Consolidated Statement of Cash Flows (Indirect)

For the years ended September 30, 2000 and 1999

(In Thousands)

	2000	1999
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Increase in Cumulative Results of Operations	$ 68,055	$ 69,942
Adjustments Affecting Cash Flow:		
(Increase)/Decrease in Accounts Receivable	(632)	545
(Increase) in Advances and Prepayments	(1,448)	(1,621)
(Decrease)/Increase in Accounts Payable	(1,132)	4,576
Increase in Accrued Payroll and Benefits	5,854	8,576
Increase in Accrued Leave and Postemployment Compensation	3,451	1,518
Increase in Customer Deposit Accounts	4,940	3,286
Increase/(Decrease) in Deferred Revenue	59,423	(27,774)
Increase/(Decrease) in Actuarial Liability	882	(98)
Increase in Capital Lease Liability	5,793	-
Depreciation, Amortization, or Loss on Asset Dispositions	63,646	63,419
Total Adjustments	140,777	52,427
Net Cash Provided by Operating Activities	208,832	122,369
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Property and Equipment	(59,317)	(77,440)
Net Cash Used in Investing Activities	(59,317)	(77,440)
CASH FLOWS FROM FINANCING ACTIVITIES		
Rescissions	(2,980)	(72,049)
Net Cash Used in Financing Activities	(2,980)	(72,049)
Net Cash Provided/(Used) by Operating, Investing, and Financing Activities	$ 146,535	$ (27,120)
Fund Balance with Treasury and Cash, Beginning	$ 683,814	$ 710,934
Net Cash Provided/(Used) by Operating, Investing, and Financing Activities	146,535	(27,120)
Fund Balance with Treasury and Cash, Ending	$ 830,349	$ 683,814
Fund Balance with Treasury	$ 810,381	$ 673,902
Cash	19,968	9,912
Fund Balance with Treasury and Cash, Ending	$ 830,349	$ 683,814

- Represents zero.

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

Notes to the Financial Statements

As of and for the years ended September 30, 2000 and 1999

NOTE 1. Summary of Significant Accounting Policies

Reporting Entity

The U.S. Patent and Trademark Office (USPTO) is an agency of the United States within the Department of Commerce (DOC). The USPTO administers the laws relevant to patents and trademarks and advises the Secretary of Commerce, the President of the United States, and the Administration on patent, trademark, and copyright protection, and trade-related aspects of intellectual property.

These financial statements include the USPTO's three core business activities that promote the use of intellectual property rights as a means of achieving economic prosperity--processing patent applications, registering trademarks, and leading intellectual property protection initiatives. These activities not only give innovators, businesses, and entrepreneurs the protection and encouragement they need to turn their creative ideas into tangible products, but also provide protection for their inventions and trademarks.

These financial statements report the accounts for salaries and expenses (13X1006), special fund receipts (revenue withheld) (135127), and customer deposits (13X6542), which are under the control of the USPTO. The federal budget classifies the USPTO under the Commerce and Housing Credit (370) budget function. The USPTO does not have custodial responsibility, nor does it have lending or borrowing authority. The USPTO does not transact business among its own operating units. Therefore, no intra-bureau eliminations are necessary.

Basis of Presentation

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

These financial statements were prepared in accordance with the guidelines specified by the Office of Management and Budget (OMB) in Bulletin Number 97-01, as amended, *Form and Content of Agency Financial Statements,* as well as the accounting policies of the USPTO. They may therefore differ from other financial reports submitted pursuant to OMB directives for the purpose of monitoring and controlling the use of the USPTO's budgetary resources.

Basis of Accounting

Transactions are recorded on the accrual basis of accounting as well as on a budgetary basis. Budgetary accounting allows for compliance with the requirements for, and controls over, the use of Federal funds. Accrual accounting allows for revenue to be recognized when earned and expenses to be recognized when goods or services are received, without regard to the receipt or payment of cash. The accompanying financial statements are presented on the accrual basis of accounting. The accounting principles and standards applied in preparing these financial statements are in accordance with (a) the Statements of Federal Financial Accounting Standards (SFFAS), promulgated by the Federal Accounting Standards Advisory Board, which constitute accounting principles generally accepted in the United States; (b) the accounting policies and practices summarized in this note; and (c) the following hierarchy of accounting principles:

- Individual standards agreed to by the Director of the OMB, the Comptroller General, and the Secretary of the Treasury and published by the OMB and the General Accounting Office.
- Interpretations related to the SFFASs issued by the OMB in accordance with the procedures outlined in OMB Circular

- Interpretations related to the SFFASs issued by the OMB in accordance with the procedures outlined in OMB Circular A-134, *Financial Accounting Principles and Standards*.
- Requirements contained in the OMB's Form and Content Bulletin in effect for the period covered by the financial statements.
- Accounting principles published by other authoritative standard-setting bodies and other authoritative sources (a) in the absence of other guidance in the first three parts of this hierarchy, and (b) if the use of such accounting principles improves the meaningfulness of the financial statements.

Budgets and Budgetary Accounting

Appropriated funds from general taxpayer revenue were gradually eliminated following the passage of the Omnibus Budget Reconciliation Act (OBRA) in 1990. The OBRA established revenue withholding on statutory patent fees. Subsequent legislation (a) removed the reference to a specific surcharge withholding of 69 percent, (b) required the USPTO to withhold and deposit exact amounts of revenue, and (c) extended the revenue withholding through the end of fiscal year 1998. This withheld revenue constitutes offsetting receipts, and was deposited into a restricted special fund receipt account at the U.S. Department of the Treasury (Treasury). The USPTO may use moneys from this account only as authorized by the Congress, and only as made available by the issuance of a Treasury warrant. Moneys not appropriated to the USPTO by the Congress are retained in the restricted receipt account at the Treasury. *The U.S. Patent and Trademark Reauthorization Act, Fiscal Year 1999* reset patent statutory fees without the OBRA surcharge. The USPTO has not collected or deposited any additional amounts in the restricted special fund receipt account during fiscal years 2000 and 1999. The special fund receipt account currently has no liabilities, and the entire fund balance will remain restricted until appropriated.

Fees other than the restricted revenue withholding are offsetting collections subject to an annual congressional limitation, and are available to the USPTO until expended. Funds authorized but not used in a given fiscal year are carried forward for use in future periods. Fees collected in excess of the annual congressional limitation are held for use in future periods as appropriated by Congress.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Revenue and Other Financing Sources

The USPTO's fee rates are established by rule and law and, consequently, in some instances may not represent full cost or market price. Since fiscal year 1993, USPTO funding has been primarily through the collection of user fees. Fees that are remitted with initial applications and requests for other services are recorded as exchange revenue when received, with an adjustment at year-end to defer revenue for services that have not yet been performed. Amounts remitted by customers without a request for service are recorded as liabilities in customer deposit accounts until services are ordered.

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

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

Entity/Non-Entity

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

Fund Balance with Treasury

The Financial Management Service (FMS) of the Treasury maintains commercial bank accounts for the USPTO to deposit revenue collected. All moneys maintained in these accounts are transferred to the Federal Reserve Bank on the next business day following the day of deposit. In addition, certain customer deposits are wired directly to the Federal Reserve Bank. All banking activity is conducted in accordance with the directives issued by the FMS of the Treasury. All disbursements are processed by the Treasury.

Accounts Receivable

Intragovernmental accounts receivable represent amounts due from other Federal entities. As of September 30, 2000 and 1999, intragovernmental accounts receivable are $2,405 thousand and $1,545 thousand, respectively. The largest of these receivables in both fiscal years is a financing agreement between the USPTO and the DOC entered into during fiscal year 1995 to fund the Commerce Administrative Management System. Also, as of September 30, 2000, the General Services Administration (GSA) owed the USPTO for a rent overbilling.

Accounts receivable from the public represent a very small portion of the USPTO's assets as the USPTO requires payment prior to the provision of goods or services during the course of its core business activities. Public accounts receivable are comprised of amounts due from former employees for the reimbursement of education expenses and other benefits, as well as amounts due from the Patent and Trademark Depository Libraries.

The USPTO recorded a $12 thousand allowance for uncollectible amounts to reduce the gross amount of public accounts receivable to net realizable value as of September 30, 2000 and 1999.

Advances and Prepayments

On occasion, the USPTO prepays amounts in anticipation of receiving future benefits. Although a payment has been made, an expense is not recorded until goods have been received or services have been performed. The largest prepayment is with the National Inventors Hall of Fame, a non-profit organization, with whom the USPTO entered into memorandums of understanding during fiscal years 2000 and 1999 for various cooperative efforts. In addition, the USPTO maintains deposit accounts with the Government Printing Office and the DOC to facilitate transactions of a recurring nature. The USPTO also advances funds to personnel for travel costs and expenses these amounts after travel has occurred.

Cash

Most of the USPTO's cash balance consists of undeposited checks for fees that were not processed at the balance sheet date due to the lag time between receipt and initial review. All such undeposited cash amounts are considered to be cash to be cash equivalents. Cash is also held outside the Treasury to be used as imprest funds for small purchases, local travel, and emergency salary advances. As of September 30, 2000 and 1999, the cash balance includes undeposited checks of $19,953 thousand and $9,897 thousand, respectively. An imprest fund of $15 thousand was also held for each year.

Property and Equipment

The USPTO's capitalization policies are summarized below:

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

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

Property and equipment acquisitions that do not meet the capitalization criteria are expensed upon receipt. Fully depreciated assets purchased prior to October 1, 1996 may be written off against accumulated depreciation. The GSA leases from private concerns the buildings in which the USPTO operates. The GSA negotiates long-term leases and levies rent charges, paid by the USPTO, approximate to commercial rental rates. The lease arrangements with the GSA are considered operating leases.

Postemployment Compensation

Claims brought by employees of the USPTO for on-the-job injuries fall under the Federal Employees Compensation Act (FECA) administered by the U.S. Department of Labor (DOL). The DOL bills each agency annually as its claims are paid, but payment on these bills is deferred two years to allow for funding through the budget process. As of September 30, 2000, the USPTO recorded a $880 thousand liability for claims paid on its behalf during the benefit period July 1, 1998 through September 30, 2000. At September 30, 1999, the USPTO recorded a $789 thousand liability for claims paid on its behalf during the period July 1, 1997 through September 30, 1999.

Employees of the USPTO who lose their jobs through no fault of their own may receive unemployment compensation benefits under the unemployment insurance program administered by the DOL. The DOL bills each agency quarterly as its claims are paid. As of September 30, 2000, the USPTO recorded a $78 thousand liability for the quarters ended June and September for claims paid by the DOL on the USPTO's behalf. At September 30, 1999, the USPTO recorded a $17 thousand liability for the quarter ended September.

Annual, Sick, and Other Leave

Annual leave and compensatory time are accrued as earned, with the accrual being reduced as leave is taken. An adjustment is made each fiscal year to ensure that the balances in the accrued leave accounts reflect current pay rates. No portion of this liability has been obligated. To the extent current or prior year funding is not available to pay for leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of non-vested leave are expensed as used.

Employee Retirement Systems and Benefits

Employees of the USPTO participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). The FERS was established by the enactment of Public Law 99-335. Pursuant to this law, the FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees who had five years of federal civilian service prior to 1984 and who are rehired after a break in service of more than one year may be able to elect to join the FERS and Social Security system or be placed in the CSRS offset retirement system.

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

For both fiscal years 2000 and 1999, the USPTO made contributions equivalent to approximately 8.5 percent and 10.7 percent of the employee's basic pay for those employees covered by CSRS and FERS.

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 USPTO makes a mandatory 1 percent contribution to this plan. In addition, the USPTO 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 the CSRS. Employees participating in the FERS are covered under the Federal Insurance Contributions Act (FICA), for which the USPTO contributes a matching amount to the Social Security Administration.

For the years ended September 30, 2000 and 1999, respectively, the USPTO's retirement plan contributions for CSRS and FERS participants were $36,606 thousand and $32,544 thousand. The USPTO also contributed $23,350 thousand and $20,406 thousand for the years ended September 30, 2000 and 1999, respectively, to the Social Security Administration for FICA benefits.

Deferred Revenue

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

Application fees that have undergone the initial processing phase but have not been reviewed by a patent examiner or trademark attorney are deferred, with revenue recognized only to the extent costs have been incurred in the initial processing phase. The balance of the application fee is considered unearned. Issue fees are earned over a ten-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 fiscal year 1999 financial statement and footnote amounts were reclassified to reflect the allocation of information dissemination costs to the Patent and Trademark business units. In addition, the USPTO updated its program goals as a result of the AIPA enactment and these new program goals are presented on the Statement of Net Cost. The activities related to the previous program goal—collection, analysis, and dissemination of statistical and technical information—have been included as a component of the new program—enhance quality, transition to E-Government, and optimize processing time. Also, the Intellectual Property Leadership business unit has been desegregated to have its own program—strengthen intellectual property protection.

In fiscal year 2000, on the Statement of Financing, the determination of the portion of the change in deferred revenue related to financing sources that fund costs of future periods versus the portion related to revenue not generating resources was improved. Certain fiscal year 1999 footnote amounts were reclassified to be consistent with fiscal year 2000 classifications.

NOTE 2. Fund Balance with Treasury

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

As of September 30, 2000 and 1999, the Fund Balance with Treasury consisted of the following:

	(In Thousands)			
	2000			1999
	Unrestricted Funds	Restricted Funds	Total	Total
Appropriated Funds (Obligated)	$ 254,352	$ -	$ 254,352	$ 245,253
Appropriated Funds (Unobligated)	267,353	-	267,353	144,913
Revenue Withheld	-	233,529	233,529	233,529
Subtotal Entity Funds	521,705	233,529	755,234	623,695
Intragovernmental Deposit Funds	-	3,218	3,218	2,784
Other Customer Deposit Funds	-	51,929	51,929	47,423
Subtotal Non-Entity Funds	-	55,147	55,147	50,207
Total Fund Balance with Treasury	$ 521,705	$ 288,676	$ 810,381	$ 673,902

- Represents zero.

NOTE 3. Property and Equipment

As of September 30, 2000, property and equipment consisted of the following:

			(In Thousands)		
Class of Fixed Asset	Depreciation/ Amortization Method	Service Life (Years)	Acquisition Value	Accumulated Depreciation/ Amortization	Net Book Value
ADP Equipment	SL	3-7	$ 167,725	$ 117,619	$ 50,106
Software	SL	3-11	92,754	46,959	45,795
Software in Progress	-	-	19,588	-	19,588
Furniture	SL	5	17,064	9,620	7,444
Equipment	SL	3-5	8,768	6,850	1,918
Total			$ 305,899	$ 181,048	$ 124,851

- Represents zero.

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

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

- Represents zero.

NOTE 4. Liabilities

The USPTO records as liabilities all amounts that are likely to be paid as the direct result of events that have already occurred. The USPTO considers liabilities covered by three types of resources: (a) realized budgetary resources, (b) unrealized budgetary resources, and (c) cash and Fund Balance with Treasury. Realized budgetary resources include obligated balances directly funding existing liabilities and unobligated balances appropriated for spending as of September 30, 2000. Unrealized budgetary resources represent fee collections in excess of amounts appropriated for current fiscal year spending that become available for spending in subsequent fiscal years. Although these resources are not yet realized due to a time constraint, they become available in future periods to cover liabilities existing as of the Balance Sheet date. A portion of cash and Fund Balance with Treasury cover liabilities that will never require the use of a budgetary resource. These liabilities consist of deposit accounts, refunds payable to customers for fee overpayments, undeposited collections and amounts collected by the USPTO on behalf of other organizations.

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

As of September 30, 2000 and 1999, the following liabilities are covered by budgetary resources with the remainder not covered as follows:

	(In Thousands)	
	2000	1999
Liabilities Covered by Resources		
Intragovernmental		
Accounts Payable	$ 3,575	$ 4,189
Accrued Payroll and Benefits	4,654	4,563
Accrued Postemployment Compensation	78	17
Customer Deposit Accounts	3,218	2,784
Total Intragovernmental	11,525	11,553
Accounts Payable	55,210	55,728
Accrued Payroll and Benefits	39,018	33,255
Customer Deposit Accounts	51,929	47,423
Deferred Revenue	267,301	141,002
Capital Lease Liability	2,761	-
Total Liabilities Covered by Resources	427,744	288,961
Liabilities Not Covered by Resources		
Intragovernmental		
Accrued Postemployment Compensation	880	789
Total Intragovernmental	880	789
Accrued Leave	25,280	21,981
Deferred Revenue	71,479	138,355
Actuarial Liability	4,581	3,699
Capital Lease Liability	3,032	-
Total Liabilities Not Covered by Resources	105,252	164,824
Total Liabilities	$ 532,996	$ 453,785

- Represents zero.

NOTE 5. Deferred Revenue

As of September 30, 2000, deferred revenue consisted of the following:

	(In Thousands)		
	Patents	Trademarks	Total
Unearned Fees	$ 259,848	$ 59,708	$ 319,556
Undeposited Checks	17,404	1,820	19,224
Total Deferred Revenue	$ 277,252	$ 61,528	$ 338,780

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

	(In Thousands)		
	Patents	Trademarks	Total
Unearned Fees	$ 238,219	$ 31,961	$ 270,180
Undeposited Checks	7,847	1,330	9,177
Total Deferred Revenue	$ 246,066	$ 33,291	$ 279,357

NOTE 6. Actuarial Liability

The FECA provides income and medical cost protection to covered Federal civilian employees injured on the job who have contracted a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits under the FECA for the USPTO's employees are administered by the DOL and are ultimately paid by the USPTO.

The DOL estimated the future workers compensation liability by applying actuarial procedures developed to estimate the liability for FECA benefits. The actuarial liability estimates for FECA benefits include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims.

The DOL method of determining liability uses historical benefit payment patterns for a specific incurred period to predict the ultimate payments for that period. During fiscal year 2000, the DOL updated the FECA liability projection to include claims incurred but not reported and extended the duration of the model. Also, during fiscal year 2000, the DOL eliminated the use of mortality tables to reduce the life pension aspects of the model and make the FECA model more comparable to a private-sector casualty insurance model. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the OMB's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as indicated in this table.

Based on information provided by the DOL, the DOC determined that the estimated liability of the USPTO as of September 30, 2000 and 1999, was $4,581 thousand and $3,699 thousand, respectively.

2000	1999
6.15% in year 1, 6.28% in year 2, 6.30% in year 3, and thereafter	5.50% in year 1, 5.50% in year 2, 5.55% in year 3, 5.60% in year 4, and thereafter

NOTE 7. Leases

Capital Lease:

The USPTO capital lease was entered into during fiscal year 2000 and consists of ADP equipment with a lease term longer than one year, a fair market value of $25 thousand or more, a useful life of 2 years or more, and agreement terms equivalent to an installment purchase. The USPTO had no capital leases in fiscal year 1999.

	(In Thousands)
ADP Equipment	$ 12,473
Accumulated Amortization	(2,072)
Total	$ 10,401

Under existing commitments as of September 30, 2000, the capital lease term extends through fiscal year 2002. Future minimum lease payments are as indicated in this table.

	(In Thousands)
FY 2001	$ 3,000
FY 2002	3,197
Total Future Minimum Lease Payments	6,197
Less: Imputed Interest	404
Net Capital Lease Liability	$ 5,793
Liabilities Covered by Budgetary Resources	$ 2,761
Liabilities Not Covered by Budgetary Resources	3,032
Total	$ 5,793

Operating Leases:

The operating lease agreements negotiated by the GSA for the USPTO's office buildings expire at various dates between fiscal year 2000 and fiscal year 2023. During fiscal years 2000 and 1999, the USPTO paid $61,013 thousand and $60,099 thousand, respectively, to GSA for rent.

Under existing commitments as of September 30, 2000, the minimum lease payments through fiscal year 2005 are as indicated in this table.

	(In Thousands)
FY 2001	$ 55,012
FY 2002	39,382
FY 2003	36,372
FY 2004	86,315
FY 2005	61,944
Thereafter	973,568
Total Future Minimum Lease Payments	$ 1,252,593

NOTE 8. Imputed Financing

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

As of September 30, 2000 and 1999, the components of the imputed financing sources and corresponding expenses are as follows:

	(In Thousands) 2000	1999
CSRS/FERS	$ 7,511	$ 7,840
FEHB	15,255	14,540
FEGLI	61	52
Total Pension/ORB	$ 22,827	$ 22,432

NOTE 9. Program or Operating Expenses

Program or operating expenses are accumulated by USPTO strategic goal and consists of both those costs that are directly charged to the business activities and those costs that are allocated to the business activities. The costs that are allocated to the business activities can be further distinguished by those costs that are centrally managed for efficiency, but can be directly controlled within the management structure of the business activities, and those costs that are indirect charges in support of the business activities that are controlled at a USPTO-wide level. The designation of the allocated costs between those directly allocated to the business activities and those considered indirect are displayed in Note 10.

Total program or operating expenses for the years ended September 30, 2000 and 1999 by expense category are as follows:

	(In Thousands) 2000 Direct	Allocated	Total	1999 Total
Personnel Services and Benefits	$ 437,382	$ 52,740	$ 490,122	$ 438,130
Unfunded Personnel Services and Benefits	25,423	3,696	29,119	27,487
Travel and Transportation	999	2,475	3,474	3,301
Rent, Communications, and Utilities	698	70,692	71,390	73,550
Printing and Reproduction	51,609	2,029	53,638	47,416
Contractual Services	61,055	71,217	132,272	147,512
Training	2,145	3,706	5,851	5,522
Maintenance and Repairs	6,055	37,802	43,857	35,641
Supplies and Materials	5,132	1,579	6,711	7,790
Equipment Not Capitalized	2,746	3,669	6,415	8,015
Insurance Claims and Indemnities	254	3	257	89
Other Services	233	4,343	4,576	3,973
Depreciation, Amortization, or Loss on Asset Disposition	46,397	17,249	63,646	63,419
Total Program or Operating Expenses	$ 640,128	$ 271,200	$ 911,328	$ 861,845

NOTE 10. Program or Operating Expenses by Category and Responsibility Segment

The program or operating expenses for the years ended September 30, 2000 and 1999 by expense category and responsibility segment is as follows:

	(In Thousands)				
	2000				
	Patents	Trademarks	Intellectual Property Leadership	Total	1999 Total
Direct Expenses					
Personnel Services and Benefits	$ 373,859	$ 56,026	$ 7,497	$ 437,382	$ 390,943
Unfunded Personnel Services and Benefits	21,334	3,755	334	25,423	24,650
Travel and Transportation	496	86	417	999	1,128
Rent, Communications, and Utilities	405	241	52	698	1,498
Printing and Reproduction	47,789	3,801	19	51,609	46,150
Contractual Services	50,998	9,034	1,023	61,055	55,315
Training	1,997	127	21	2,145	1,676
Maintenance and Repairs	5,249	737	69	6,055	4,269
Supplies and Materials	4,288	631	213	5,132	6,289
Equipment Not Capitalized	2,090	432	224	2,746	3,381
Insurance Claims and Indemnities	252	2	-	254	61
Other Services	159	61	13	233	372
Depreciation, Amortization, or Loss on Asset Disposition	38,448	6,668	1,281	46,397	45,597
Subtotal Direct Expenses	547,364	81,601	11,163	640,128	581,329
Allocated Expenses					
Rent	42,747	7,312	1,265	51,324	51,215
Telecommunications	8,253	1,694	188	10,135	13,908
Program Automation	46,730	11,264	844	58,838	75,138
Subtotal Allocated Expenses	97,730	20,270	2,297	120,297	140,261
Allocated Indirect Expenses					
Allocated Automation	45,327	11,346	1,639	58,312	52,142
Resource Management	74,837	14,236	3,518	92,591	88,113
Subtotal Allocated Indirect Expenses	120,164	25,582	5,157	150,903	140,255
Total Program or Operating Expenses	$ 765,258	$ 127,453	$ 18,617	$ 911,328	$ 861,845

- Represents zero.

NOTE 11. Adjustments to Budgetary Resources

For the years ended September 30, 2000 and 1999, the components of adjustments to budgetary resources are as follows:

	(In Thousands)	
	2000	1999
Recoveries of Prior Year Obligations	$ 14,005	$ 10,756
Temporarily Not Available Pursuant to Public Law	(254,889)	(142,683)
Enacted Rescissions	(2,980)	(71,000)
Total Adjustments	$ (243,864)	$ (202,927)

NOTE 12. Commitments and Contingencies

Commitments

In addition to the future lease commitments discussed in Note 7, the USPTO is obligated for the purchase of goods and services that had been ordered but not yet received at fiscal year-end. Total undelivered orders for all of the USPTO's activities were $175,231 thousand and $165,959 thousand as of September 30, 2000 and 1999, respectively. Of these amounts $170,695 thousand and $162,867 thousand were unpaid.

Contingencies

The USPTO is a party to various routine administrative proceedings, legal actions, and claims brought by or against it, including threatened or pending litigation involving labor relations claims, some of which may ultimately result in settlements or decisions against the Federal Government. Management expects that as of September 30, 2000 and 1999 it is reasonably possible that an adverse outcome will result. However, it is not possible to speculate as to a range of loss.

Judgment Fund

Certain legal matters to which the USPTO is named a party may be administered and in some instances litigated and paid by other Federal agencies. These primarily relate to tort claims and contract disputes. Generally, amounts paid in excess of $2.5 thousand for Federal Tort Claims Act settlements or awards pertaining to these litigations are funded from a special appropriation called the Judgment Fund. During fiscal years 2000 and 1999 there were no payments from the Judgment Fund on behalf of the USPTO. Although the ultimate disposition of any potential Judgment Fund proceedings cannot be determined, management does not expect that any liability or imputed costs that might ensue would be material to the USPTO's financial statements.

Required Supplemental Information

Required Supplemental Information

As of September 30, 2000

(In Thousands)

Intragovernmental Assets:

Trading Partner	Fund Balance with Treasury	Accounts Receivable	Prepayments
04-Government Printing Office	$ -	$ -	$ 2,153
13-Department of Commerce	-	1,548	622
17-Department of the Navy	-	8	-
20-Department of Treasury	810,381	-	-
47-General Services Administration	-	788	-
49-National Science Foundation	-	60	-
97-Defense Agencies	-	1	10
Total	$ 810,381	$ 2,405	$ 2,785

Intragovernmental Liabilities:

Trading Partner	Accounts Payable	Accrued Payroll and Benefits	Accrued Postemployment Compensation	Customer Deposit Accou
04-Government Printing Office	$ 2,481	$ -	$ -	$ -
12-Department of Agriculture	-	-	-	142
13-Department of Commerce	902	-	-	82
14-Department of Interior	-	-	-	16
15-Department of Justice	-	-	-	11
16-Department of Labor	-	-	958	-
17-Department of the Navy	-	-	-	624
18-United States Postal Service	-	-	-	4
20-Department of Treasury	2	1,367	-	-
21-Department of the Army	-	-	-	847
24-Office of Personnel Management	51	3,287	-	-
57-Department of the Air Force	-	-	-	15
64-Tennessee Valley Authority	-	-	-	2
68-Environmental Protection Agency	139	-	-	53
69-Department of Transportation	-	-	-	1
75-Health and Human Services	-	-	-	49
80-National Aeronautics and Space Administration	-	-	-	487
89-Department of Energy	-	-	-	842
96-United States Army Corps of Engineers	-	-	-	40
97-Defense Agencies	-	-	-	3
Total	$ 3,575	$ 4,654	$ 958	$ 3,218

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Required Supplemental Information—Continued

For the year ended September 30, 2000

(In Thousands)

Intragovernmental Earned Revenue and Related Cost:

Trading Partner	Earned Revenue
12-Department of Agriculture	$ 226
13-Department of Commerce	91
14-Department of Interior	16
15-Department of Justice	7
17-Department of the Navy	1,333
18-United States Postal Service	40
20-Department of Treasury	1
21-Department of the Army	789
33-Smithsonian Institution	1
49-National Science Foundation	61
57-Department of the Air Force	251
64-Tennessee Valley Authority	17
68-Environmental Protection Agency	34
69-Department of Transportation	25
75-Health and Human Services	8
80-National Aeronautics and Space Administration	482
89-Department of Energy	1,046
90-Selective Service System	1
96-United States Army Corps of Engineers	57
Total	$ 4,486

Budget Functional Classification	Gross Cost to Generate Revenue
370-Commerce Housing Credit	$ 4,486
Total	$ 4,486

Intragovernmental Non-Exchange Revenue:

Trading Partner	Non-Exchange Revenue
24-Office of Personnel Management	$ 22,827
Total	$ 22,827

Independent Auditor's Reports

Ernst & Young

Ernst & Young LLP
8484 Westpark Drive
McLean, VA 22102

Phone: (703) 747-1000
www.ey.com

Report of Independent Auditors

To the Office of Inspector General,
Department of Commerce, and
Under Secretary of Commerce for Intellectual Property and Director of the United States Patent and Trademark Office

We have audited the consolidated balance sheets of the U.S. Patent and Trademark Office (USPTO), an Agency of the United States within the Department of Commerce as of September 30, 1999 and 2000, and the related consolidating statements of net cost and changes in net position and consolidated statements of budgetary resources, financing, and cash flows for the fiscal years then ended. These financial statements are the responsibility of the USPTO's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit for the years ended September 30, 1999 and 2000 in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*. These standards and bulletin require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the USPTO as of September 30, 1999 and 2000, and its net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and cash flows for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States.

Our audits were conducted for the purpose of expressing an opinion on the financial statements referred to in the first paragraph. The information in the Management Discussion and Analysis (MD&A), Supplemental Information, and Other Accompanying Information are not a required part of the USPTO's financial statements, but are considered supplementary information required by OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, as amended. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

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However, we were unable to assess the control risk relevant to USPTO's governmental transactions and balances with non-Department of Commerce trading partners, as required by OMB Bulletin 01-02, because these procedures were to be performed at the Department level. The Department of Commerce was unable to perform most of the reconciliations with its federal trading partners as required by the January 7, 2000 technical amendments to OMB Bulletin 97-01.

In accordance with *Government Auditing Standards*, we have also issued our reports as of and for the year ended September 30, 2000 dated December 29, 2000, on our consideration of the USPTO's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Ernst & Young LLP

December 29, 2000

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■ Ernst & Young LLP
1225 Connecticut Avenue, N.W.
Washington, DC 20036

■ Phone: (202) 327-6000
www.ey.com

Report of Independent Auditors on Internal Control

To the Office of Inspector General,
Department of Commerce, and
Under Secretary of Commerce for Intellectual Property and Director of the United States Patent and Trademark Office

We have audited the financial statements of the U.S. Patent and Trademark Office (USPTO) as of and for the year ended September 30, 2000, and have issued our report thereon dated December 29, 2000. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the USPTO's internal control over financial reporting by obtaining an understanding of the USPTO's internal control, determined whether internal control had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin 01-02. We did not test all internal control relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the USPTO's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements, losses or noncompliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

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In addition, with respect to internal control related to performance measures reported in the Management Discussion and Analysis (MD&A), we obtained an understanding of the design of internal control relating to the existence and completeness assertions and determined whether they have been placed in operation, as required by OMB Bulletin 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

Separate letters, dated December 4, 2000 and December 29, 2000, were provided to management which further discuss certain matters involving internal control in relation to our electronic data processing review and other matters that came to our attention, respectively, as a result of our audit.

This letter is intended solely for the information and use of the management of the USPTO, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

December 29, 2000

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ERNST & YOUNG ■ Ernst & Young LLP
1225 Connecticut Avenue, N.W.
Washington, D.C. 20036
■ Phone: (202) 327-6000
www.ey.com

Report of Independent Auditors on Compliance with Laws and Regulations

To the Office of Inspector General,
Department of Commerce, and
Under Secretary of Commerce for Intellectual Property and Director of the United States Patent and Trademark Office

We have audited the financial statements of the U.S. Patent and Trademark Office (USPTO) as of and for the year ended September 30, 2000, and have issued our report thereon dated December 29, 2000. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The management of the USPTO is responsible for complying with laws and regulations applicable to the USPTO. As part of obtaining reasonable assurance about whether the USPTO's financial statements are free of material misstatement, 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 specified in OMB Bulletin 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the USPTO. We caution that noncompliance may occur and not be detected by the tests performed and that such testing may not be sufficient for other purposes.

The results of our tests disclosed no instances of noncompliance with the laws and regulations discussed in the preceding paragraph exclusive of FFMIA that are required to be reported under *Government Auditing Standards* or OMB Bulletin 01-02.

Under FFMIA, we are required to report whether the USPTO's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed no instances in which the USPTO'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.

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This report is intended solely for the information and use of the management of the USPTO, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

December 29, 2000

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Other Accompanying Information

Other Accompanying Information

For the year ended September 30, 2000

(In Thousands)

	Patents	Trademarks	Total
PROGRAM			
Enhance Quality, Transition to E-Government, and Optimize Processing Time			
With the Public	$ 596,587	$ 99,361	$ 695,948
Intragovernmental	168,671	28,092	196,763
Total Program Cost	765,258	127,453	892,711
Earned Revenue	(817,399)	(139,157)	(956,556)
Net Program Income	(52,141)	(11,704)	(63,845)
Strengthen Intellectual Property Protection			
With the Public	12,488	2,026	14,514
Intragovernmental	3,531	572	4,103
Total Program Cost	16,019	2,598	18,617
Net Income From Operations	$ (36,122)	$ (9,106)	$ (45,228)
TOTAL ENTITY			
Total Program Cost	$ 781,277	$ 130,051	$ 911,328
Earned Revenue	(817,399)	(139,157)	(956,556)
Net Income from Operations	$ (36,122)	$ (9,106)	$ (45,228)

The Nature of the Training Provided to USPTO Examiners

Achieving organizational excellence demands a high performing workforce that delivers high quality work products and provides customer service excellence. Training is a critical component in achieving consistently high quality products and services.

Patent examiners and Trademark examining attorneys received extensive legal, technical and automation training in fiscal year 2000. The USPTO has a comprehensive training program for new patent examiners and trademark examining attorneys, which has a well-established curriculum including initial legal training and training in examination practice and procedure. Additionally, in fiscal year 2000 the USPTO provided legal lectures on current issues such as the Utility Guidelines and Written Description Guidelines and training on new rules changes. Automation training is provided to all examiners on an as-needed just-in-time basis. Technology specific legal and technical training was conducted throughout the examining operations. This specific training either focused on practices particular to the technology or was developed to address training needs identified through performance measurement.

Patent Examiner Training

Procedural Training - mandatory for all first year examiners	Patent Examiner Initial Training (PEIT) Introduction to Practice and Procedures
Legal Training - mandatory for all first year examiners	Practice and Procedures Lectures covering the following topics: * Types of application and application requirements * "Novelty" requirements * "Non-Obviousness" requirements * "Utility" requirements * Restriction practice * Unity of invention * Double patenting * Allowance and issue * Appeals
Legal Training - Technology Center Focused	* "Novelty" requirements * Docket Management * Part of Application * USPTO Forms * After Final Practice * "Non-Obviousness" requirements * "Utility" requirements * Prior Art (special topics) * Restriction Practice * Response to Arguments * Double Patenting * Reexam/Reissue
Legal Training - Legal Lectures	Various topics offered each year
Legal Training - Legal Courses	* Patent Law * Evidence
Examiner Technical Training (Technology Center Focused	* Biotechnology * Chemical Engineering * Mechanical Engineering * Computer Software and Hardware * Optics, Semiconductor, Electrical Engineering * Communication Technology
Examiner Technical Training - In-house Technical Lectures	Examples: * Organic Chemistry Basic * Streaming Digital Video * Introduction to Cable, MPEG, Imaging * DVD Technology * Disk Drive operations * PRML Read Channels * Communications Basics * 3rd Generation Cellular * Display System * Flat Panel Display Lecture * Artificial Intelligence * Computer Architecture
Automation Training	Examples: * Introduction to Computer Skills * Keyboarding Skills * Windows™ NT Overview * Windows™ NT Hands On * Computer Housekeeping * Microsoft® Outlook * Microsoft® Excel * Microsoft® Word I, II, III, IV * Office Action Correspondence Subsystem * US Classes, International Patent Classification Codes and the Concordance Online * Search Strategy Development Overview * Automated Searching for Design Examiners * Automated Searching for Shoe Searcher * Chemical Searching for Non-Chemists * Introduction to Sequence Searching * Examiner's Automated Search Tool (EAST) - Search Strategy for Chemical, Mechanical, Electrical, and Biotechnology Arts * Web-Based Examiner Search Tool (WEST) - Search Strategy for Chemical, Mechanical, Electrical, and Biotechnology Arts * Search Strategy for the Biotechnology Arts * WEST for EAST Searchers/ EAST for WEST Searchers * Understanding and Locating Foreign Patents * Commercial Databases and Web Resources

Trademark Examining Attorney Training

Trademark Organization Training and Learning (TOTAL)	Practice and Procedures Lectures and Activities covering the following topics:
Legal Training - mandatory for all first year trademark examining attorneys.	* Trademark Law Overview * Refusals under Section 2(d) of Trademark Act (Likelihood of Confusion) * Refusals under Section 2(e)(1) of Trademark Act (Mere Descriptiveness/Deceptively Misdescriptive) * Trademark Manual of Examining Procedure * Refusals under Section 2(e)(2) of Trademark Act (Geographically Descriptive) * Refusals under Section 2(e)(3) of Trademark Act (Geographically Deceptively Misdescriptive) * Refusals under Section 2(e)(4) of Trademark Act (Primarily Merely Surname) * Intent to Use Procedural Requirements * Identification and Classification of Goods and Services Practice * Legal Letter Writing * Drawings, Specimens and Use-Based Refusals * Basis Requirements * Options Practice - Section 2(f) of Trademark Act and Supplemental Register * Disclaimer Requirements * Evidence Practice * Refusals under Sections 2(a), (b) and (c) of Trademark Act
Automation Training	* PTOnet System and Applications * X-Search Automated Trademark Search System

Fiscal Year 2000 USPTO Workload Tables

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