

A MESSAGE FROM THE CHIEF FINANCIAL OFFICER —

Bruce A. Lehman, Assistant Secretary of Commerce and Commissioner of Patents and Trademarks, has communicated his desire to create a world class organization where quality is customer satisfaction. Such an organization requires a financial management philosophy that is also centered upon quality and customer satisfaction. To this end, I envision an environment where program and financial managers work together to achieve an optimum balance between efficiency and effectiveness in the delivery of products and services to satisfied customers; where accurate and timely financial information is an integral part of program delivery and decision-making; where financial managers are valued members of the management team; and where the public, members of Congress, and others are confident that assets are safeguarded and used wisely, and where operating results are reported accurately.

Specific accomplishments have been realized as these plans are put into practice. During the reorganization, a Comptroller position was created to provide enhanced leadership in the financial arena. Continuing professional education programs were implemented for accountants and budget analysts. Other financial staff members enrolled in business and automation programs offered through our PTO University.

Progress continues on the automation front towards my goal of an integrated financial management system that provides accurate, timely, and accessible information. Computer assisted design tools are being used to redevelop our revenue accounting and management system. Pilot testing of electronic commerce capabilities and phased implementation of a state-of-the-art procurement system are under way. Other initiatives include the development of an enhanced fee and cost management system, the implementation of a new travel subsystem, and the development of unit cost information for our products and services.

As the Chief Financial Officer of the Patent and Trademark Office, I am committed to strong accountability for sound financial performance. Thus, I am pleased to convey that the Office of the Inspector General of the Department of Commerce has rendered an unqualified opinion on our Financial Statements for fiscal year 1994. These include the Statement of Financial Position which indicates that assets grew by 34 percent to \$337 million dollars while liabilities increased by 16 percent to \$235 million; the Statement of Operations and Changes in Net Position which depicts total revenues of \$544 million for fiscal year 1994 and corresponding expenses of \$485 million; the Statement of Cash Flows which shows the sources and uses of our funds; and the Statement of Budgetary Resources and Actual Expenses which reconciles our actual expenditures to our budgeted resources.



Bradford R. Huther
Associate Commissioner and
Chief Financial Officer

LIMITATIONS

Pursuant to the requirements of the Chief Financial Officer's Act of 1990, the financial statements which follow the financial review have been prepared to report the financial position and results of operations of the Patent and Trademark Office (PTO). The fiscal year 1994 financial statements consist of the Statement of Financial Position; Statement of Operations and Changes in Net Position; Statement of Cash Flows; and the Statement of Budgetary Resources and Actual Expenses. The following limitations apply to the preparation of the fiscal year 1994 financial statements:

While the statements are prepared from the books and records of the entity in accordance with the formats prescribed by the Office of Management and Budget (OMB), the statements vary from 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 they are for a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than contracts can be abrogated by the sovereign entity.

FINANCIAL REVIEW

During the first part of this century, the Patent and Trademark Office (PTO) was virtually self-supporting. As the century progressed, fee receipts, as a percentage of operating costs, declined substantially. By 1982, only 23 percent of total operating costs were offset by fee recoveries. On August 27, 1982, the Patent and Trademark Authorization Act was signed. This act provided for a growing recovery of operating costs from fee income and allowed the PTO to retain the fee income as offsetting collections.

The most recent Congressional act to impact the user fee-funded environment was the Omnibus Budget Reconciliation Act (OBRA) of 1990. Statutory patent fees were increased by 69%. The PTO received only nominal appropriations from general taxpayer revenues in fiscal year 1992. With the start of fiscal year 1993 and as stipulated in the OBRA, funding from such appropriations ceased completely. All operating costs are now funded by the collection of user fees. These collections have risen from \$413 million in 1992 to almost \$544 million in 1994.

This is the third annual financial statement prepared in response to the requirements of the Chief Financial Officer's Act of 1990. These statements have been compiled in accordance with guidance issued by the Office of Management and Budget and the Department of Commerce.

During 1994, the Office of Inspector General (OIG) performed an audit on the Statement of Financial Position for fiscal year 1993 and rendered an unqualified opinion on this statement. In their letter to the Chief Financial Officer, the OIG made recommendations for improving internal controls and promoting operating efficiencies. Actions have been initiated by the PTO to implement these recommendations.

TRENDS IN INCOME AND EXPENSES

User fees are the source of all revenues earned by the Patent and Trademark Office (PTO). Customers pay fees in advance of the products and services to be received. A broad spectrum of products and services are provided and sold to the general public, and individual fees are assessed accordingly. Fee collections have continued to climb as the demand for PTO products and services has increased. This has caused the PTO to have unusually large year end balances in our Fund Balance with Treasury; Net Position; and Excess of Revenues and Financing Sources Over Total Expenses. These balances are attributable to several factors.

Incoming workloads (or orders for products and services) have exceeded planned levels. In fiscal year 1994, new patent applications (utility, plant, reissue and design applications) were planned at 193,500. The actual number of new applications received in 1994 was 201,554, which was four percent higher than projected. A similar situation exists in the trademark area where new applications exceeded plan by 7,376 or 5 percent in fiscal year 1994.

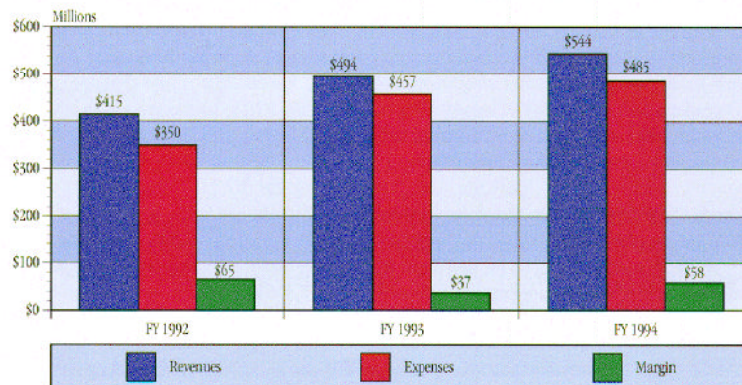
The PTO also collects fees for the maintenance of issued patents over the 17 year life of the patent. Maintenance fees are collected in three stages. Maintenance fees were planned based upon an anticipated renewal rate of 75 percent at the first stage (at the end of the third year after a patent is issued); 50 percent at the second stage (at the end of the seventh year after a patent is issued); and 25 percent at the third stage (at the end of the eleventh year after a patent is issued). In fiscal year 1994, the PTO was just beginning to receive the full effects of the third stage renewal. Actual renewal rates were higher than planned: for the first stage, 76 percent versus 75 percent; for the second stage, 54 percent versus 50 percent; and for the third stage, 34 percent versus 25 percent. The PTO will continue to refine its estimates, but the decision to renew a patent or not is entirely up to the patent owner and is thus not under the control of the PTO.

The net result of higher than planned incoming workloads and payment of patent maintenance fees resulted in fee collections in excess of plan. These amounts totaled \$28.2 million in fiscal year 1994. The good news, of course, is that our business is booming. The reality of the situation is that the PTO is often unable to immediately respond to increased business, as our still largely manual processes rely upon trained and experienced patent examiners and trademark attorneys, the majority of whom are hired as recent college and university graduates. Thus, from one year to the next, advanced fee payments may be carried over to the next year while the PTO expands its operational capacity to address growing inventories of unexamined patent and trademark applications.

Also included in the year end balances are fees that have been collected but are not available for the PTO's use. The Omnibus Budget Reconciliation Act of 1990, as amended in 1993, imposed a surcharge upon specific patent fees. These surcharges, to be collected by the PTO and deposited to the Treasury, are subject to appropriations by the Congress. In fiscal year 1994, the PTO deposited \$103.0 million in surcharge fees. The Congress appropriated \$88.329 million. The difference, \$14.671 million, was not made available to the agency.

The fiscal year 1995 budget request was similarly reduced by the Congress. In addition to withholding \$24.7 million from deposits of surcharge fees, the Congress also earmarked funds for specific projects and enacted reductions for administrative and other savings. The total changes to the PTO budget request for fiscal year 1995 total \$36.2 million. To address these changes, the PTO will apply balances from fiscal year 1994. In addition, the PTO is planning to implement an agreement signed by the Secretary of Commerce with the Government of Japan in which, in return for concessions to US inventors filing patent applications in Japan, the PTO has agreed to the publication of patent applications within 18 months of the earliest filing date. Development of this pre-grant publication system is estimated to cost \$8.0-\$10.0 million in fiscal year 1995. Finally, remaining balances could be used in fiscal year 1995 for automation infrastructure improvements and for the acquisition of business reengineering support required for the streamlining of PTO operations.

Trends in Income & Expenses



Revenue includes restricted Surcharge Fees
 Net Margin includes restricted Equity

PTO is a provider of services, and, as such, personnel costs represent the single greatest expense. In fiscal year 1994, salaries and benefits accounted for 62 percent of operating expenses. Investments in new automation technology are also continuing to increase as some processes are transformed from paper-based to electronic systems. One of PTO's largest automation efforts is the deployment of the Automated Patent System (APS). A portion of the costs associated with deploying the APS are capitalized and will be depreciated over the useful life of the system. As a result, the Statement of Operations includes all APS costs expensed in fiscal year 1994 and the annual depreciation recognized on the capitalized assets.

CHANGES IN PRINCIPAL ACCOUNTS

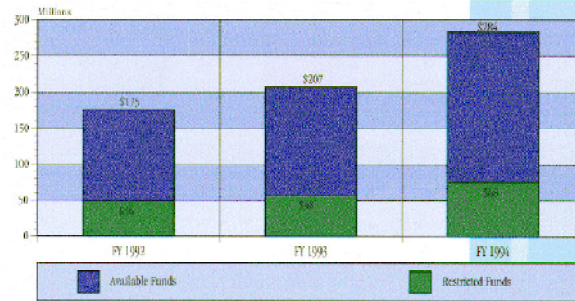
The bulk of the assets managed by the PTO are comprised of cash and capital equipment. This equipment includes hardware, software, and assets under capital lease. To expedite the collection and deposit of cash assets, various mechanisms are used which provide customers with several options for remitting fees. These include payment by mail, payments by electronic transfer, and payments to cashiers located in the PTO office complex.

Customers may also establish deposit accounts with the PTO. These monies are paid to the PTO in anticipation of a future demand for services. When a service request is received from a customer maintaining a deposit account, the appropriate fee is deducted from the pertinent account. Monthly statements are provided to deposit account customers.

A comparison of selected ending balances for fiscal years 1992 through 1994, as reflected in the Statement of Financial Position, is displayed in the following charts. The graphs presented do not display ending balances by line item. Also, it is important to note that the restricted fund balances and equity segments associated with patent surcharge fees are not available for use without additional appropriations by the Congress.

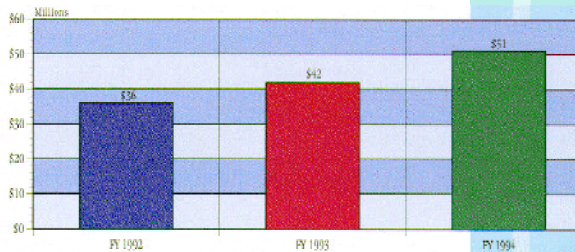
FUNDBALANCES WITH TREASURY

include available and restricted amounts. Funds which are restricted include advance payments by customers and surcharge fees which were collected but not appropriated for use. At the end of fiscal year 1994, available fund balances were \$217 million, an increase of about 36 percent above 1993. For the same period, funds which were restricted increased by 41 percent to a total of \$68 million. Approximately \$102 million of the available balances are earmarked for the payment of outstanding obligations.



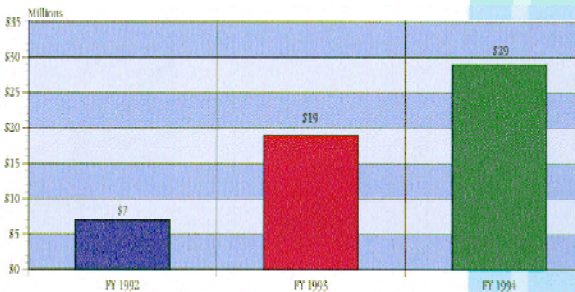
PROPERTY AND EQUIPMENT (NET)

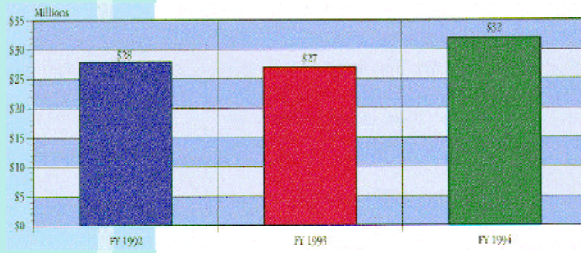
increased to a balance of \$51 million on September 30, 1994. This balance is stated at net book value, which is the original acquisition cost of \$108 million less the total accumulated depreciation of \$57 million. The change resulted from the continuing implementation of automation plans.



ACCOUNTS PAYABLE

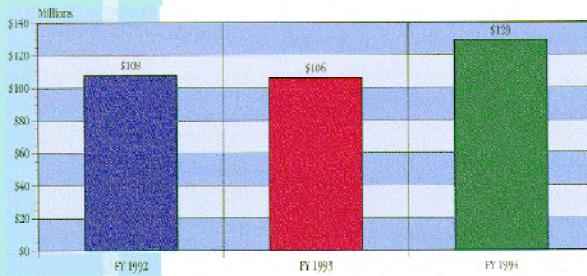
balances shown include Federal and non-Federal accounts payable. These are monies owed for goods and services that have been received but for which payment has not yet been made. At the end of the 1994 fiscal year, payments due to other Federal agencies were \$4 million and \$25 million was owed to non-Federal entities.





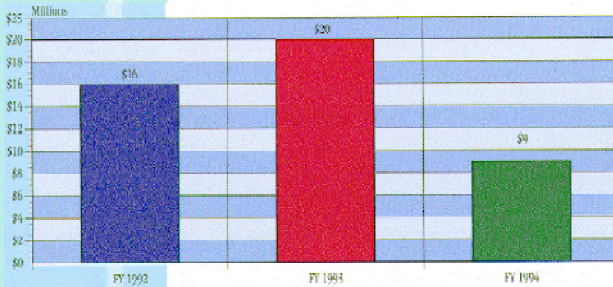
DEPOSIT ACCOUNTS

are maintained by the PTO as a service to our customers. The associated liability results from advance payments made by customers in anticipation of a future demand for services. At the end of fiscal year 1994, the total liability was \$32 million. There was a slight increase in the balance as the result of a net increase in the number of accounts as well as the amount of funds deposited by customers.



DEFERRED REVENUE

results from advance payments which are made by customers and are recorded as a liability until a particular service is rendered. Fees which are remitted with initial applications are recorded as deferred revenue until the processing of the application actually begins. An increase in applications received as well as a processing backlog resulted in an increase in the deferred revenue as of September 30, 1994.



CAPITAL LEASE LIABILITIES

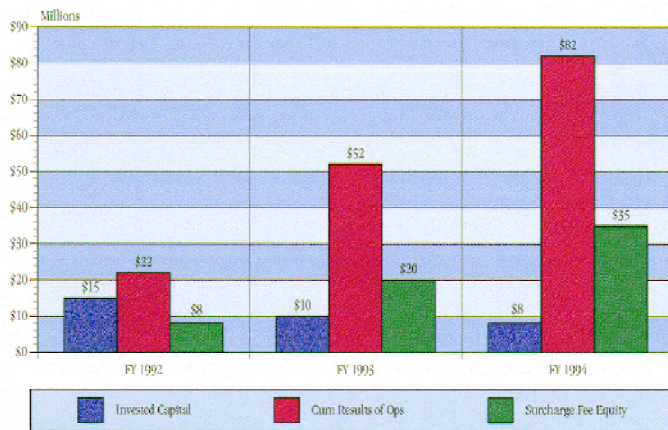
represent future payments owed for capital lease transactions. The lease total for future payments decreased by 54 percent due to the purchase of previously leased hardware used in connection with the Automated Patent System (APS). Most of the APS leases have a duration of three to five years. Also included in this account balance are leases for reproduction equipment, which usually span a period of three to four years. With the exception of reproduction equipment, the current policy of the PTO is to purchase rather than lease capital assets.



INVESTED CAPITAL is the book value of capitalized fixed assets which were purchased with appropriations from general taxpayer revenue. Since the PTO is no longer funded from taxpayer revenues, this account balance will decrease each year as depreciation expense is realized. The balance in this account was \$8 million on September 30, 1994, a decrease of 20 percent from the balance of \$10 million on September 30, 1993.

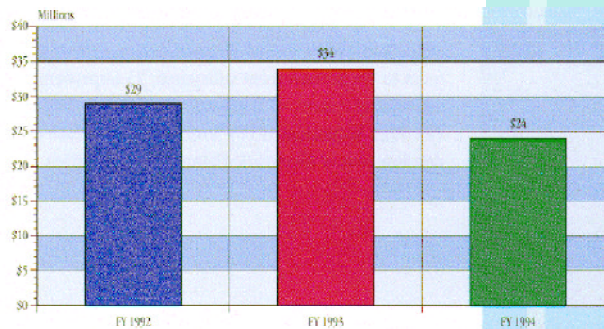
CUMULATIVE RESULTS OF OPERATIONS represent the total unrestricted net operating gain which has been realized over the years. The balance in this account does not include surcharge fees which have been earned but not appropriated for use. The equity position associated with the surcharge fees is shown separately. This account does not reflect charges for future funding requirements of approximately \$24 million and outstanding purchase orders valued at \$102 million.

SURCHARGE FEE EQUITY is a segment of net position. This portion of the equity position is segregated due to restrictions associated with the availability of the surcharge fees. Although these fees were earned, additional action by Congress is required to make these balances available for use by the PTO. Total surcharge fee equity reached \$35 million at the end of FY 1994.



The above chart does not reflect future funding requirements which decrease equity

FUTURE FUNDING REQUIREMENTS include annual leave accrued but not used as well as future lease payments. The decrease of \$10 million, or 30 percent, was mainly due to lease buyouts, and reduction in the number of new capital lease arrangements in FY 1994, and reductions in the outstanding balance of future payments for existing capital leases.



SIGNIFICANT ACTIONS, ACCOMPLISHMENTS AND RESULTS

FINANCIAL MANAGEMENT

In June 1993, the Office of Management and Budget (OMB) recommended quantitative indicators to monitor progress toward improved financial management. The following chart depicts the goals or target performance established by OMB for FY 1994 and the performance of the PTO during that period.

<i>MEASURE</i>	<i>TARGET PERFORMANCE</i>	<i>PTO PERFORMANCE</i>
Percent of Timely Vendor Payments	95%	99%
Percent of Payroll by Electronic Transfer	90%	95%
Percent of Agency Locations Fully Reconciled	95%	100%
Timely Posting of Inter-agency Charges	30 days	20 days
Timely Reports to Central Agencies	95%	100%
Timely Travel Payments Avg. Processing Time	15 days	4 days
Audit Opinion on FY 94 Financial Statement	Unqualified	Unqualified
Material Weaknesses Reported by Auditor	None	None

FINANCIAL SYSTEMS: Prior to October 1, 1991, the majority of the accounting activities were performed by an administrative center within the National Oceanographic and Atmospheric Administration (NOAA). At the beginning of FY 1992, the PTO implemented the Federal Financial System (FFS) and assumed responsibility for all accounting records. Software and hardware support for the core system are supplied via a cross-servicing arrangement with the U. S. Geological Survey of the Department of the Interior.

Other improvements and planned enhancements to PTO's financial management system include: 1) a major enhancement to the procurement subsystem; 2) improvements to the travel subsystem; 3) the redevelopment of the revenue accounting system; 4) a re-engineering of the budget process; 5) the development of a system to monitor Position and Full Time Equivalent (FTE) levels; 6) an interface of the property subsystem to the core financial system; and 7) the development of Electronic Commerce capabilities.

MANAGEMENT CONTROLS: For fiscal year 1994, the PTO provided reasonable assurance of compliance with the provisions of the Federal Managers Financial Integrity Act. As required by OMB circular A-130, weaknesses in existing subsystems were identified in prior years and reported to the Department of Commerce. The implementation of compensating management controls allowed the PTO to provide the assurance referenced above. No additional material deficiencies were identified or reported in FY 1994, and progress continues to correct weaknesses identified in earlier years. Reported weaknesses and anticipated dates for full correction follow.

SECTION 2 MATERIAL WEAKNESSES	CORRECTION DATE
System Security Weaknesses in the Cash Receipts/Deposit Accounts System (A Privacy Act Records System)	1995
SECTION 4 MATERIAL NON CONFORMANCE	
Violation of Financial Information Standards in Cash Receipts/Deposit Accounts System	1995

*DEPARTMENT OF COMMERCE
PATENT AND TRADEMARK OFFICE
STATEMENT OF FINANCIAL POSITION
As of September 30, 1994 and 1993*

ASSETS	1994	1993
Entity Assets:		
Intragovernmental Assets:		
Fund Balance With Treasury (note 2)	\$284,206,145	\$207,484,842
Advances and Prepayments	937,610	936,230
Governmental Assets:		
Accounts Receivable, Net	499,227	76,246
Property and Equipment, Net (note 3)	51,436,575	42,195,340
Total Entity Assets	\$337,079,557	\$250,692,658
LIABILITIES		
Liabilities Covered by Budgetary Resources:		
Intragovernmental Liabilities:		
Accounts Payable	\$ 3,993,132	\$ 1,895,044
Governmental Liabilities:		
Accounts Payable	24,991,865	17,362,219
Accrued Payroll & Benefits	18,398,354	15,213,719
Actuarial Liability (note 4)	2,356,889	0
Customer Deposit Accounts	32,421,236	27,400,204
Deferred Revenue (note 5)	129,095,599	106,315,092
Total Liabilities Covered by Budgetary Resources:	211,257,075	168,186,278
Liabilities not covered by Budgetary Resources:		
Governmental Liabilities:		
Capital Leases (note 6)	9,435,323	20,410,156
Accrued Annual Leave	14,205,493	13,125,630
Total Liabilities not Covered by Budgetary Resources	23,640,816	33,535,786
Total Liabilities	\$234,897,891	\$201,722,064
NET POSITION		
Balances:		
Invested Capital	\$ 8,327,877	\$ 10,444,239
Cumulative Results of Operations	82,389,606	51,628,142
Surcharge	35,104,999	20,433,999
Future Funding Requirements	(23,640,816)	(33,535,786)
Total Net Position	102,181,666	48,970,594
Total Liabilities and Net Position	\$337,079,557	\$250,692,658

The accompanying notes are an integral part of these statements.

*DEPARTMENT OF COMMERCE
PATENT AND TRADEMARK OFFICE
STATEMENT OF OPERATIONS AND CHANGES IN NET POSITION
For the years ended September 30, 1994 and 1993*

	1994	1993 (unaudited)
REVENUES AND FINANCING SOURCES		
Revenues from Sales of Goods and Services		
To the Public	\$541,593,879	\$488,417,591
Intragovernmental	11,338	185,937
Appropriated Capital Used (note 1)	2,116,362	4,920,078
Total Revenues and Financing Sources	543,721,579	493,523,606
EXPENSES		
Program or Operating Expenses (note 7)	469,147,924	444,616,546
Depreciation and Amortization	16,889,332	12,249,743
Change in Actuarial Liability (note 4)	(604,882)	0
Total Expenses	485,432,374	456,866,289
Excess of Revenues and Financing Sources Over Total Expenses	\$ 58,289,205	\$ 36,657,317
Net Position, Beginning Balance, as Previously Stated	\$ 48,970,594	\$ 17,233,355
Cumulative Effect of a Change in Accounting Principle (note 4)	(2,961,771)	0
Net Position, Beginning Balance, as Restated	46,008,823	17,233,355
Excess of Revenues and Financing Sources Over Total Expenses	58,289,205	36,657,317
Decrease in Invested Capital	(2,116,362)	(4,920,078)
Net Position, Ending Balance	\$102,181,666	\$ 48,970,594

The accompanying notes are an integral part of these statements.

*DEPARTMENT OF COMMERCE
 PATENT AND TRADEMARK OFFICE
 STATEMENT OF CASH FLOWS (INDIRECT)
 For the years ended September 30, 1994 and 1993*

	1994	1993 (unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess of Revenues and Financing Sources over Total Expenses	\$ 58,289,205	\$ 36,657,317
Adjustments Affecting Cash Flow:		
Appropriated Capital Used	(2,116,362)	(4,920,078)
(Increase) Decrease in Accounts Receivable	(422,981)	731,813
Increase in Other Assets	(1,380)	(513,782)
Increase in Accounts Payable	9,727,734	12,665,908
Increase (Decrease) in Other Liabilities	33,343,063	(10,578,574)
(Decrease) Increase in Capital Lease Liability	(10,974,833)	4,557,939
Depreciation and Amortization	16,889,332	12,249,743
Other Unfunded Expenses	1,079,863	311,506
Cumulative Effect of Change in Accounting Principle (note 4)	(2,961,771)	0
Total Adjustments	44,562,665	14,504,475
Net Cash Provided by Operating Activities	102,851,870	51,161,792
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of Property and Equipment	(26,130,567)	(18,265,033)
Net Cash Used in Investing Activities	(26,130,567)	(18,265,033)
Net Cash Provided by Operating and Investing Activities	76,721,303	32,896,759
Fund Balances with Treasury and Cash, Beginning	207,484,842	174,588,083
Fund Balances with Treasury and Cash, Ending	\$284,206,145	\$207,484,842

The accompanying notes are an integral part of these statements.

DEPARTMENT OF COMMERCE
 PATENT AND TRADEMARK OFFICE
 STATEMENT OF BUDGETARY RESOURCES AND ACTUAL EXPENSES
 For the year ended September 30, 1994

	BUDGET			ACTUAL
	OBLIGATIONS			
	Resources	Direct	Reimbursed	Expenses
Salaries & Expense/Surcharge	\$569,159,702	\$88,329,000	\$442,556,936	\$485,432,374
Budget Reconciliation:				
Total Expenses		\$485,432,374		
Add:				
Capital Acquisitions		26,130,567		
Capital Lease Payments		11,468,295		
Change in Actuarial Liability		604,882		
Less:				
Fiscal Year 1994 Capital Lease Acquisitions		505,778		
Depreciation and Amortization		16,889,332		
Annual Leave Expense		1,079,863		
Other		29,805		
Accrued Expenditures		505,131,340		
Less: Reimbursements		(443,964,722)		
Accrued Expenditures, Direct		\$61,166,618		

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements

NOTE 1. Summary of Significant Accounting Policies

Basis of Presentation

As required by the Chief Financial Officers Act of 1990, these financial statements have been prepared to report the financial position and results of operations of the Patent and Trademark Office (PTO) of the United States. The books and records of the PTO have served as the source of the information contained herein. The Financial Statements have been prepared in accordance with the guidance specified by the Office of Management and Budget (OMB) in Bulletin 94-01, as well as the accounting policies of the PTO; therefore, they may differ from other financial reports submitted pursuant to OMB directives for the purpose of monitoring and controlling the use of PTO's budgetary resources.

Reporting Entity

The Patent and Trademark Office is a program of the U.S. Department of Commerce (DOC) which administers the Nation's patent and trademark laws. Since the passage of the Omnibus Budget Reconciliation Act of 1990 (OBRA), the program has been funded almost entirely by user fees. Prior to fiscal year 1993, the appropriated funds from general taxpayer revenue gradually decreased until PTO became fully fee funded in fiscal year 1993. In fiscal years 1993 and 1994, all revenues were derived from the payment of user fees which are appropriated by Congress for use by the PTO. The bulk of the fees collected are offsetting collections which are retained by the PTO until expended; however, the surcharge imposed on statutory patent fees with the enactment of the OBRA constitute offsetting receipts. These offsetting receipts are deposited into a restricted account at the U.S. Treasury. The PTO is only authorized to use monies from this account to the extent appropriated by Congress. Thus, the U.S. Treasury makes these funds available to the PTO by the issuance of a warrant each month to the extent such funds were authorized for use. The excess monies are not available to the PTO and are retained in a restricted receipt account by the U.S. Treasury. Any authorized funding which is not expended during a given fiscal year is carried forward for use in the following fiscal year.

The accompanying financial statements include the accounts for salaries and expense (13X1006), surcharge (13X5127), and customer deposits (13X6542) appropriations, which are under the control of the PTO. The PTO has no lending or borrowing authority.

Budgets and Budgetary Accounting

In fiscal years 1993 and 1994, all funding was received through the collection of user fees. User fee rates are established by rule and law.

Surcharges on patent statutory fees were established by the OBRA. Subsequent pieces of legislation removed the reference to a specific surcharge of 69%, required the PTO to deposit exact amounts of surcharges, and extended the surcharge through the end of fiscal year 1998. These represent offsetting receipts and are available to the entity only to the extent appropriated by Congress. All surcharge fees collected are recorded as revenue. However, any surcharge fees collected by PTO, but not appropriated by Congress for use, are maintained by the U.S. Treasury as restricted funds.

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

Basis of Accounting

Transactions are recorded on the accrual basis of accounting as well as on a budgetary basis. Under the accrual method, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to the receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. The accompanying financial statements are presented on the accrual basis of accounting.

Revenues and Other Financing Sources

In fiscal years 1993 and 1994, the majority of revenues were derived from the collection of user fees. Appropriations expended in prior years for the purchase of property and equipment are recognized as revenues as the assets are consumed in operations.

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

Advance payments which are made by customers are recorded as a liability until a particular service is rendered. Fees which are remitted with initial applications are recorded as deferred revenue until the processing of the application actually begins.

Funds with the U.S. Treasury and Cash

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

the U.S. Treasury Department. With the exception of those which are restricted, funds with the U.S. Treasury and cash are available to pay current liabilities and to finance duly authorized purchases. All disbursements are processed by the Philadelphia Regional Finance Center of the U.S. Treasury Department. Finally, cash balances held outside the U.S. Treasury Department are not material and are used as imprest funds to facilitate small purchases, local travel, and emergency salary advances.

Property and Equipment

The buildings in which the PTO operates are leased from private concerns by the General Services Administration (GSA). Long-term leases are negotiated by GSA and appropriate rent charges are levied. The rental rates assessed by GSA and paid by the PTO approximate the market rates for similar commercial properties.

Automated data processing software purchased "off the shelf" with an estimated service life of two years or greater is capitalized when the cost exceeds \$25,000.

The costs for developing APS software are capitalized when incurred for creating the detailed design, coding, and final testing of the software. Software costs are divided into two major categories: Text Search and Classified Search and Image Retrieval (CSIR).

Bulk purchase costs of furniture, with an estimated service life of two years or greater are capitalized when the total monetary value of the purchase order/delivery order equals or exceeds \$50,000 (including shipping and installation).

APS Hardware, equipment and other assets with an individual unit cost of \$5,000 or greater (including shipping and installation) and an estimated service life of two years or greater is capitalized. In instances other than those listed above, the entire cost is recorded as an expense upon receipt of the equipment or other asset, with the following exceptions:

- (1) The total amount of the order, including shipping and installation, is capitalized if the equipment procured is made via a major contract.
- (2) The total amount of the order, including shipping and installation, is capitalized if the procurement represents the initial purchase of equipment in connection with the installation of a major system.
- (3) If the procurement represents the purchase of additional items for an existing major system, only those items with an individual unit cost of \$5,000 or greater will be capitalized.

Depreciation is calculated using the straight line method over the following service lives: APS equipment 3-10 years, APS software 3-11 years, Furniture 5 years, ADP equipment 3 years, ADP software 3 years, Equipment 3 years and Assets under Capital Lease 3-7 years.

Advances and Prepayments

Payments made in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and recognized as expenses when the related goods and services are received. PTO rendered prepayments to the U.S. Geological Survey for approximately \$470,000 and \$936,000 in fiscal years 1994 and 1993, respectively. These prepayments were made in anticipation of services to be provided under a cross-service agreement relating to the Federal Financial System.

Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by the PTO as the direct result of an event that has already occurred. All such liabilities recognized in fiscal years 1994 and 1993 have been fully funded except for the accrual for annual leave and the commitments under capital leases. However, no liability can be paid by the PTO unless appropriate funding is available. Also, liabilities of the PTO arising from other than contracts can be abrogated by the government acting in its sovereign capacity.

Annual, Sick, and Other Leave

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. An appropriate adjustment is made at the end of each fiscal year to ensure that the balance in the accrued annual leave account reflects current pay rates. To the extent current or prior year funding is not available to cover annual leave earned but not taken, funding will be obtained from future financing sources.

Sick leave and other types of non-vested leave are expensed as taken. Any liability for sick leave that is accrued by an individual but not taken is transferred to the Office of Personnel Management upon the retirement of that individual.

Retirement Plan

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

For those employees covered by the CSRS, the PTO makes contributions equivalent to 7 percent of the employee's pay. For those covered by the FERS, the PTO makes contributions equal to approximately 13 percent. All employees are eligible to contribute to a thrift savings plan. For those employees participating in the FERS, a thrift savings plan is

automatically established, and the PTO makes a mandatory one percent contribution to this plan. In addition, PTO makes matching contributions, ranging from 1 percent to four percent, for FERS eligible employees who contribute to their thrift savings plans. No matching contributions are made to the thrift savings plans established by CSRS employees.

FERS employees and certain CSRS reinstatement employees are eligible to participate in the Social Security Program after retirement. In these instances, the PTO remits the employer's share of the required contribution.

The financial statements of the PTO do not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, which may be applicable to its employees. Such reporting is the responsibility of the Office of Personnel Management.

Comparative Data

1993 Financial Statements were reclassified and restated to conform with the 1994 presentation.

NOTE 2. Fund Balance with Treasury and Cash

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

	<i>Available</i>	<i>Restricted</i>	<i>1994</i>	<i>1993</i>
Appropriated Funds	\$216,664,910	\$ 0	\$216,664,910	\$159,635,639
Deposit Accounts	0	32,421,236	32,421,236	27,400,204
Surcharge	0	35,104,999	35,104,999	20,433,999
Cash	15,000	0	15,000	15,000
Total Fund Balances and Cash	\$216,679,910	\$ 67,526,235	\$284,206,145	\$207,484,842

Deposit Account balances represent advance payments by customers for future services.

Surcharge represents fees earned but not available for use.

NOTE 3. Property and Equipment

Property and Equipment consisted of the following as of September 30, 1994:

	<i>Service Life (Years)</i>	<i>Acquisition Value</i>	<i>Accumulated Depreciation</i>	<i>Net Book Value</i>
Classes of Fixed Assets				
APS Equipment	3-10	\$ 39,795,517	\$26,967,133	\$12,828,384
APS Software	3-11	19,471,225	10,018,233	9,452,992
ADP Equipment	3	19,386,929	7,449,855	11,937,074
ADP Software	3	1,558,658	850,975	707,683
Equipment	3	3,390,787	759,600	2,631,187
Assets Under Capital Lease	3-7	18,502,153	9,447,666	9,054,487
Furniture	5	3,851,148	1,244,505	2,606,643
APSSoftware in Progress		2,218,125	0	2,218,125
Total		\$108,174,542	\$56,737,967	\$51,436,575

NOTE 3. Property and Equipment - continued

Property and Equipment consisted of the following as of September 30, 1993:

	<i>Service Life (Years)</i>	<i>Acquisition Value</i>	<i>Accumulated Depreciation</i>	<i>Net Book Value</i>
Classes of Fixed Assets				
APS Equipment	3-10	\$20,886,962	\$14,833,891	\$ 6,053,071
APS Software	3-11	17,833,812	7,974,355	9,859,457
ADP Equipment	3	8,857,467	3,289,388	5,568,079
ADP Software	3	1,341,742	409,608	932,134
Equipment	3	299,885	192,284	107,601
Assets Under Capital Lease	3-7	30,722,883	12,491,546	18,231,337
Furniture	5	2,101,224	657,563	1,443,661
Total		\$82,043,975	\$39,848,635	\$42,195,340

NOTE 4. Actuarial Liabilities

The Federal Employees Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for PTO employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by the PTO. These future workers' compensation estimates were generated from an application of actuarial procedures developed to estimate the liability for FECA benefits. The actuarial liability estimates for FECA benefits include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability was determined using the paid losses extrapolation method calculated over the next 23-year period. This method utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. These annual benefit payments have been discounted to present value using the discount rate of 7% in year one and thereafter. Based on information provided by the Department of Labor, the Department determined that the estimated liability of the PTO as of September 30, 1994 and 1993 was \$2,356,889 and \$2,961,771, respectively. In prior fiscal years, the PTO recorded these compensation benefits on a cash basis. The PTO has recorded the estimated liability for claims incurred as of September 30, 1994, as the effect of a change in accounting principle. The effect of the decrease in the estimated liability of \$604,882 is reflected as a change in actuarial liability on the Statement of Operations and Changes in Net Position. These amounts are expected to be paid in future periods.

NOTE 5. Deferred Revenue

Deferred revenues represent fees received but not yet earned until the related service is provided. Two types of deferred revenues are recorded. The first type results from checks received but not yet deposited. Unearned fees amounted to \$40,499,742 and \$23,097,015 as of September 30, 1994 and 1993, respectively.

The second type of deferred revenues relate to fees received on applications which underwent the initial processing phase but were not reviewed by a patent examiner or a trademark attorney. Revenues are recognized to the extent of costs incurred in the initial processing phase. The balance of the fees received is considered unearned and amount to \$88,595,857 and \$83,218,077 as of September 30, 1994 and 1993, respectively.

NOTE 6. Leases

Capital Leases

PTO has commitments under leases for reproduction, Automated Patent System (APS) and PTONET equipment. APS and PTONET leases are 60 months in duration and reproduction equipment leases are 36-48 months. The future payments due as of September 30 are as follows:

<i>Fiscal Year</i>	<i>1994</i>	<i>1993</i>
1994	\$ 0	\$ 8,272,396
1995	4,652,986	7,045,013
1996	3,476,712	3,934,116
1997	2,617,115	2,713,975
1998	555,291	497,812
1999	8,400	0
Total Future Lease Payments	11,310,504	22,463,312
Imputed Interest	1,875,181	2,053,156
Total Capital Lease Liability	\$ 9,435,323	\$ 20,410,156
Funded	\$ 0	\$ 0
Unfunded	\$ 9,435,323	\$ 20,410,156

Operating Leases

The buildings in which PTO operates are leased by the General Services Administration (GSA), and PTO is charged rent intended to approximate commercial rental rates. The majority of PTO's lease agreements will expire in early fiscal year 1997. The amounts shown below for fiscal years 1997 through 1999 are estimates due to ongoing rent negotiations with GSA.

<i>Fiscal Year</i>	<i>1994</i>	<i>1993</i> <i>(unaudited)</i>
1994	\$ 0	\$ 43,326,000
1995	42,340,000	45,035,000
1996	46,600,000	48,349,379
1997 (estimate)	48,900,000	0
1998 (estimate)	50,700,000	0
1999 (estimate)	52,500,000	0
Total Future Lease Payments	\$241,040,000	\$136,710,379

Rent expense was \$39,018,347 and \$38,057,853 in fiscal years 1994 and 1993, respectively.

NOTE 7. Program/Operating Expenses

For the Years Ended September 30

	1994	1993 (unaudited)
Operating Expenses by Object Classification		
Personal Services and Benefits	\$291,386,886	\$266,850,328
Travel and Transportation	830,595	648,496
Rental, Communication and Utilities	46,070,894	45,589,600
Printing and Reproduction	30,326,630	30,233,911
Contractual Services	71,382,620	57,541,316
Supplies and Materials	7,464,602	6,609,359
Equipment not Capitalized	5,931,758	7,783,730
Insurance Claims and Indemnities	13,785	12,000
Other:		
(a) Other services	6,356,131	19,207,716
(b) Training	3,811,531	2,912,801
(c) Maintenance and Repair	5,572,492	7,227,289
Total Expenses by Object Class	\$469,147,924	\$444,616,546

NOTE 8. Commitments and Contingencies**A. Commitments**

In addition to future lease commitments discussed in Note 6, PTO is committed under obligations for goods and services which have been ordered but not yet received (undelivered orders) at fiscal year end. Total undelivered orders for all PTO activities amounted to \$102,380,157 and \$82,109,985 as of September 30, 1994 and 1993, respectively.

B. Contingencies

In 1991, a contractor asserted a claim for \$1.9 million on behalf of two of its equipment subcontractors. The basis of the claim is that PTO's failure to exercise contract options to purchase certain equipment constituted a breach of contract or an improper termination for convenience. The contractor contends that the equipment leased was unique to the PTO procurement, and they have been unable to re-lease it. PTO will vigorously defend the case. A hearing was held in July 1994 before the General Services Board of Contract Appeals. The outcome of this litigation is not known at this time.

PTO is a party in various administrative proceedings, legal actions, and claims brought by or against it, which may ultimately result in settlements or decisions adverse to the federal government. Although the ultimate disposition of these proceedings is not presently determinable, management does not expect that any liability that might ensue would be material to PTO's financial statements.

