



Treasurer's Report **Jean Paul Gagnon, Ph.D.**

At the last Quinquennial meeting, Jack Fay wished great success for the next Treasurer, Board, and management team. As outgoing Treasurer I would like to thank Jack for making that wish five years ago because his wish came true; I am here to report that the financial results of USP have been stellar.

Of course, financial results don't occur from good wishes. They are the result of the combined efforts of USP's volunteers, staff, and Board. So while I talk today about the financial successes of the last five years it is important to remember that financial results are merely quantitative measures of broader organizational successes including the superb science, management, outreach, and oversight that support this great institution.

The data in Figure 1 show the financial results from the last three cycles. Dramatic, wouldn't you say? Each cycle shows substantial growth over the previous cycle with the last cycle showing a 33% growth in revenue. While revenues were up, change in net assets remained level due to USP's investment in infrastructure and the development of new public health programs.

A for-profit firm would look at USP's revenue growth and positive operating results as penetrating the market and maximizing shareholder value. USP looks at this success from a public health perspective. Remember that the revenue line on our financials is an indication of the reach of USP's public health impact. Revenue growth indicates that a wider audience is using our products and services. Wider use of our standards ensures that good quality pharmaceutical products enter commerce. The economic engine at USP is so robust that it is easy to lose sight of the science and public health impact that produces these strong financial results. Our success demonstrates that relevant and useful public health initiatives and good public policy can be delivered in a fiscally responsible and self-sustaining manner.

The data in Figure 2 show the revenue growth for reference standards, the *USP-NF*, and the *USP-Pharmacopeial Forum* has been excellent. Revenue from these core standards-setting products grew by over 68% during this cycle. In fact, in Fiscal Year 1994, reference standards sales were \$13 million. In fiscal year 2004, reference standards sales were just over \$42 million – triple the 1994 result. Again, remember my comment on revenue as a proxy measure. The revenue growth in this very important standards-setting component of USP should both excite and gratify all who made it happen.

During this cycle, USP experienced something of a rebirth with new public health programs being developed and others being redeveloped. The data in Figure 3 show the growth trends over the cycle for USP's four public health programs.

Public Health Program #1 includes Reference Standards, Publications, and Pharmacopeial Education. Pharmacopeial Education (PE) is a new comer to PHP #1. These educational programs offer standard purchasers the opportunity to learn USP analytical methods taught by USP staff. In 2004, PE revenue was \$435,000 of the total for PHP#1. In 2002, USP also introduced the annual edition of the *USP-NF* as seen in the graph.

Public Health Program #2, the Dietary Supplement Verification Program is a new program, which verifies the content of dietary supplements made by supplement manufacturers. This program currently runs a financial deficit of about \$600,000 for the current fiscal year. The deficits associated with this program continue to trend downward as more manufacturers qualify to use the USP verification seal on their products.

Public Health Program #3 includes the global assistance grant from the US Agency for International Development, which focuses on improving drug quality in developing nations and the royalty payments from Micromedex for the USP-DI. These royalties disappear in fiscal year 2005, but they will be replaced by a grant from the Center for Medicare and Medicaid Services to construct the Model Guidelines under the Medicare Modernization Act.

Public Health Program #4, Patient Safety, markets MEDMRX, a voluntary database for hospitals to report medication errors. The program also includes the Center for the Advancement of Patient Safety, which produces original research on medication errors. This program came into its own financially during this cycle growing from \$305,000 in revenue in 2000 to \$2.5 million in 2004. This important public health program is expected to run a deficit in 2005 of just over \$1 million, also a substantial reduction from deficits incurred earlier in the cycle.

The revenue growth observed in these four public health programs necessitated increased staffing for USP. The data in Figure 4 shows the trends in actual staff employed at USP during the last cycle. The staff growth over the last five years represents a substantial investment in the science and infrastructure of USP.

The financial results of the last cycle coupled with the performance in the financial markets leaves USP with very strong financial reserves. As the data in Figure 5 show, USP reserves grew significantly over the five year cycle. On June 30, 1989, the reserves were \$6.6 million; today they are over \$60 million. This level of reserves allows for future expansion of USP public health programs.

The data in Figure 6 shows the returns on the investment portfolio. The composition of the investment portfolio changed with the introduction of a value fund in 2003. The move was made at just the right point in the market to take advantage of high value related returns. As you can see USP's portfolio outperformed the indices throughout the course of the cycle.

At the January Board meeting, the Board accepted the Investment Committee's recommendation for a revised investment policy, which increased the diversification of the investment portfolio. We still shy away from options and other derivatives, but we now have an expressed position on large and small cap as well as value and growth holdings. The new investment policy will be executed by the Smith Barney Consulting Group who will provide active oversight to staff and to the Investment Committee on an ongoing basis. I feel this change is very important for USP given the size of the portfolio and the dynamics of the financial markets.

There were other financial achievements that do not reflect themselves in the financial statements but are, nevertheless, important to USP's present and future. The information in Figure 7 summarizes several of those achievements

One of the most significant achievements was the bond financing for the new buildings. Staff executed this transaction providing \$87.5 million to fund the development of the new laboratory and office building at a tax-exempt interest rate of 3.728%. During the bond financing, USP received an A2 financial rating from Moody's. This rating is "investment grade" in Wall Street terms and recognizes the underlying fundamental strength of USP's performance – both scientific and financial.

Another significant achievement was the recognition we received from our external auditors on how well USP managed its financial resources. During a period of time marked by well-publicized corporate scandals, USP took proactive and very conservative steps to ensure proper revenue recognition and expense accruals and that financial statements were completely accurate and useful for staff and the Board. Staff received unqualified audit opinions from the external financial auditors and strong praise for its financial management practices every year during the last cycle. The Audit Committee and the Governance Committee implemented several of the best practices from the Sarbanes Oxley Act including management signoff of the audited financial statements. In fact, during our last audit the auditors stated they were using USP procedures as an example for other not-for-profit organizations on how to implement Sarbanes Oxley best practices.

There were many improvements in the financial systems including the implementation of the Oracle system and an electronic timekeeping system. These improvements paved the way for improved financial reporting including operating statements for each of the four public health programs.

Likewise, there were operational changes that had positive financial impacts. For example, USP implemented the annual edition of the *USP-NF* at the request of customers. This change smoothed the cash cycle under which USP operates providing other cash management and investment opportunities. Similarly, USP developed a more effective credit management program that balances the desires of customers for easy ordering with the financial interests of USP. The result was less bad debt expense from higher sales. Finally, Brian Hendrix, John Fowler and I developed a "dash board" presentation format for the Treasurer's report to the Board that made it easy for them to quickly understand USP's financial health.

As you can tell, I am very proud to have served as Treasurer of USP. I am proud of the accomplishments of the organization – both public health and financial. But now it is my time to turn the green eyeshade over to a new Treasurer for the upcoming cycle. I do this with sadness because I will miss serving in this role but I also do it with pride of where USP stands today. I wish the new Treasurer, the new Board, and the management team great success and I look forward to learning five years from now that MY wish for them came true.

Thank you.