking System, or STATS) that had been implemented in fiscal year 1996. The inventory count was expected to be uploaded to the NFC/PPS subsidiary property ledger and

*Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996*

maintained from that point on. However, the reconciliation of the inventory counts within STATS has taken longer than anticipated, and the database has not yet been uploaded to the NFC/PPS, which is the Department's official subsidiary property ledger.

Furthermore, all additions, deletions, and movement of property are still not being tracked with the hand-held units. It is imperative that the database be maintained and routinely updated. Otherwise, the system, once fully implemented, will become unreliable, requiring another full inventory of PTO assets.

Based on the results of our procedures, it appears that PTO's accountable property is at risk of misuse, waste, loss, or theft without detection. Furthermore, although PTO was able to provide an adequate reconciliation of individual fiscal year 1997 purchases to the inventory database, representing the material portion of the capital asset balance as of September 30, 1997, the general ledger is at risk of misstatement due to the poor controls over PTO property.

Supporting Documentation Used to Populate the Fixed Asset Subsystem

As stated above, PTO hired a contractor to populate the Fixed Asset Subsystem during fiscal year 1997. This task was accomplished by manually inputting numerous spreadsheets prepared in prior years into FAS by asset category and fiscal year. Before testing acquisitions for the current fiscal year, we attempted to verify the accuracy of FAS for all assets acquired prior to fiscal year 1997 by reconciling the total net book value as recorded in FAS to the amounts documented in the OIG permanent records. In performing this reconciliation, we encountered numerous differences that affected depreciation expense and accumulated depreciation. Although some differences resulted from adjustments subsequent to our audit, numerous adjustments were required by PTO to reach the accurate balances by asset category and fiscal year. After the adjustments were made, we deemed FAS materially accurate, enabling us to test from that system for fiscal year 1997.

Although the majority of adjustments made by PTO were considered immaterial to the property and equipment balance, the property subsidiary ledger would not have been accurate for assets acquired prior to FY 1997 had PTO not utilized the OIG's documentation.

Receipt and Accountability of Assets

PTO needs to evaluate whether controls relating to the receipt and accountability of goods are operating effectively. During fiscal year 1997, PTO was involved in a dispute with a major vendor over the quantity of goods received. The vendor claimed that it had delivered more

***Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996***

computer workstations than accounted for by PTO. Due to the poor controls over the receipt and accountability of assets, PTO paid the vendor for the workstations under dispute; however, PTO is uncertain whether all of these workstations were received because it was not able to fully reconcile how many workstations had in fact been delivered and accepted. For example, in its reconciliation, PTO was unable to account for 15 out of 140 workstations. In addition, nine of the 15 workstations were accounted for as stolen, but no documentation was provided to show that the thefts had been reported to PTO's Property Review Board.

Due to the lack of controls over the receipt and accountability of assets at the time of delivery of the workstations, PTO's property and equipment balance is at risk of being misstated.

Bulk Purchase Analysis

PTO determined that all bulk purchases of automated data processing (ADP) and office equipment having an individual acquisition cost of less than \$25,000 each, but totaling over \$500,000 in the aggregate, should be capitalized. This dollar threshold was established by PTO and incorporated into its capitalization policies without determining the potential impact on the financial statements. To ensure that expenses are not distorted as a result of high-dollar, infrequent purchases, we requested that an analysis be performed by applying several different thresholds to fiscal year 1997 purchases. However, PTO responded that such an analysis was not considered cost beneficial, as all fiscal year 1997 purchases would have to be reviewed a second time.

Based on our current year audit procedures, we noted one purchase that was capitalized even though it did not meet PTO's new bulk purchase threshold. Although we agree that the purchase should be capitalized, as expenses would have been distorted if it had been expensed due to its infrequent nature, the purchase illustrates that the bulk purchase threshold established by PTO may not be appropriate. We believe that PTO should perform a more in-depth analysis to support the current threshold.

Review of Purchase Documentation

By establishing capitalization policies during fiscal year 1997, PTO has made progress towards properly and consistently treating capitalized assets. However, we noted several deficiencies in the treatment of fiscal year 1997 purchases. For example, PTO improperly capitalized \$2.1 million in software maintenance agreements that were separate from the related software.

***Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996***

Additionally, in four instances, PTO paid the full amount of mathematically inaccurate or incorrectly billed invoices. In three of these instances, the overpayments were immaterial. However, one invoice resulted in an overpayment of approximately \$220,000. These errors indicate that the invoices are not being properly reviewed prior to payment and, as a result, the true value of the capitalized assets is misstated.

As mentioned above, PTO has made significant progress in improving its controls over property, in part due to the hiring of additional staff, the establishment of the Financial Reporting and Analysis Division within the Office of Finance, and the involvement of the major PTO offices. It is important to note that none of the above issues currently indicate material deficiencies in and of themselves; however, they each represent areas for improvement to ensure effective property management and to prevent potential misstatements of the capital asset balances that are a result of control weaknesses.

Analysis and Monitoring of Financial Information Should Be Improved

The main objective of financial reporting is to provide management with clear, concise, and useful information on which to base financial management decisions. We identified the following issues pertaining to PTO's analysis and monitoring of financial information that could inhibit management's decision-making process.

Deferred Revenue

Calculations for deferred revenue were not sufficiently reviewed. As a result, we noted that PTO used incorrect figures and fee codes in its calculation. In addition, the methodology documented as being used by PTO was inconsistent with the actual calculation.

Although the issues noted did not have a material impact on the financial statements, we believe that management may have identified them if a more detailed review of the calculations had been performed.

Open Obligations

Although the Office of Finance performs a monthly review of the open obligation report, we noted that eight of 20 items sampled, or 40 percent, were not valid as of September 30, 1997. In addition, we were informed that 19 of the 20 individuals responsible for purchasing had not

*Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996*

received the open obligations report as of September 30, 1997 to review. These reports are provided to the program offices once a year, in the spring. We believe that the program offices should be more involved in the review process throughout the fiscal year. Perhaps the reports should be forwarded to them quarterly rather than annually.

Deposit Accounts

PTO continues to have recording errors to its customer deposit accounts. As a result of our audit, we noted that an account holder was erroneously using another holder's account number, duplicate charges were erroneously charged to two customer accounts, a deposit was credited to the wrong account, and PTO was unable to provide sufficient documentation supporting adjustments requested for two accounts.

Duplicate Payments

PTO's procedures surrounding identification of duplicate payments are reactive rather than preventative. As a result, of 20 items sampled, we noted two, or 10 percent, duplicate payments that were not identified during PTO's review. Management had identified and corrected several duplicate payments as a result of its review. However, PTO's procedures are not sufficient to eliminate the risk of loss of funds.

Fluctuation Analyses

PTO has implemented procedures that require monthly analyses of account balances, however, the fluctuation analyses did not contain sufficient detail to provide management with the true cause for an increase or decrease between years. Instead, the initial analysis of the variance between the prior year's balances and the current year's balances merely reflected the fact that an account increased or decreased. Although management subsequently prepared a better analysis, we believe that management should be using the analysis throughout the fiscal year for monitoring purposes, rather than just at year end for audit purposes.

In addition, PTO has unfilled positions in key financial management areas. Specifically, the positions of Associate Commissioner and Chief Financial Officer and the Director for the Office of Budget are currently filled by acting officials. Permanently filling these positions is pertinent to the continued success of PTO's operations.

*Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996*

As stated above, we recognize that PTO has begun to hire individuals, which we believe will help address the lack of resources needed to perform the necessary review and monitoring of financial information. However, improvement is still needed.

Cash Receipts Should Be Deposited Timely

PTO continues to have delays in the deposits of its cash receipts. At September 30, 1997, checks not deposited amounted to approximately \$60.8 million. This was a \$13 million increase from the September 30, 1996 balance of approximately \$47.8 million. Approximately \$10.2 million, or 17 percent, of these unearned fees had a lag time of two to three months. The majority of the unearned fees with a lag time of two to three months consisted of patent application fees. The remaining 83 percent of undeposited checks, \$50.6 million, had a lag time for patents and trademarks of approximately 20 and 9 working days, respectively. The trademark figure represented a decrease from the 13 day lag time at September 30, 1996. However, the lag time for patents remained the same as the prior year. The time elapsed from the receipt of fees until their deposit results in a loss of interest earned to the U.S. Government.

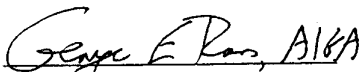
Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

We have reviewed our findings and recommendations with PTO's financial management and have incorporated their comments as appropriate. Management concurs with our findings and recommendations and will provide an audit action plan in accordance with applicable Department of Commerce directives.

*Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996*

We also noted other matters involving the internal control structure and its operation that we have reported to PTO's Acting Associate Commissioner and Chief Financial Officer in a separate letter dated December 29, 1997.

This report is intended for the information of management of PTO, Department of Commerce management, and the Office of Management and Budget. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

for 
Frank DeGeorge
Inspector General

December 29, 1997

*Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996*

**INSPECTOR GENERAL'S REPORT ON COMPLIANCE WITH LAWS AND
REGULATIONS**

Mr. Bruce A. Lehman
Assistant Secretary of Commerce and
Commissioner of Patents and Trademarks
Patent and Trademark Office
Washington, D.C.

We have audited the Statement of Financial Position of the Patent and Trademark Office (PTO) as of September 30, 1997, and the Statements of Operations and Changes in Net Position, and Cash Flows for the year then ended and have issued our report thereon dated December 29, 1997.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.

The management of PTO is responsible for complying with laws and regulations applicable to the bureau. As part of obtaining reasonable assurance about whether PTO's financial statements are free of material misstatements, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations designated by the Office of Management and Budget and PTO, including the requirements referred to in the Federal Financial Management Improvement Act of 1996.


The results of our tests of compliance with the laws and regulations described above disclosed no material instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we did note one immaterial instance of noncompliance that we have reported to management of PTO in a separate letter dated December 29, 1997.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with Federal financial management systems requirements, applicable accounting standards, and the United States Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB on September 9, 1997.

*Audit of the Patent and Trademark
Office's Financial Statements
as of September 30, 1997 and 1996*

The results of our tests disclosed no instances where the agency's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. This report is intended for the information of the management of PTO, Department of Commerce management, and the Office of Management and Budget. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

fu 
Frank DeGeorge
Inspector General

December 29, 1997