UNITED STATES DEPARTMENT OF COMMERCE
Office of Inspector General
Washington, D.C. 20230

September 4, 2015

MEMORANDUM FOR: Michelle K. Lee
Under Secretary of Commerce for Intellectual Property and Director of the United States Patent and Trademark Office

FROM: Andrew Katsaros
Principal Assistant Inspector General for Audit and Evaluation

SUBJECT: *Audit of USPTO's Management of Unliquidated Obligation Balances*
Final Memorandum No. OIG-15-041-A

This memorandum reports the results of our audit of the effectiveness of USPTO's unliquidated obligation (ULO) review policies and procedures developed in response to an OIG audit report issued in June 2013 (OIG-13-026-A). In that report, we concluded that Department-wide controls over the management of unliquidated obligations needed strengthening.[1] Further, effective management of outstanding obligation balances allows agencies to review and deobligate unneeded funds, promoting a better use of federal resources.

In this follow-up audit, we found that overall controls and procedures USPTO implemented in response to the report were effective in reducing and managing unliquidated obligation balances and USPTO had achieved the intent of our recommendations. As a result of implementation of these procedures and management's focus on the management of obligation balances, USPTO was able to reduce excess unliquidated balances by more than 90 percent since our last review.[2]

Although it did not impact our overall conclusion, we did note approximately $1.7 million in unliquidated balances for obligations that we recommend reviewing for potential deobligation. We also recommend implementing quarterly, rather than semiannual, reviews of outstanding obligations. We believe this would further enhance USPTO's management of unliquidated obligations.

Objective

Our objective was to evaluate the effectiveness of USPTO's obligation and deobligation review policies and procedures implemented in response to our June 2013 audit report, which

[1] U.S. Department of Commerce Office of Inspector General, June 18, 2013. *Monitoring of Obligation Balances Needs Strengthening*, OIG-13-026-A. Washington, DC: DOC OIG.

[2] USPTO reduced its unliquidated obligation balances from approximately $255 million to approximately $22 million. See OIG-13-026-A, Table 1, and *PTO Open Obligation Report as of January 31, 2015*.

reviewed the Department's unliquidated obligation balances as of December 31, 2011. In that report, we recommended that the bureaus develop initiatives for timely deobligation of unneeded balances, as well as issue guidance to promote more effective obligation management.

To accomplish our audit, we first obtained an understanding of USPTO's ULO oversight process by reviewing the policies and procedures that were implemented in response to our prior report. We then tested the effectiveness by reviewing the implementation of these controls for both FYs 2013 and 2014 (the period after the issuance of our 2013 report), as well as analyzing the impact on USPTO's outstanding obligation balances. We also judgmentally selected 56 remaining unliquidated obligation balances as of January 2015 and determined whether there was still a valid need for the balances. Appendix A provides more details about our audit scope and methodology. Appendix B provides further details about the 56 samples tested; appendix C notes the monetary benefits to USPTO that could be realized in the form of funds put to better use.

Background

An *obligation* is the formal reservation of agency funds for the amount of an order placed, contract awarded, or service purchased during an accounting period to sufficiently cover all future payments. Examples of obligations include signed contracts, purchase orders, issuance of travel vouchers, and lease agreements. An *unliquidated* obligation is an amount of funds that has been designated for a specific purpose but has not been disbursed. Obligations must be liquidated within certain time limits. If obligated funds are not used for their original purpose within these time frames, the agency is required to release the funds for other allowable purposes or, depending on restrictions placed by Congress, return the money to the U.S. Department of the Treasury.

In the June 2013 audit report OIG-13-026-A, we reviewed the Department's policies, procedures, and controls to manage unliquidated obligation balances. Generally, we found

- obligation balances that could not be verified,
- obligations recorded in accounting records before becoming valid,
- ineffective bureau monitoring and obligation status reporting, and
- contract obligations that were improperly liquidated.

Our conclusions were based on the evaluation of a statistical sample of balances as of December 2011, which determined that the Department was holding a minimum of approximately $159 million that could have been deobligated. We recommended that the Department develop

- initiatives related to the timely liquidation, deobligation, and closure of unneeded open obligations, and

- guidance for consistent monitoring and deobligation of unliquidated obligation balances, as well as quarterly verification of open obligations.[3]

To address these recommendations, USPTO developed and implemented policies and procedures for managers to review outstanding obligation balances and take action if required. Generally, the process begins with the USPTO Office of Finance (OF) preparing a list of current obligation balances. The list, with detailed procedures, is then sent to the respective business unit and obligation managers who then determine whether the obligation is still needed to be kept open. In coordination with OF and the Office of Procurement (OP), the managers then take appropriate action: either deobligate the funds or ensure a valid need exists in order to remain open.

At the end of FY 2014, USPTO reported a total budgetary (obligational) authority of about $3 billion, as well as $550 million in unliquidated obligations.

Finding and Recommendations

USPTO's Controls Are Effective but Can Be Improved

This audit focused on the procedures implemented by USPTO since our previous report, which concluded that the Department and its bureaus needed stronger internal controls, policies, and procedures to ensure that obligation balances were adequately monitored and deobligated when appropriate. We recommended that the Department and bureaus implement and strengthen the review process; the Department concurred with our recommendation.

We found that USPTO generally addressed the intent of our original recommendations related to the monitoring of outstanding balances. Our conclusion is based on our review of the adequacy of procedures and their effectiveness in monitoring and reducing unliquidated obligation balances.

Adequacy of procedures. OF provides each of the USPTO program offices a listing of outstanding obligations and contracts, as well as obligation review instructions. The program office must then review the listing and indicate whether open obligations can be deobligated. For obligations that are needed beyond the initial performance period, the program office must provide a justification for maintaining the open obligation. According to USPTO's FY 2013 and FY 2014 obligation review memorandums, examples of acceptable justifications for keeping obligations open include the following:

- Not all goods/services ordered or procured have been delivered or provided.

[3] We made two additional recommendations in OIG-13-026-A: to investigate instances where contract obligations may have liquidated against an incorrect fiscal year funding source, and to provide training on the proper methodology for funding invoices of multiple-year contracts. However, these are not applicable to USPTO because it has no-year funding.

- All needed goods/services have been delivered or provided but have yet to be accepted, certified, invoiced or paid for.[4]

The program offices then send the completed listing, along with any supporting documentation, to OF. OF then coordinates with OP concerning all procurement-related obligations to post the deobligation in OF's accounting system.

Based on observations of the process for both FYs 2013 and 2014 (the period after the issuance of our 2013 report), we concluded that USPTO has developed sufficient policies and procedures to monitor unliquidated obligation balances—and has achieved the intent of our recommendation. We found that reviews were conducted in a timely and efficient manner, as required by the procedures. Table 1 below shows each of the recommendation elements and the results of our testing.

Table 1. Summary of USPTO Unliquidated Obligations Review Policies as of September 30, 2014

Recommendations from Audit Report OIG 13 026	Does FY 2013 Deobligation Review Memorandum and SOP Satisfy Recommendation?	Does FY 2014 Deobligation Review Memorandum and SOP Satisfy Recommendation?
(1) Develop initiatives related to the timely liquidation, deobligation, and closure of unneeded open obligations	Yes	Yes
(2) Develop guidance for consistent monitoring and deobligation of unliquidated obligation balances and for quarterly verification of open obligations	Yes (semiannual reviews conducted)	Yes (semiannual reviews conducted)
(3) Investigate instances where contract obligations may have liquidated against an incorrect fiscal year funding source	Yes	Yes
(4) Provide training on the proper methodology for funding invoices of multiple-year contracts.	N/A	N/A

Source: OIG analysis of USPTO documentation

We did note that the current procedures do not comply with Departmental standards. According to the Office of Financial Management's *Accounting Principles and Standards*

[4] USPTO *FY 2013 Semiannual Obligation Review;* USPTO *FY 2014 Annual Obligation Review.*

Handbook, bureaus must review and verify undelivered orders at least quarterly. However, current USPTO policy only requires a semiannual review. Although a semiannual review process was deployed due to the volume of outstanding items balanced with limited resources, we believe that USPTO has reached a point such that quarterly reviews would further enhance its controls for monitoring balances.

Effectiveness of procedures. We determined the effectiveness of the procedures by analyzing the impact on the unliquidated obligation balances with no current activity since our prior review date of December 2011. We also tested the validity of remaining obligation balances by reviewing a sample of outstanding balances with no current activity as of January 2015. For these, we reviewed the justifications and documentation to determine whether the open balance was valid or should be reviewed for deobligation.

Overall, we found that the procedures achieved the intended effect and, further, had a significant impact on USPTO's outstanding balances. Specifically, for obligations with no activity for 1 year or more, USPTO reduced the unliquidated obligation balance by more than 90 percent from December 2011 to January 2015. The impact of these new monitoring controls has reduced USPTO's balance of non-current obligations from approximately $255 million to about $22 million in the same period. As of January 2015, only about 4.2 percent of the approximately $526 million in outstanding balances were for potentially dormant obligations with no activity in more than a year.

We did note that about 70 percent of the items we selected were no longer needed and should be reviewed for deobligation; however the total dollar value did not indicate inefficient or ineffective controls overall. We selected a sample of 56 items totaling $2.1 million representative of the different obligation types (see appendix A and appendix B) from the $23 million balance and found that 40 of the items sampled could not be supported and should be deobligated (see appendix B). USPTO did not provide any supporting documentation, deobligation timeline, or further details to justify the need to maintain the open balance.

As a result, we identified an approximate amount of $1.7 million that may be put to better use (also see appendix C). Table 2 summarizes the testing results.

Table 2. Summary of USPTO Unliquidated Obligations as of January 31, 2015, That Can Be Deobligated

Number of Obligations Tested	Total Amount of Obligations Tested	Number of Obligations with Adequate Justification	Number of Obligations That Can Be Deobligated	Total Amount That Can Be Deobligated
56	$2,068,797	16	40	$1,722,052

Source: OIG analysis of documentation provided by USPTO

We concluded that this was not the result of ineffective procedures but, rather, USPTO's prior focus on prioritizing the review of larger or older balances. Because of the significant progress USPTO has already made—and considering the relatively small amount of obligations identified that can be deobligated, compared to the $526 million total outstanding ULO amount—we did not view this as a control deficiency. We believe that, by implementing and conducting quarterly obligation reviews, and focusing on small-dollar items, USPTO will improve the effectiveness of controls for monitoring and timely deobligation of excess balances.

Subsequent to our review, USPTO stated that they will be taking steps to review and deobligate the unneeded balances for the items we identified.

Recommendations

We recommend that the Under Secretary of Commerce for Intellectual Property and Director of the U.S. Patent and Trademark Office instruct the Director of USPTO Office of Finance to

1. follow up on the remaining obligations identified in this report to ensure that, if they are no longer needed, then proper action is taken; and
2. update its obligation review policies to conduct quarterly reviews.

On August 21, 2015, OIG received USPTO's comments on the draft memorandum report's recommendations, which we include here as appendix D. (The agency's response also included suggested modification of the language of one passage; we accepted the revision but did not include this segment of the agency response in appendix D.) USPTO concurs with our recommendations and is confident in its abilities to meet the recommendations in a timely manner. This final memorandum report will be posted on the OIG's website pursuant to section 8M of the Inspector General Act of 1978, as amended.

In accordance with Departmental Administrative Order 213-5, please submit to us—within 60 calendar days of the date of this memorandum—an action plan that responds to the recommendations in this memorandum report.

We appreciate your cooperation and courtesies extended to us by your staff during our audit. If you have any questions or concerns about this memorandum report, please contact me at (202) 482-7859 or Rich Bachman at (202) 482-2877.

cc: Welton Lloyd, Audit Liaison, USPTO
Anthony Scardino, Chief Financial Officer, USPTO
Katrina Anwar, Office of Planning and Budget, USPTO

Appendix A. Objective, Scope, and Methodology

The objective of this audit was to evaluate the effectiveness of U.S. Patent and Trademark Office's obligation and deobligation review policies and procedures that were implemented since the 2013 audit report OIG-13-026, *Monitoring of Department's Obligation Balances Needs Strengthening*.

To satisfy this objective, we reviewed Departmental and USPTO's policies and procedures pertaining to the monitoring and oversight of unliquidated obligations including the following:

- the Department's Office of Financial Management's *Accounting Principles and Standards Handbook*
- USPTO's *FY 2013 Semiannual Obligation Review* memorandum
- USPTO's *FY 2014 Annual Obligation Review* memorandum
- USPTO's *Internal Standard Operating Procedures*/FY 2013 *De-Obligation Review*
- USPTO's *Internal Standard Operating Procedures*/FY 2014 *De-Obligation Review*

For the purpose of this review, we judgmentally selected 56 obligations from a total of 10,489 based upon the following selection factors:

- FY 2013 and FY 2014 obligation amounts left unliquidated over a year after the period of performance has ended
- obligation types we considered risky
- obligation types with high dollar amounts
- obligation types with higher percentage of total obligations

We conducted site visits at the USPTO Office of Finance and Office of Procurement to (1) gain understanding of how the ULO review process works, and (2) perform physical file reviews.

We performed our work in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective.

We conducted our fieldwork from March 2015 through May 2015 under the authority of the Inspector General Act of 1978, as amended and Department Organization Order 10-13, dated April 26, 2013. We performed our work at USPTO offices in Alexandria, VA.

Appendix B.
Sample of Obligations Tested

Obligation Type	Total Number of Obligations Tested	Total Amount of Obligations Tested ($)	Number of Obligations with Adequate Justification	Number of Obligations That Can Be Deobligated	Total Amount of Obligations That Can Be Deobligated ($)
Task orders	7	1,052,685	0	7	1,052,685
Interagency agreements	5	207,524	1	4	135,025
Contracts	7	96,225	7	0	0
Credit card orders	4	10,714	4	0	0
Printing orders	2	58,084	2	0	0
Non-FAR orders	8	183,876	2	6	74,653
FAR Non-itemized orders	5	285,581	0	5	285,581
Blanket agreement calls	18	174,108	0	18	174,108
Total	**56**	**2,068,797**	**16**	**40**	**1,722,052**

Source: OIG analysis of documentation provided by USPTO

Appendix C.
Potential Monetary Benefits

	Funds Put To Better Use
Finding 1, Table 3	$1,722,052

UNITED STATES PATENT AND TRADEMARK OFFICE

UNDER SECRETARY OF COMMERCE FOR INTELLECTUAL PROPERTY AND
DIRECTOR OF THE UNITED STATES PATENT AND TRADEMARK OFFICE

AUG 21 2015

MEMORANDUM FOR Andrew Katsaros
Principal Assistant Inspector General for Audit and Evaluation

FROM: Michelle K. Lee Michelle K. Lee
Under Secretary of Commerce for Intellectual Property and
Director of the U.S. Patent and Trademark Office

SUBJECT: Comments on OIG Draft Memorandum "*Audit of USPTO's Management of Unliquidated Obligation Balances" (July 2015)*

Executive Summary

We appreciate the effort you and your staff have made in reviewing the United States Patent and Trademark Office's (USPTO's) unliquidated obligation balances process and practices. We have carefully considered the two recommendations made in the subject draft report.

Our response to each recommendation is discussed in detail below.

Response to Recommendations

IG Recommendation (1): Follow up on the remaining obligations identified in this report to ensure that, if they are no longer needed, then proper action is taken.

USPTO Response:
The USPTO concurs with this recommendation. We have obtained a listing of these obligations and are currently in the process of assessing the validity of any remaining unliquidated balances. Depending on the results of this assessment process, we will take proper action upon any balances that are no longer needed.

IG Recommendation (2): Update its obligation review policies to conduct quarterly reviews.

USPTO Response:
The USPTO concurs with this recommendation. We have been conducting quarterly reviews since October 2014, consistent with the Department of Commerce's "Policy for Monitoring Undelivered Orders" issued July 15, 2014.

The specific review frequencies as set forth in that policy are as follows:

A. Quarterly for travel balances
B. Semi-annually, conducted on December 31 and June 30, for non-travel balances

Conclusion

In closing, we thank the Principal Assistant Inspector General for Audit and Evaluation for providing us with this report. We are confident in our abilities to meet the OIG's recommendations in a timely manner and look forward to working with your office in the future in our efforts to improve the unliquidated obligation balances process. If you have any questions regarding this response, please contact Tom Hellmer at 571-272-6331.

Attachment:
Technical comments