

Financial Discussion and Analysis

American Inventors Protection Act (AIPA)

Any law that fundamentally restructures the USPTO and alters the nature of the agency's operations as the AIPA, will have far-reaching impacts in the financial management arena. The AIPA established Patents and Trademarks as separate operating units that demanded new financial reporting, budgetary tracking, and financial management tools to facilitate meeting missions and performance goals.

Becoming the largest and only second PBO in the Federal Government, the USPTO had many challenges and little precedent to follow in financial and budgetary arenas. We were challenged to operate as a business in a Federal system that is based on Federal budget appropriation laws, proscriptive regulations, and administration. As we rise to the challenge, our organization will be scrutinized for success or failure as a new kind of Federal Government agency.

Operating Our Business as a Performance-Based Organization

Our new PBO status gave us greater independence and managerial flexibility than ever before. With relief from some Federal procurement and management regulations, and the creation of two Public Advisory Committees to advise the USPTO Director on budgets, fees, policies, and performance, we began operating in a more businesslike manner. The Advisory Committees are drawn from a cross-section of our private sector customers, and will function very much like the board of directors of a large corporation, advising our Director on all aspects of USPTO operations. Although we have always been a results-driven organization, as a PBO, we are more committed to fiscal accountability by having clear objectives and specific measurable performance goals. We will also be judged ultimately by our results — the bonuses of both Patent and Trademark Commissioners are tied directly to meeting specific performance goals that have been established for their respective units.

Operating as a business, we understand that pendency time plays a large part in customer satisfaction, as well as in our financial stability because they affect how we match our costs to revenue and the amount of liability we carry as unearned revenue. We believe that our PBO status provides us with opportunities to help control pendency, enabling us to be more responsive to our customers and more financially sound. For example, various factors that affect pendency, such as personnel and information technology, can be managed better. Where we were once constrained by a hiring cap, the number of employees under the PBO structure is constrained only by our annual operating budget. Similarly, we are no longer subject to certain time-consuming Federal acquisition rules when buying products and services, such as information technology.

Other productivity factors that affect pendency, such as employee satisfaction and retention, will be positively influenced by our space consolidation project. The five new buildings linked in a campus-like setting will give the USPTO a unified and "corporate" presence which, in turn, facilitates program delivery and increases our ability to attract and retain high quality staff. Our financial management staff established policies and procedures to manage, account for, and specifically track moving and construction costs related to the space consolidation.

Increased application volumes also present future challenges in managing our operations. For fiscal year 2001, we anticipate a workload of approximately 335,000 patent applications and 470,000 trademark application classes. If these forecasts are realized, it means that patent applications will have increased by

more than 75 percent in the last five years — mirroring the growth in industrial research and development spending during the same period — and that trademark applications will have more than doubled in the last four years.

To control and manage the increasing volume and complexity of our workloads and meet our pendency reduction goals, we must conduct more of our business activities through electronic means. One of our key priorities this past fiscal year was to continue providing our customers with more efficient, user-friendly service by making a number of significant improvements in our automation and information technologies.

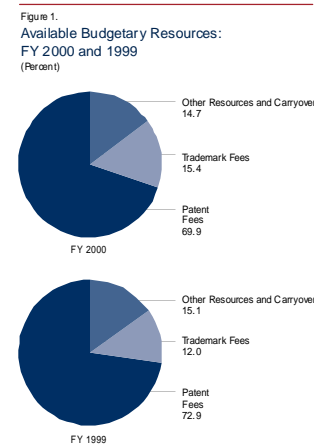
Ultimately, our success or failure as a PBO hinges on whether we have the resources to do the job our customers have paid and entrusted us to do. As previously mentioned, our PBO status did not give us direct control over our budgetary resources and fee collections—AIPA did not resolve our fee retention issue. An additional challenge in managing our growing business is the possibility that Congress will not allow the USPTO to access \$367.7 million of our patent and trademark fee collections in fiscal year 2001, or 31.9 percent of our estimated fee collections. Budget restriction of this magnitude hinders our ability to reduce pendency and continue our automation and information technology efforts, which greatly impact current and future operations.

Budgetary Resources

Available budgetary resources totaled \$907.7 million for fiscal year 2000, a 12.6 percent increase over the fiscal year 1999 total available budgetary resources of \$805.8 million. The USPTO is a financially self-sufficient Federal Government agency that funds the cost of its operations from user fees rather than appropriations from taxes paid into the general fund of the U.S. Department of the Treasury. Our major fees are set by statute and activity-based cost accounting techniques are used to determine fee amounts necessary to recover the costs of business operations. As a Government agency, our goal is to realize budgetary resources provided through the collection of user fees that are equal to budgetary spending incurred to fill customer orders, as opposed to generating net income.

The USPTO's budgetary resources came from several sources. Patent fees represent approximately seven-tenths of total budgetary resources and any fluctuation experienced in patent fees or in the patent industry has a direct and significant impact on our budgetary resources. Trademark fees represent more than another tenth of budgetary resources with the balance from other sources, such as recoveries of prior year spending and miscellaneous collections under reimbursable agreements. Available fee collections totaled \$773.6 million and \$744.0 million; other resources totaled \$15.1 million and \$11.2 million; and amounts carried forward from prior years totaled \$119.0 million and \$50.6 million, for fiscal years 2000 and 1999, respectively.

Figure 1 depicts the sources of available budgetary resources prior to rescissions being deducted.



Temporarily unavailable fee collections occur when the Congress does not allow the USPTO access to use all fees collected during the fiscal year, making the management of funds and pendency difficult. Sometimes our appropriation is very definitive, limiting our ability to operate as good business practices may dictate. In fiscal year 2000, limitations on our fees were as follows:

- Originally we were appropriated \$755.0 million in current year fee collections;
- The next \$229.0 million in fee collections were restricted until fiscal year 2001;
- Any fee collections beyond \$984.0 million (the \$755.0 million plus the \$229.0 million) had to be reappropriated before we could use them. A reappropriation request for an additional \$17.0 million was submitted and approved for fiscal year 2000;

Figure 2.
Patent Resource Requirements:
FY 1997-2000
(Millions of Dollars)

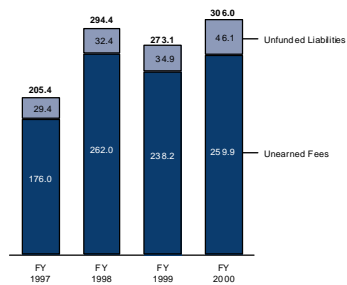
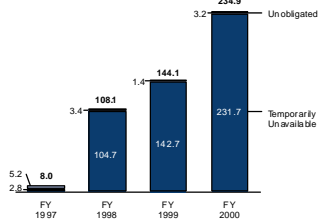


Figure 3.
Patent Resource Availability:
FY 1997-2000
(Millions of Dollars)



- By fiscal year-end, we had collected another \$4.6 million above the \$17.0 million reappropriated to us. This amount was included in the \$773.6 million in fees available as of September 30, 2000, but was later designated as temporarily unavailable until fiscal year 2002 or after.

For fiscal year 1999, \$142.7 million in fee collections were restricted until fiscal years 2000 and 2001.

Rescissions also reduced a sizeable portion of our fee resources. These amounts are withheld in the annual congressional appropriations process and diverted to other government programs. As a fee-funded agency, we do not pass these budget reductions on to customers as they are not related to the operation of the patent and trademark business. For example, the Congress rescinded \$3.0 million and \$72.0 million of USPTO fee funding in fiscal years 2000 and 1999, respectively. This was equivalent to taking away, over a two-year time period, the budgetary resources provided by approximately 133,000 patent filings or 231,000 trademark applications. Though the Congress removed these amounts from our funding permanently, we still were required to incur cost to process applications and conduct business as usual, using funds received from other applications.

Even if all other factors involving pendency were resolved, we could still not process all outstanding orders. Figures 2 and 4 show unfunded liabilities related to earned fee collections, as well as a liability for work to be performed on unearned fee collections. In an agency that sets its fees by the related service cost, unearned fee collections approximate the spending necessary to earn the collections.

Figure 4.
Trademark Resource Requirements:
FY 1997-2000
(Millions of Dollars)

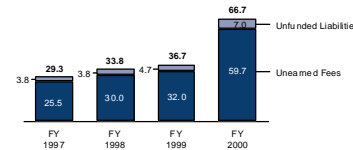
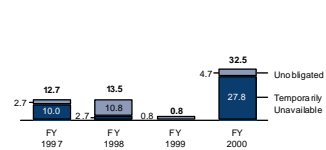


Figure 5.
Trademark Resource Availability:
FY 1997-2000
(Millions of Dollars)



We still could not have earned all fee collections and funded all outstanding liabilities in any given fiscal year, even if we had access to our temporarily unavailable resources. Figures 3 and 5 show available and unavailable resources that were not used as of the end of fiscal years 1997 through 2000.

Liquidity and Capital Resources

Figures 6 and 7 depict the USPTO's financial condition for the past four fiscal years. There has been a gradual increase in both assets and liabilities, indicating steady growth.

Figure 6.
Composition of USPTO Assets:
FY 1997-2000
(Millions of Dollars)

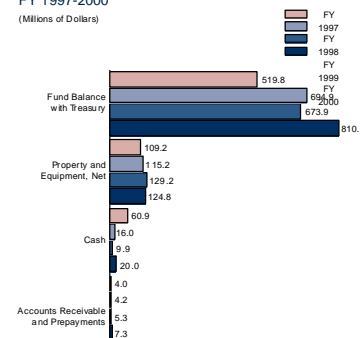
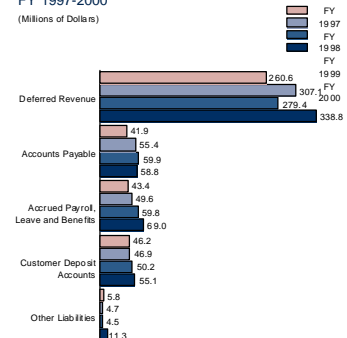


Figure 7.
Composition of USPTO Liabilities:
FY 1997-2000
(Millions of Dollars)



Current ratio measures the adequacy of our resources in terms of current assets per dollar of current liabilities. A current ratio greater than 1.0 normally indicates current assets are sufficient to cover current liabilities. At the USPTO, two important factors must be taken into consideration. First, the ratio does not reflect undelivered orders, which are obligations with no corresponding liability, causing the denominator to be understated. Second, the enactment of the Omnibus Budget and Reconciliation Act (OBRA) of 1990, as amended in 1993, established a surcharge on patent fees from fiscal year 1992 through fiscal year 1998. Although these fees were earned and collected, the Congress controlled their use and the amounts remain restricted until appropriated. The restricted surcharge cash of \$233.5 million included in our current assets

Financial Ratios	FY2000	FY1999	FY1998	FY1997
Current Ratio	1.66	1.60	1.62	1.55
Current Ratio, <i>Net of Surcharge</i>	1.17	1.01	1.05	1.14
Current Ratio, <i>Net of Surcharge and Undelivered Orders</i>	.85	.72	.68	.65

Financial Ratios	FY2000	FY1999	FY1998	FY1997
Total Assets Turnover	1.02	1.14	.99	1.09
Total Assets Turnover, <i>Net of Surcharge</i>	1.34	1.59	1.22	1.27

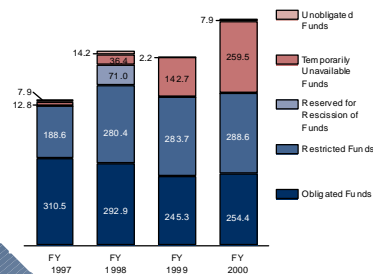
causes our numerator to be overstated. To demonstrate the effect of undelivered orders and the OBRA surcharge on our liquidity, the current ratio is also presented net of these amounts. This modified ratio shows that our current ratio is greater than 1.0 when only the surcharge is considered, but falls significantly below 1.0 when undelivered orders are factored in for each of the four years presented. This indicates that we did not have enough current assets to cover our current liabilities.

Total assets turnover measures operating efficiency in terms of total revenue per dollar of total assets. Higher turnover ratios reflect greater ability in using total assets to generate revenue. Over the past four years, our total assets turnover remained fairly flat, due mainly to the inclusion of surcharge amounts in the calculations. To demonstrate the OBRA surcharge's effect on financial performance, this financial ratio is also presented net of the OBRA surcharge.

Cash and Fund Balance with Treasury was \$830.4 million at September 30, 2000, a 21.4 percent increase from the fiscal year 1999 balance of \$683.8 million (Figure 8). A detailed analysis of our cash flow activities can be found later in this discussion.

Our cash accounts and Fund Balance with Treasury do not represent funds available for spending. Of the total \$830.4 million at September 30, 2000, \$254.4 million is set aside for the payment of existing obligations, \$233.5 million continues to be restricted as required by the OBRA, \$20.0 million represents cash or checks in transit, and \$55.1 million represents funds held on deposit in trust for

Figure 8.
Fund Balance with Treasury:
FY 1997-2000
(Millions of Dollars)



customers. After considering these amounts, only \$267.4 million remains to meet patent and trademark needs. This amount includes \$259.5 million that is restricted for use until subsequent fiscal years, \$0.2 million in unobligated funds that were not apportioned for use at the end of the fiscal year, and only \$7.7 million, or 0.9 percent, available to meet fiscal year 2000 needs.

Property and equipment (P&E), net was \$124.8 million at September 30, 2000, representing the original acquisition value of \$305.9 million less accumulated depreciation of \$181.1 million. Although the net book value decreased \$4.4 million, or 3.4 percent, from the fiscal year 1999 net balance of \$129.2 million, total acquisition value of P&E increased \$10.9 million, or 3.7 percent, over the 1999 balance of \$295.0 million (Figure 9). This increase reflects our sustained commitment to automation and information technology to improve business quality and efficiency and integrate E-Government practices into our business practices. During fiscal year 2000, we incurred only minimal costs related to the Y2K issue because no information technology problems occurred related to the event.

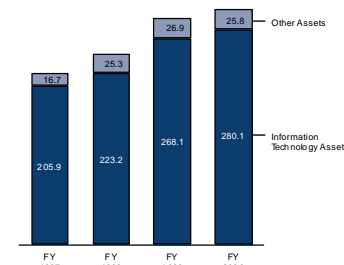
To continue as a Federal sector leader in today's fast-paced, high-tech economy, and manage pendency and the increases in volume and complexity of our workloads, it became necessary to conduct more of our business activities through electronic means. Over the last decade, we have invested almost \$500 million to automate our patent and trademark business processes and have made significant strides towards providing an efficient, cost-effective, and paperless service to our customers.

In Patents, we continued to implement state-of-the-art information technology. This is evident in our information technology spending trends. In fiscal year 2000, we piloted the EFS for biotechnology patents. We also deployed PAIR, allowing applicants and their designated agents or attorneys to obtain up-to-the-minute information securely on their pending applications. Finally, we expanded our Patent and Full-Text and Image Database to more than 6.5 million U.S. patents dating back to 1790.

In Trademarks, we extended access to our customers by making additional systems available over the Internet. Customers accessed our trademark database to search for conflicting marks by using the Trademark Electronic Search System (TESS). Access to application and registration status, mark, ownership, and prosecution history information is available using the Trademark Application and Registration Retrieval (TARR) system. Also, the Trademark E-Commerce law office was launched in August 2000. The E-Commerce law office receives, processes, and examines electronically filed trademark applications for registration.

In addition to automating our patent and trademark production systems, we continued to make improvements in our financial management and resource management systems — to provide better customer service and to achieve our E-Government goals, reduce costs, attain greater processing efficiency, and improve

Figure 9.
Property and Equipment Acquisition
Values: FY 1997-2000
(Millions of Dollars)



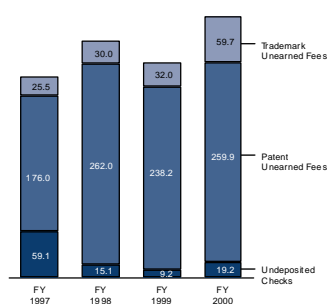
customer service and to achieve our E-Government goals, reduce costs, attain greater processing efficiency, and improve accountability and data integrity. For instance, we upgraded our Revenue Accounting and Management (RAM) system to expand the financial transactions over the Internet and to provide our customers with added convenience and enhanced financial services. We began accepting credit card payments for all fees and services, such as the basic filing fee for a utility patent application, patent maintenance fees, trademark application for registration, and trademark application for renewal, to name a few. As more and more of our products and services became available over the Internet, the use of credit cards made it easier and more convenient for our customers to make required fee payments. This should be particularly helpful to our small business and small inventor customers.

Customers were also afforded the convenience of maintaining their deposit account over the Internet. They can replenish a deposit account using a credit card; view deposit account information including holder name, address, and current balance; request a deposit account statement; and add, change, or delete deposit account authorized users.

The RAM system upgrade was part of our long-term E-Government strategy to modernize financial management practices and procedures, provide increased options for paying required fees, and provide improved service to our customers. A next step in our strategy is to expand the E-Government payment methods to include transactions using an automated clearinghouse debit. This will give customers the ability to provide banking information and allow the USPTO to debit their account for approved charges.

Deferred revenue was \$338.8 million at September 30, 2000, an increase of \$59.4 million, or 21.3 percent over the fiscal year 1999 balance of \$279.4 million (Figure 10).

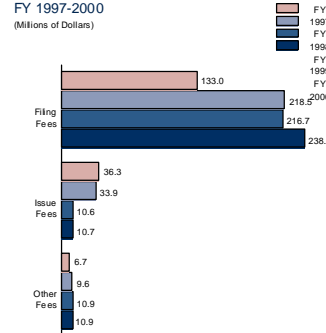
Figure 10.
Deferred Revenue: FY 1997-2000
(Millions of Dollars)



The USPTO defers the recognition of income for fees collected for services that have not been provided yet. Our deferred revenue liability includes undeposited checks as of the end of the fiscal year, unearned patent fees, and unearned trademark fees.

trend in undeposited checks reveals a return on investing additional resources in decreasing fee processing backlogs, the ability to maintain low undeposited checks balance is highly dependent on fee adjustments each fiscal year. The undeposited checks component of deferred revenue increased 108.7 percent from \$9.2 million at the end of fiscal year 1999 to \$19.2 million at the end of fiscal year 2000. This increase was attributable to the fee increase on October 1, 2000. When fees increase, customers traditionally file applications and pay maintenance fees in September to obtain "mail dates" prior to the fee increase set for October 1. This increased the workload volume and dollar value of transactions as of September 30. When the workload for September increases and processing times remain constant, undeposited checks will also increase. A historical trend analysis reveals that when a fee increase is anticipated, the September workload increases to more

Figure 11.
Patent Unearned Fees:
FY 1997-2000
(Millions of Dollars)



anticipated, the September workload increases to more than one-half over the monthly average fee processing workload. Patent fees decreased at the beginning of fiscal years 1999 and 2000, eliminating an increased September fee processing workload and allowing for less undeposited checks.

Unearned patent fees at the end of fiscal year 2000 increased \$2.1 million, or 9.1 percent, over the prior year, due primarily to increased collections of filing fees and PCT – International Stage fees, as well as slight increases in cycle times (Figure 11).

Unearned trademark fees increased \$27.7 million, or 86.6 percent, over the prior year, due primarily to sharp increases in the year-end backlog of pending trademark applications and trademark renewals. As of September 30, 2000, revenue was deferred for 157,753 pending applications as compared to the fiscal year 1999 backlog of 119,751 pending applications — a 31.7 percent increase in the backlog of pending applications. Concurrent with the higher backlog, the increased deferred revenue attributed to trademark applications was due to the increase in the application fee amount, from \$245 to \$325. Similarly, at fiscal year end, revenue was deferred for 13,354 pending trademark renewals as compared to the prior fiscal year end backlog of 730 pending renewals — a dramatic 1,729.3 percent increase in the backlog of renewals. The increased deferred revenue attributed to trademark renewals was also due to the increase in the renewal fee amount, from \$300 to \$400 and a change in the law that increases requirements for filing and therefore increases the workload (Figure 12).

Return on net position measures management performance and operating effectiveness in terms of results of operations per dollar of net

Financial Ratios (percent)	FY2000	FY1999	FY1998	FY1997
Return on Net Position	15	19	19	30
Return on Net Position, <i>Net of Surcharge</i>	33	53	-16	23

Figure 12.
Trademark Unearned Fees:
FY 1997-2000
(Millions of Dollars)

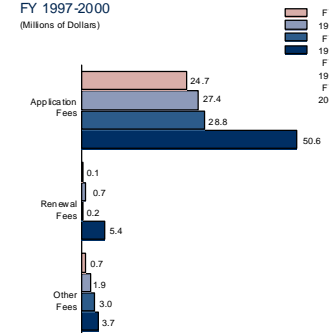
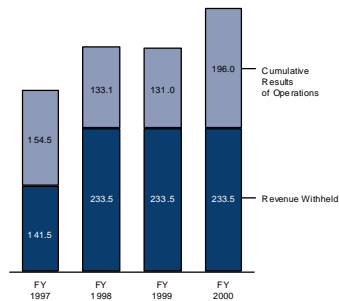


Figure 13.
Components of Net Position:
FY 1997-2000
(Millions of Dollars)



of net position. In a profit-motivated, private-sector business, higher returns typically reflect higher performance and effectiveness. For a government agency, this is not the case because we do not work towards achieving net income. Over the past four years, our return on net position decreased from 30 percent in 1997 to 15 percent for fiscal year 2000. To demonstrate the OBRA surcharge's significant effect on our operations, the return on net position is also presented net of the OBRA surcharge.

Net position was \$429.5 million as of September 30, 2000, an increase of \$65.0 million over the fiscal year 1999 total of \$364.5 million (Figure 13).

Cumulative results of operations was \$196.0 million as of September 30, 2000, comprising net P&E in the amount of \$124.8 million and non-cash assets totaling \$7.3 million, leaving the remaining interest in the cash and fund balance as \$63.9 million.

The \$63.9 million interest in cash and the fund balance is calculated on a financial accounting basis and does not reflect the impact of our obligations for \$170.7 million in unpaid undelivered orders (goods and services ordered, but not yet received) less \$1.5 million in receivables that provide budgetary resources. Therefore, after liquidating our unpaid undelivered orders and funded liabilities at September 30, 2000, future funding in the amount of \$105.3 million will have to be earned, or surcharge revenue withheld will need to be appropriated, to liquidate unfunded liabilities at September 30, 2000.

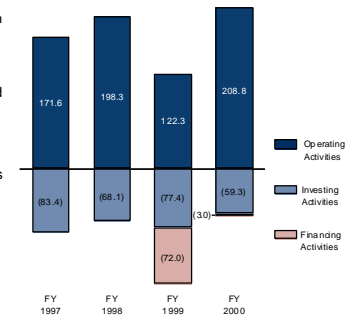
Revenue withheld was \$233.5 million as of September 30, 2000, the same as the prior year balance. Revenue withheld is segregated as a portion of net position because the OBRA restricted its availability. Increasing amounts of our customer fees were withheld from fiscal year 1992 through fiscal year 1998. Initially, the surcharge amounts were small when compared with revenue, but the amounts increased over time. Annual amounts withheld ranged from \$8.1 million in fiscal year 1992 to \$92.0 million in fiscal year 1998, reaching a total withheld balance of \$233.5 million at the end of fiscal year 1998.

Cash flow return on assets measures operating effectiveness in terms of cash generated from operations per dollar of total assets. Higher cash flow returns reflect greater operating performance. Our cash flow return on assets presented without the effects of the OBRA surcharge in the calculation indicates that our cash flow return has improved.

Financial Ratios (percent)	FY2000	FY1999	FY1998	FY1997
Cash Flow Return on Assets	22	15	24	25
Cash Flow Return on Assets, <i>Net of Surcharge</i>	29	21	18	21

Cash and Fund Balance with Treasury was \$830.4 million as of September 30, 2000, a 21.4 percent increase over the fiscal year 1999 balance of \$683.8 million. During fiscal year 2000, we generated a net of \$208.8 million in cash from patent and trademark fees and other operating activities, an increase of \$86.5 million, or 70.7 percent, from the \$122.3 million generated during fiscal year 1999. A large portion of this net increase in operating cashflow is restricted for use until a future fiscal year since the related budgetary resources are temporarily unavailable. Therefore, we have operating cash inflows without corresponding cash outflows (Figure 14).

Figure 14.
USPTO Cash Flows: FY 1997-2000
(Millions of Dollars)



Of the \$208.8 million generated from operating activities during fiscal year 2000, \$59.3 million was invested in new property and equipment, principally automation and information technology. This amount represented a decrease of \$18.1 million, or 23.4 percent, from the \$77.4 million of net cash invested in property and equipment during fiscal year 1999. The large decrease was partly due to postponing furniture and equipment purchases until after the move to the new USPTO facility. Also, large amounts of software development in progress were placed in production recently. Once placed in production subsequent costs are classified as maintenance, which is not capitalizable. After funding fiscal year 2000 investments in automation and information technology, the net cash provided by our operating and investing activities was \$149.5 million. However, \$3.0 million in rescissions of funds left us with net cash provided of \$146.5 million for the year. This represented an increase of 640.6 percent from the \$27.1 million in cash used during fiscal year 1999.

Results of Operations

Operations index measures operating effectiveness in terms of cash generated from operations per dollar of results of

operations. In a profit-motivated, private-sector business, a higher return typically reflects greater operating performance. For a Government agency, this index is not as crucial as we do not work towards achieving net income. Nonetheless, this index does show that over the past four years the results we achieved with our operating cashflow fluctuated due, largely, to changes in deferred revenue. As deferred revenue increased, operating cashflow increased without a corresponding increase in revenue.

We are one of the first Federal agencies to have implemented activity-based cost (ABC) accounting on an agency-wide basis. Progress with enterprise-wide ABC accounting allowed the USPTO to move from managing program costs at a USPTO-wide level to a business level. We used ABC to make informed decisions on the costs of conducting our activities and delivering our products and services. The cost for a particular program provided better information about specific operations. We compared trends in the USPTO-wide costs to trends in the program or business costs to determine unusual fluctuations.

Financial Ratios	FY2000	FY1999	FY1998	FY1997
Operations Index	3.21	1.75	2.81	1.91
Operations Index, <i>Net of Surcharge</i>	3.21	1.75	-4.94	3.27

The process of leveraging the ABC system to provide activity-based management (ABM) commenced in fiscal year 1999 and began manifesting itself during the past year. The incremental benefits that ABC/ABM provided enabled more effective management and accountability over costs. At the USPTO, our ABC/ABM principles were used to determine and adjust fees for full cost recovery. We also used ABC/ABM to analyze the cost of law changes, assess the impact of fee alternatives, compare revenues and costs for products and services, and promote continuous improvement and reengineering, among other items. Our ABC data helped us see the interconnectivity between quality, capacity, flexibility, and cost, and ABM helped us identify improvement opportunities and measure the realized benefits of performance initiatives.

Earned revenue totaled \$956.5 million for the year ended September 30, 2000, a 5.2 percent increase over fiscal year 1999 earned revenue of \$909.3 million. Our fee collections exceeded \$1.0 billion for the first time ever, and for fiscal year 2001, we expect to generate between \$1.1 and \$1.2 billion in fee revenues. Our plans for fiscal year 2001 are to use these fee revenues to continue our many initiatives for providing greater productivity and improved level of service to our customers. In addition to continuing to upgrade our information technology and fully implementing the provisions of AIPA, our fiscal year 2001 budget request includes quality enhancement activities, such as the independent inventor's program, expanded training for patent and trademark examiners, and a continuation of the prominent quality management program.

Program costs totaled \$911.3 million for the year ended September 30, 2000, a 5.7 percent increase over fiscal year 1999 program costs of \$861.8 million. The higher rate of increase in program costs over earned revenue caused our net income from operations to decrease 4.8 percent from \$47.5 million for fiscal year 1999 to \$45.2 million for fiscal year 2000 (Figure 15).

As a service organization, our production was related directly to the personnel examining patent and trademark applications. Accordingly, personnel services and benefits costs traditionally represent over one-half of total costs. Any change or fluctuation in our staffing patterns directly affects the change in total program costs. Total personnel services and benefits costs increased 11.9 percent over the fiscal year 1999 amount of \$438.1 million, to \$490.1 million for fiscal year 2000. This change drove the 5.7 percent increase in total program cost (Figure 16).

Rent, communications, utilities, contractual services, maintenance, repairs and depreciation costs traditionally

Figure 15. Operating Trends: FY 1997-2000

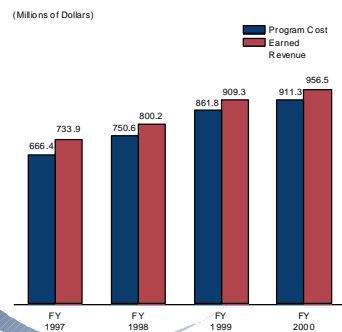
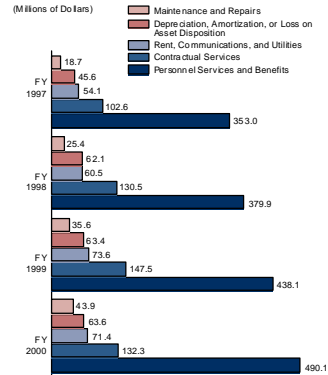


Figure 16. Trends in Major Operating Expenses: FY 1997-2000 (Millions of Dollars)



Rent, communications, utilities, contractual services, maintenance, repairs and depreciation costs traditionally comprise a third of total program costs each year. Maintenance and repair costs increased while contractual services decreased. As systems were implemented, many of our major information technology vendors transitioned from development type activities to maintenance support services.

Earned revenue for our patent business operations

totalled \$817.4 million for fiscal year 2000, a 1.5 percent increase over patent earned revenue of \$805.0 million in fiscal year 1999. Fiscal year 2000 patent maintenance fees accounted for \$267.7 million, or 32.8 percent of total patent fee revenue. Patent

Patent Renewal Rates (percent)	FY2000	FY1999	FY1998	FY1997
First Stage (end of 3rd year after patent is issued)	84.3	83.1	81.8	80.3
Second Stage (end of 7th year after patent is issued)	59.4	57.9	56.6	55.8
Third Stage (end of 11th year after patent is issued)	38.8	37.7	36.1	35.4

maintenance fees have traditionally been the largest category of patent fee income. Therefore, fluctuations in rates of renewal can significantly affect patent revenue. As indicated in this table, patent renewal rates are on the rise, further enhancing the notion that intellectual property protection is a highly coveted commodity in this Information Age. However, there can be no assurance that we will be able to sustain or improve on historic or current renewal rates in future years.

Program cost for our patent business operations totaled \$765.3 million for fiscal year 2000, a 6.2 percent increase over total patents program cost of \$720.8 million in fiscal year 1999. The increase in Patent Office program cost was driven primarily by increases in personnel services and benefits, contractual services, and printing expenses. In fiscal year 2000, personnel services and benefits directly attributable to the patents program area were \$373.9 million, an increase of 11.1 percent over the fiscal year 1999 total of \$336.4 million. This increase was due primarily to a 4.9 percent increase in the general Federal pay schedule and the locality pay schedule. In addition, incentives such as overtime, recruitment bonuses, and special act awards were increased to become more competitive with private sector industries. In fiscal year 2000, outside contractual services relating to the patents program area were \$51.0 million, an increase of 14.1 percent over the fiscal year 1999 total of \$44.7 million. This increase was largely a result of increased use of contracted online services, such as text search software, by patent examiners. In fiscal year 2000, printing expenses relating to the patents program area were \$47.8 million, an increase of 10.9 percent over the fiscal year 1999 total of \$43.1 million. This increase was due to issuing approximately 14 percent more patents in fiscal year 2000 than fiscal year 1999.

Earned revenue for our trademark business operations totaled \$139.1 million for fiscal year 2000, a 33.4 percent increase over trademark fee income of \$104.3 million in fiscal year 1999. In addition to a 27 percent increase in trademark applications during fiscal year 2000, application fee amounts for registration and renewal increased by a third.

Program cost for our trademark business operations totaled \$127.4 million for fiscal year 2000, a 1.3 percent increase over total trademarks program costs of \$125.8 million in fiscal year 1999. In fiscal year 2000, personnel services and benefits directly attributable to the trademarks program area were \$56.0 million, an increase of 16.7 percent over the fiscal year 1999 total of \$48.0 million. As with Patents, this increase was primarily due to the increase in the general Federal pay schedule and locality pay, as well as increased hiring and retention incentives. In fiscal year 2000, contractual services relating to the trademarks program area were \$9.0 million, a decrease of 3.2 percent from the fiscal year 1999 total of \$9.3 million. Also, in fiscal year 2000, automation technology expense supporting the trademarks business line area was \$22.6 million, a decrease of 14.1 percent from the fiscal year 1999 total of \$26.3 million.

Program cost for our intellectual property leadership operations totaled \$18.6 million for fiscal year 2000, a 22.4 percent increase from the fiscal year 1999 total of \$15.2 million. In fiscal year 2000, personnel services and benefits relating to the intellectual property policy program area were \$7.5 million, an increase of 15.4 percent over the fiscal year 1999 total of \$6.5 million.

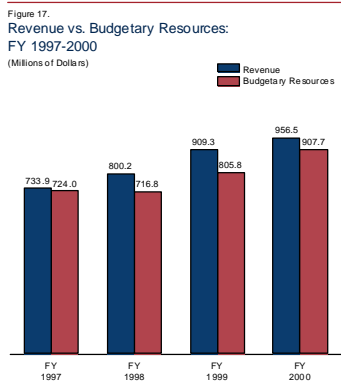
Linking Results of Operations to Budget Execution

Revenue less cost, or net cost, is not the same as budgetary resources less budgetary spending. Timing differences occur when proprietary accounting events and budgetary accounting events are not recognized simultaneously. Therefore, for a “business-like” Federal agency it is important to understand how the Statement of Net Cost and the Statement of Budgetary Resources relate to each other to comprehend true financial position.

Customer orders are a budgetary resource immediately, however they are recorded as revenue over the time period that the work is performed. Approximately \$250.3 million of prior fiscal year fees were earned—recorded as revenue but not a budgetary resource—during fiscal year 2000. Approximately \$299.7 million of new fiscal year 2000 fees were unearned—recorded as a budgetary resource but not revenue—at the end of fiscal year 2000. As pendency grows, the Statement of Budgetary Resources shows a more favorable financial position than the Statement of Net Cost. In this case, the Statement of Net Cost is a better indicator of financial position.

In addition to the timing difference of fee collection and work performance, budgetary resources are reduced but revenue is still recognized when the Congress rescinds or makes unavailable current year fee collections. Ultimately this is the most significant difference between budgetary resources and revenue, resulting in a less

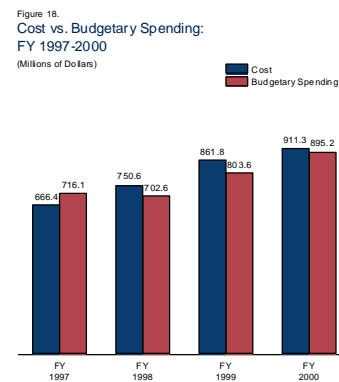
favorable financial position on the Statement of Budgetary Resources than the Statement of Net Cost. In this case, the Statement of Budgetary Resources is a better indicator of financial position (Figure 17).



Budgetary spending occurs, without a corresponding cost, when resources have been obligated or set aside for a particular purpose but goods or services have not been received. The USPTO experienced an increase in these legally binding obligations of \$9.3 million during fiscal year 2000 over the fiscal year 1999 amount as compared to a decrease of \$58.3 million during fiscal year 1999 from the fiscal year 1998 amount. These fluctuations were largely a function of major contract closeouts and new contract awards. When obligations for goods and services that have not been received increase, the Statement of Budgetary Resources shows a less favorable financial position than the Statement of Net Cost. When these obligations decrease, the Statement of Budgetary Resources shows a more favorable financial position. In both cases, the Statement of Budgetary Resources is a better indicator of financial position.

Another difference exists in the accounting for property and equipment. Purchases are recorded as budgetary spending immediately, however, they are recorded as a cost over the period the property and equipment is amortized or depreciated. The USPTO purchased \$59.3 million and \$77.4 million during fiscal year 2000 and 1999, respectively, while \$63.6 million and \$63.4 million of the total asset value on hand as of September 30, 2000 and 1999, respectively, was amortized or depreciated. When amounts purchased exceed amounts amortized or depreciated, the Statement of Budgetary Resources shows a less favorable financial position than the Statement of Net Cost. When amounts purchased are less, the Statement of Budgetary Resources shows a more favorable financial position. In both cases, the Statement of Net Cost is a better indicator of financial position.

There are also situations when a cost has been recorded but budgetary spending has not occurred and these costs are considered unfunded. For example, annual leave is recorded as a cost when it is earned, however, budgetary spending is not recorded until the leave is used. Unfunded liabilities, other than deferred revenue, increased during fiscal year 2000 and 1999 by \$13.5 million and \$3.4 million, respectively. These unfunded liabilities cause the Statement of Budgetary Resources to show a more favorable financial position than the Statement of Net Cost. In this case, the Statement of Net Cost is a better indicator of financial position (Figure 18).



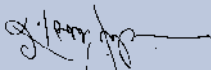
Compliance With Legal and Regulatory Financial Requirements

This section provides information on the USPTO's compliance with the following legislative mandates:

- Federal Managers' Financial Integrity Act
- Inspector General Act Amendments
- Federal Financial Management Improvement Act
- Office of Management and Budget Financial Management Indicators
- Prompt Payment Act
- Civil Monetary Penalty Act
- Debt Collection Act
- Biennial Review of Fees

Federal Managers' Financial Integrity Act

On the basis of USPTO's comprehensive management control program, I am pleased to certify, with reasonable assurance, that USPTO's systems of accounting and internal control are in compliance with the internal control objectives in OMB's Bulletin Number 98-08, as amended. I also believe these same systems of accounting and internal control provide reasonable assurance that the Agency is in compliance with the provisions of the Federal Managers' Financial Integrity Act.



Q. Todd Dickinson
 Under Secretary of Commerce for Intellectual Property and
 Director of the United States Patent and Trademark Office

The Federal Managers' Financial Integrity Act (FMFIA) requires Federal agencies to annually provide a statement of assurance regarding management controls and financial systems.

The USPTO was pleased to assert that its fiscal year 2000 management controls and financial systems, taken as a whole, provided reasonable assurance that the objectives of Sections 2 and 4 of the FMFIA were achieved. These conclusions were based on the review and consideration of a wide variety of evaluations, internal analyses, reconciliations, reports, and other information, including DOC Office of Inspector General audits, and independent public accountant's opinion on our financial statements and reports on internal control and compliance with laws and regulations.

Inspector General Act Amendments

The Inspector General (IG) Act (as amended) requires semiannual reporting on IG audits and related activities as well as agency follow-up. It is required by Section 106 of the IG Act Amendments (P.L. 100-504). The report is required to provide (a) information on the overall progress on audit follow-up and internal management controls; (b) statistics for audit reports with disallowed costs; and (c) statistics on audit report with funds put to better use. The USPTO did not have audit reports with disallowed costs or funds put to better use.

The USPTO's follow-up actions on audit findings and recommendations are essential to improving the effectiveness and efficiency of our programs and operations. For fiscal year 2000, management completed action on one audit report containing two recommendations. In addition, action was taken to close 21 recommendations contained in three audit reports over one year old. These three audit reports still have five recommendations remaining open. Actions are under way to close these five recommendations during fiscal year 2001.

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act (FFMIA) requires Federal agencies to report on agency substantial compliance with Federal financial management system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger. The USPTO complied substantially with the FFMIA for fiscal year 2000.

Financial Management Indicators

The Office of Management and Budget (OMB) prescribes the use of quantitative indicators to monitor improvements in financial management. This table shows the USPTO's performance during fiscal year 2000 against the performance targets established by the OMB.

Financial Performance Measure	Fiscal Year 2000 Target	Fiscal Year 2000 Performance
Percentage of Timely Vendor Payments	95%	99%
Percentage of Payroll by Electronic Transfer	90%	98%
Percentage of Treasury Agency Locations Fully Reconciled	95%	100%
Timely Posting of Interagency Charges	30 days	18 days
Timely Reports to Central Agencies	95%	100%
Average Processing Time for Travel Payments	15 days	9 days
Audit Opinion on Fiscal Year 2000 Financial Statements	Unqualified	Unqualified
Material Weaknesses Reported for Fiscal Year 2000	None	None

Prompt Payment Act

The Prompt Payment Act requires Federal agencies to report on their efforts to make timely payments to vendors, including interest penalties for late payments. In fiscal year 2000, we did not pay interest penalties on 99.3 percent of our 11,271 vendor invoices, representing payments of approximately \$273.3 million. Of the 221 invoices that we did not process timely, we were required to pay interest penalties on 76 invoices, and were not required to pay interest penalties on 145 invoices, where the interest was calculated at less than \$1. We paid only \$7.28 for every million dollars disbursed in fiscal year 2000. Virtually all recurring payments were processed by electronic funds transfer (EFT) in accordance with the EFT provisions of the Debt Collection Improvement Act of 1996.

Civil Monetary Penalty Act

There were no Civil Monetary Penalties assessed by the USPTO during fiscal year 2000.

Civil Monetary Penalty Act

There were no Civil Monetary Penalties assessed by the USPTO during fiscal year 2000.

Debt Collection Act

The Debt Collection Act (Act) prescribes standards for the administrative collection, compromise, suspension, and termination of Federal agency collection actions, and referral to the proper agency for litigation. Although the Act has no material effect on the USPTO since we operate with minimal delinquent debt, we transferred any debt more than 180 days old to Treasury for cross servicing.

Biennial Review of Fees

The Chief Financial Officers Act of 1990 requires a biennial review of agency fees, rents, and other charges imposed for services and things of value it provides to specific beneficiaries as opposed to the American public in general. The objective of the reviews is to identify such activities and to begin charging fees, where permitted by law, and to periodically adjust existing fees to reflect current costs or market value so as to minimize general taxpayer subsidy of specialized services or things of value (such as rights or privileges) provided directly to identifiable non-Federal beneficiaries. The USPTO is a fully fee-funded agency without subsidy of general taxpayer revenue. We use activity-based cost accounting to evaluate the costs of activities and determine if fees are set appropriately. When necessary, fees are adjusted to be consistent with the program and with the legislative requirement to recover the full cost of the goods or services provided to the public.

Limitations

We have prepared our fiscal year 2000 financial statements in accordance with the requirements of the OMB Bulletin Number 97-01, as amended, *Form and Content of Agency Financial Statements*, and supplementary guidance provided by the DOC. OMB Bulletin Number 97-01, as amended, incorporates the concepts and standards contained in the Statements of Federal Financial Accounting Concepts (SFFAC) and the Statements of Federal Financial Accounting Standards (SFFAS) recommended by the Federal Accounting Standards Advisory Board (FASAB) and approved by the Secretary of the Treasury, the Director of the OMB, and the Comptroller General. On October 19, 1999, the American Institute of Certified Public Accountants Council designated the FASAB as the accounting standards-setting body for Federal Government entities. Therefore, the SFFAS constitute generally accepted accounting principles (GAAP) for the Federal Government. These concepts and standards have been set by FASAB to help Federal agencies comply with the requirements of the Chief Financial Officers Act of 1990 as amended by the Government Management and Reform Act of 1994. These two acts demand greater financial accountability from Federal agencies and require the integration of accounting, financial management, and cost accounting systems.

The financial statements that follow have been prepared in conformity with accounting principles generally accepted in the United States. Our financial statements consist of the Balance Sheet, the Statement of Net Cost, the Statement of Changes in Net Position, the Statement of Budgetary Resources, the Statement of Financing, and the Statement of Cash Flows. The following limitations apply to the preparation of the financial statements:

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

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

Management Responsibilities

USPTO management is responsible for the fair presentation of information contained in the principal financial statements, in conformity with accounting principles generally accepted in the United States and the requirements of the OMB Bulletin Number 97-01, as amended, and supplementary guidance provided by the DOC. Management is also responsible for the fair presentation of the USPTO's performance measures in accordance with OMB requirements. The quality of the USPTO's internal control rests with management, as does the responsibility for identifying and complying with pertinent laws and regulations.