Consolidated Financial Statements and Report of Independent Certified Public Accountants

United States Pharmacopeial Convention and Subsidiaries

June 30, 2018 and 2017

United States Pharmacopeial Convention and Subsidiaries

Contents

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
United States Pharmacopeial Convention and Subsidiaries

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of United States Pharmacopeial Convention and Subsidiaries (USPC), which comprise the consolidated statements of financial position as of June 30, 2018 and 2017, and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to USPC's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of USPC's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of United States Pharmacopeial Convention and subsidiaries as of June 30, 2018 and 2017, the statements of activities and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Arlington, Virginia
November 14, 2018

United States Pharmacopeial Convention and Subsidiaries

Consolidated Statements of Financial Position

June 30,		2018		2017
Assets				
Current Assets				
Cash and cash equivalents	$	63,857,079	$	65,180,356
Short-term investments		30,104,715		8,670,588
Accounts receivable:				
Reference standards and publications (less allowance of $82,007 and $103,086 for 2018 and 2017, respectively)		24,947,138		21,854,685
Cooperative agreements and grants		1,730,325		4,756,165
Inventory – net		50,046,827		47,545,673
Prepaid expenses and other assets		8,079,427		7,549,947
Total current assets		178,765,511		155,557,414
Other Assets				
Long-term investments		153,781,711		121,567,371
Property and equipment – net		156,940,685		166,512,682
Other assets		830,085		948,476
Total other assets		311,552,481		289,028,529
Total Assets	$	490,317,992	$	444,585,943
Liabilities and Net Assets				
Current Liabilities				
Accounts payable and accrued expenses	$	50,696,397	$	43,968,313
Current portion of 2012 taxable term loan		335,183		1,325,117
Current portion of 2012 USP Holding term loan		1,061,776		4,213,949
Deferred revenue		3,971,766		4,448,818
Total current liabilities		56,065,122		53,956,197
Long-term Liabilities				
Deferred rent		6,705,486		6,827,477
Long-term portion of 2012 taxable term loan		-		335,183
Long-term portion of 2012 bond series		109,360,000		109,360,000
Less debt financing costs		(732,145)		(815,818)
Long-term portion of 2012 USP Holding term loan		-		1,061,776
Total long-term liabilities		115,333,341		116,768,618
Total Liabilities		171,398,463		170,724,815
Net Assets – Unrestricted		318,919,529		273,861,128
Total Liabilities and Net Assets	$	490,317,992	$	444,585,943

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

United States Pharmacopeial Convention and Subsidiaries

Consolidated Statements of Activities and Changes in Net Assets

Year ended June 30,	**2018**	**2017**
Operating Revenue		
Reference standards	$ 281,970,180	$ 250,541,363
Publications	10,955,924	10,777,868
Total compendial activities	292,926,104	261,319,231
Verification programs	4,060,650	3,166,118
Pharmacopeial education	1,007,436	1,052,178
Other	594,019	646,943
Total allied compendial activities	5,662,105	4,865,239
USAID cooperative agreement	13,876,746	15,944,308
Other donor funded	2,396,443	3,476,090
Other	773,851	363,037
Total non-compendial activities	17,047,040	19,783,435
Contributed reference standards	1,763,063	1,751,327
Contributed services	15,465,011	15,479,399
Total Operating Revenue	332,863,323	303,198,631
Expenses		
Compendial activities	251,526,358	239,773,437
Allied compendial activities	10,169,279	10,489,503
Non-compendial activities	30,025,097	29,770,907
Total Expenses	291,720,734	280,033,847
Increase in Net Assets from Operations	41,142,589	23,164,784
Net investment income	7,425,087	11,592,309
Interest expense	(3,861,083)	(3,810,162)
Amortization of bond debt financing costs	(83,674)	(83,674)
Letter of credit – fees and commissions	(7,978)	(7,904)
Loss on impairment of long-lived assets	—	(6,381,848)
Other income	914,783	135,273
Foreign currency exchange loss	(471,323)	(1,275,809)
Change in Net Assets	45,058,401	23,332,969
Net Assets, beginning of year	273,861,128	250,528,159
Net Assets, end of year	$ 318,919,529	$ 273,861,128

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

United States Pharmacopeial Convention and Subsidiaries

Consolidated Statements of Cash Flows

Year ended June 30,	**2018**	**2017**
Cash Flows from Operating Activities		
Change in net assets	$ 45,058,401	$ 23,332,969
Adjustments to reconcile change in net assets to net cash from operating activities:		
Depreciation	16,426,529	15,065,886
Loss on disposal of property and equipment	136,454	1,273,040
Loss on impairment of long-lived assets	—	6,381,848
Net realized and unrealized gains on investments	(4,779,927)	(9,287,740)
Revenue from contributed reference standards	(1,763,063)	(1,751,327)
Cost of goods sold from contributed reference standards	3,885,313	4,496,564
Reserve for slow moving inventory	1,524,513	2,181,071
Revenue from contributed services	(15,465,011)	(15,479,399)
Expenses from contributed services	15,465,011	15,479,399
Amortization of bond debt financing costs	83,674	83,674
Changes in operating assets and liabilities:		
Accounts receivable	(66,613)	2,406,609
Inventory	(5,202,014)	(2,554,261)
Prepaid expenses and other assets	(529,481)	(502,046)
Other assets	118,391	(9,647)
Accounts payable and accrued expenses	6,728,084	(1,076,263)
Long-term portion of deferred rent	(121,991)	5,435,568
Deferred revenue	(477,052)	14,038
Net Cash Provided by Operating Activities	61,021,218	45,489,983
Cash Flows from Investing Activities		
Proceeds from sales of investments	56,861,347	30,919,801
Purchases of investments	(105,729,888)	(35,676,074)
Proceeds from sale of property and equipment	6,945	11,726
Purchases of property and equipment	(7,943,833)	(30,178,971)
Net Cash Used In Investing Activities	(56,805,429)	(34,923,518)
Cash Flows from Financing Activities		
Payments on 2012 taxable term loan	(1,325,117)	(1,300,551)
Payments on 2012 USP Holding term loan	(4,213,949)	(4,161,782)
Net Cash Used In Financing Activities	(5,539,066)	(5,378,659)
Net (Decrease) Increase in Cash and Cash Equivalents	(1,323,277)	5,104,132
Cash and Cash Equivalents, beginning of year	65,180,356	60,076,224
Cash and Cash Equivalents, end of year	$ 63,857,079	$ 65,180,356

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

NOTE A—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization

The United States Pharmacopeial Convention (USPC), established in 1820, is a not-for-profit organization whose purpose is to promote the public health by establishing and disseminating officially recognized standards of quality and authoritative information for the use of medicines and health care technologies by health care professionals, patients and consumers. Initially founded to ensure that consumers receive medicines of the highest possible quality, strength, and purity in the United States, USPC provides standards for approximately 6,600 drugs and dosage forms for medicines and dietary supplements. USPC's standards-setting role also has grown to include development of authoritative information on the use of medicines and dietary supplements, as well as reporting and prevention programs regarding product problems and medication errors, which seek to reduce such occurrences and benefit consumers nationwide.

On May 27, 2005, USPC formed United States Pharmacopeia – India Private Limited (USP India), a private company held under India law through two intermediate holding companies.

On June 13, 2006, USPC formed a wholly owned subsidiary in China called United States Pharmacopeia Research and Development (Shanghai) Corporation Limited (USP China I). USP China I began operations during 2007. USP China I was dissolved as of July 21, 2016. Full operations have been merged and absorbed by USP China II.

On September 21, 2007, USPC formed a wholly owned subsidiary in Brazil called United States Farmacopeia Brasil Ltda (USP Brazil) located in Sao Paulo, Brazil. This subsidiary is in fully operational in June 30, 2009.

On April 11, 2012, USPC formed a wholly owned subsidiary in China called United States Pharmacopeia Standard Research and Development and Technical Service (Shanghai) Co., Ltd., (USP China II). USP China II was fully operational in January 2014.

On November 13, 2012, USPC incorporated a wholly owned subsidiary, termed as the Center for Pharmaceutical Advancement and Training (CePAT), in Accra, Ghana. The purpose of this entity is to address deficiencies in human and laboratory resources in pharmaceutical quality control and to seek to build the capacity of African professionals in quality control and quality assurance of medicines. CePAT was fully operational in April 2013. On August 4, 2017 CePAT officially changed its name to United States Pharmacopeia – Ghana (USP Ghana).

On May 5, 2013, USPC incorporated the USPC Foundation pursuant to the District of Columbia Nonprofit Corporation Act. The USPC Foundation is classified as a public charity and is exclusively intended for charitable, educational and scientific purposes as set forth under section 501(c)(3). Since its inception, the USPC Foundation did not have operations and was dissolved on May 4, 2016.

NOTE A—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES—Continued

Organization—Continued

On July 20, 2015, USPC formed a wholly owned subsidiary in the Philippines called United States Pharmacopeia – Philippines, Inc. (USP Philippines). The purpose of this entity is to engage in the promotion, support, and improvement of non-profit public health programs in cooperation with the United States Agency of International Development (USAID) to quality, safety, and efficacy of medicines and foods. The subsidiary was fully operational in March 2016.

On January 19, 2016, USPC formed a wholly owned subsidiary in Nigeria called United States Pharmacopeia – Nigeria Ltd./Gte (USP Nigeria). The purpose of this entity is to assist USP in implementing its Global Health Impact Program by promoting the quality of medicines in Nigeria. The subsidiary was fully operational in March 2016.

On May 4, 2017, USPC formed a wholly owned subsidiary in Singapore called United States Pharmacopeia Singapore Pte. Ltd. (USP Singapore). The subsidiary was fully operational in September 2018.

USP India, USP China I, USP China II, USP Brazil, USP Ghana and USP Singapore are wholly owned subsidiaries of USP Holding, LLC and USP Holding International. USP Philippines and USP Nigeria are wholly owned subsidiaries of USPC. USP Holding, LLC and USP Holding International are disregarded entities for federal income tax purposes of USPC.

Principles of Consolidation

The consolidated financial statements include the accounts of USPC, USP India, USP China I, USP China II, USP Brazil, USP Ghana, USP Philippines, USP Nigeria and USP Singapore (collectively "USPC"). All significant intercompany transactions have been eliminated.

Basis of Presentation

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting.

NOTE A—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES—Continued

Cash and Cash Equivalents

For consolidated financial statement purposes, USPC considers highly liquid debt instruments with original maturities of three months or less when purchased, except for amounts held in investment brokerage accounts, to be cash equivalents. USPC maintains cash balances, which may exceed federally insured limits. At June 30, 2018, USPC had approximately $54,297,163 in excess of the Federal Deposit Insurance Corporation insured limit. USPC believes that its exposure to this credit risk is limited.

USPC had cash in foreign accounts totaling $10,570,910 and $6,779,865 as at June 30, 2018 and 2017, respectively.

Inventory

USPC maintains an inventory of finished reference standards, publications, work in process and bulk raw materials. Most bulk raw materials are contributed to USPC. Contributed reference standards are valued at an average price for finished goods inventory, and are determined on a moving average method. USP capitalizes the costs associated with the purchase of raw materials or fair value of contributed raw materials. USP capitalizes costs associated with the production of raw materials, including labor and overhead. Inventories are stated at the lower of cost of market using a moving average method. Market is defined as net realizable value. USPC analyzes its inventory levels periodically and writes down inventory to its net realizable value if it has become obsolete, has a cost basis in excess of its expected net realizable value or is in excess of expected requirements.

Contributions

Contributions of services are recognized by USPC if the services received require specialized skills, are provided by individuals possessing those skills and would typically need to be purchased if not provided by donation. Contributions of materials are recognized as revenues in the period received and as assets, decreases of liabilities, or expenses, depending on the form of benefits received. Contributions received are measured at their estimated fair value and are reported as unrestricted support based on the absence of donor imposed restrictions.

NOTE A—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES—Continued

Investments

Investments are stated at fair value. Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value based upon market prices with gains and losses included in the statements of activities, unless their use is temporarily or permanently restricted by explicit donor stipulations or by law. The alternative investments, which are not readily marketable, are carried at estimated fair values as provided by the investment managers. USPC reviews and evaluates the values provided by the investment managers and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these securities existed. USPC classifies investments as short term or long term based on management intentions.

USPC has classified as restricted certain short term investments related to its USP India subsidiary that is not available for use in its operations. As of the period ended June 30, 2018 and 2017, USP India held a short term investment in the amount of $316,817 and $335,868, respectively that is specifically related to a bank guarantee that was initiated in May 2014 as a result of an India customs notice raised that elicited investigation and is pending appeal with the Indian government.

Fair Value Measurements

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurement,* provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under this guidance are described below.

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that USPC has the ability to access.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability, inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

NOTE A—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES—Continued

Fair Value Measurements—Continued

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of observable inputs. USPC uses the Net Asset Value (NAV) to determine the fair value of all underlying investments which (1) do not have a readily determinable fair value and (2) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2018 and 2017.

Money market: Carrying value of cash equivalents such as money market funds approximates the fair value due to the short maturity of these investments.

Corporate bonds, asset-backed securities, international bonds, and government obligations: When quoted prices are available in an active market, they are classified within level 1 of the fair value hierarchy. Quoted prices in inactive markets are classified within level 2. If quoted market prices are not available or accessible, then fair values are estimated using pricing models, matrix pricing, or discounted cash flow models. The most significant inputs to the discounted cash flow model are the coupon, yield and expected maturity date. The fair values of corporate bonds, asset-backed securities, international bonds or government obligations that are estimated using pricing models or matrix pricing based on observable prices of the investments that trade in inactive markets are generally classified within level 2 of the fair value hierarchy. Securities are classified within level 3 when there is limited activity or less transparency concerning inputs to the valuation.

Mutual funds: Valued at the closing share price reported on the active market on which the individual securities are traded.

Mortgage-backed securities: Fair values for level 2 mortgage-backed securities are estimated using a market approach, including a pricing model with observable inputs. An industry standard valuation model is used to estimate fair value based on a market approach.

NOTE A—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES—Continued

Fair Value Measurements—Continued

Alternative investments: Alternative investments consist of investments in funds of funds based on their underlying investments. The funds in this class of investments invest primarily in managed futures, foreign exchange and private investment companies to achieve diversification to provide for increased return and/or reduced volatility. The fair values of such investments are determined using the NAV per share as a practical expedient.

457(b) plan: Valued at the closing share price reported on the active market on which the individual securities within the plan are traded.

Property and Equipment

Property and equipment includes items exceeding $7,500 and are stated at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets of three to fifty years. Leasehold improvements are amortized on a straight-line basis over the lesser of the remaining lease term or the estimated useful lives of the improvements.

Impairment of Long Lived Assets

USPC monitors long-lived assets for impairment whenever events or changes in circumstances indicate that the carry amount of such assets may not be recoverable. Recoverability of these assets is determined by comparing the forecasted undiscounted net cash flows of operation to which the assets relate to the carry amount. If the operation is determined to be unable to recover the carry amount of its assets, then the assets are written down to fair value. Fair value is determined based on discounted cash flows or appraised values, depending on the nature of the assets. For the years ended June 30, 2018 and 2017, there are impairment losses recognized for long-lived assets amounting to $0 and $6,381,848, respectively, which are included in the Loss on property and equipment line item in the Statement of Activities.

Debt Financing Costs

On March 29, 2012, USPC refinanced the Maryland Economic Development Corporation (MEDCO) Series 2008 Bonds A and B and the Series 2009 Bond with the issuance of a MEDCO Series 2012 Bond. Additionally, USP refinanced its outstanding term loans with two new term loans on March 29, 2012.

NOTE A—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES—Continued

Debt Financing Costs—Continued

In fiscal year 2012, USPC incurred debt financing costs of $1,255,106. The costs were incurred for legal, underwriting, advisory and other fees associated with the debt incurred under both the MEDCO 2012 Bond Series and Term Loan issuance. The debt financing costs are being amortized over a 15 year period, based on the Initial Term Rate Period of the debt, using the straight-line method. This method does not materially differ from the effective interest method. Amortization for both the years ending June 30, 2018 and 2017 were $83,674. Remaining unamortized balance amounting to $732,145 and $815,818 as of June 30, 2018 and 2017, respectively, are netted against long-term liabilities in the consolidated statements of financial position. No material additional debt financing costs were incurred for the years ended June 30, 2018 and 2017.

Leases

For lease agreements that provide for escalating rent payments or free-rent occupancy periods USPC recognizes rent expense on a straight-line basis over the non-cancelable lease term. The difference between the rent expense and the required lease payments is reflected as deferred rent in the accompanying consolidated statements of financial position. Also, tenant improvement allowances provided are recorded as a deferred rent and recognized ratably as a reduction to rent expense over the lease term. The current portion of deferred rent is included within accounts payable and accrued expenses in the consolidated statements of financial position.

Accounts Receivable

The face amount of accounts receivable is reduced by an allowance for doubtful accounts. The allowance for doubtful accounts reflects the best estimate of probable losses determined principally on the basis of historical experience, specific allowances for known troubled accounts, and future business trends for USPC. Account balances are charged off against the allowance after collection efforts have been exhausted and the potential for recovery is considered remote. Allowance for doubt accounts recorded as of June 30, 2018 and 2017 amounted to $82,007 and $103,086, respectively.

Deferred Revenue

Deferred revenue represents revenues collected but not earned as of June 30. This is primarily comprised of revenue from online subscription products received in advance of the publication distribution.

NOTE A—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES—Continued

Revenue Recognition

Revenue from the sale of reference standards is recognized as income when the reference standards are distributed to customers based on estimated delivery date.

Revenue from the sale of publications and their related supplements is recognized as income during the fiscal year in which the publications or supplements are distributed. Subscriptions for print products are sold on an annual basis. Recognition of revenue occurs in the month in which the products are distributed. Revenue from online subscription products is recognized uniformly over the subscription period.

Revenue from conferences and meetings is recognized as income in the year when the conference or meeting takes place.

Revenue from cost-type contracts is recognized as costs are incurred on the basis of direct costs plus allowable indirect costs.

Revenue recognized on contracts for amounts unbilled at year-end is reflected in the accounts receivable – cooperative agreements and grants classification on the consolidated statement of financial position.

Revenue on service-based fixed-price contracts is accounted for using the proportional performance method. If actual and estimated costs to complete a contract indicate a loss, provision is made currently for the anticipated loss on the contract.

Revenue from royalties is recognized as income on a monthly basis according to the terms specified in the contract.

Allocation of Expenses

USPC is organized into departmental cost centers. Each department's expenses are allocated directly and indirectly to the products and services delivered by USPC.

Advertising

Advertising costs are expensed as marketing expense when incurred. Advertising expense was $2,819,498 and $1,807,488 for the years ended June 30, 2018 and 2017, respectively.

NOTE A—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES—Continued

Foreign Currency Translation

The consolidated financial statements and transactions of USPC's foreign subsidiaries are generally maintained in the relevant local currency. Where local currencies are used, assets and liabilities are translated at current exchange rates in effect at the date on the consolidated statement of financial position. Revenue and expenses are translated at the average exchange rate for each period. Gains and losses from foreign currency transactions are included in the consolidated statement of activities.

Income Taxes

USPC follows guidance that clarifies the accounting for uncertainty in tax positions taken or expected to be taken in a tax return, including issues relating to consolidated financial statement recognition and measurement. This guidance provides that the tax effects from an uncertain tax position can only be recognized in the consolidated financial statements if the position is "more-likely-than-not" to be sustained if the position were to be challenged by a taxing authority. The assessment of the tax position is based solely on the technical merits of the position, without regard to the likelihood that the tax position may be challenged.

USPC is exempt from federal income tax under IRC section 501(c)(3), though they are subject to tax on income unrelated to its exempt purpose, unless that income is otherwise excluded by the Code. USPC has processes presently in place to ensure the maintenance of its tax-exempt status; to identify and report unrelated income; to determine its filing and tax obligations in jurisdictions for which it has nexus; and to identify and evaluate other matters that may be considered tax positions. The tax years ending June 30, 2018, 2017, 2016 and 2015 are still open to audit for both federal and state purposes. USPC has determined that there are no material unrelated business activities or uncertain tax positions that require recognition or disclosure in the consolidated financial statements.

In addition, USPC's wholly owned subsidiaries, USP India, USP China I, USP China II, USP Brazil, USP Philippines, USP Nigeria and USP Singapore are subject to local country taxes per India, China, Brazil, Philippines, Nigeria and Singapore tax regulations, respectively. Collectively, the corporate income tax paid by USP India, USP China I, USP China II, USP Brazil, USP Philippines, USP Nigeria and USP Singapore for the years ended 2018 and 2017 are $735,078 and $1,353,500, respectively.

NOTE A—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES—Continued

Management Estimates

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

Risks and Uncertainties

USPC invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported.

USPC is subject to the risks of doing business outside the United States, including, among other risks, foreign currency exchange rate risks, tax laws and political or labor disturbances.

NOTE B—ACCOUNTS RECEIVABLE – COOPERATIVE AGREEMENTS AND GRANTS

The Accounts receivable – cooperative agreements and grants consist of billed and unbilled recoverable amounts under contracts in progress with U.S. Government units and non-federal organizations. At June 30, 2018 and 2017, accounts receivable – cooperative agreements and grants by customers were as follows:

June 30,	**2018**	**2017**
Billed and unbilled receivable:		
USAID	$ 1,730,315	$ 4,750,329
Others	—	5,836
Total	$ 1,730,325	$ 4,756,165

For the years ended June 30, 2018 and 2017, USPC recognized revenue from the USAID contract of $13,876,746 and $15,944,308, respectively.

NOTE C—INVENTORY

Inventory consisted of the following at June 30:

June 30,	2018	2017
Reference standards:		
Finished goods	$ 29,330,919	$ 25,429,512
Work in process	1,678,922	1,040,334
Raw materials	26,903,230	27,343,480
Reserve for slow moving items	(8,520,857)	(6,996,344)
Publications:		
Finished goods	654,613	728,691
Total inventory, net	$ 50,046,827	$ 47,545,673

USPC, through research, experimentations and other proper methods, develops officially recognized reference standards. Once it is established that such materials' identity, strength, and purity may be accurately determined, USPC sells the reference standards along with publications revealing such formulae and results. Materials for use in establishing reference standards are either purchased or synthesized by USPC or contributed by pharmaceutical manufacturers. Purchased and synthesized inventories are recorded at cost. For the years ended June 30, 2018 and 2017, approximately 56% and 60% of inventory value is contributed, respectively. Contributed reference standard materials are valued at the estimated market value upon receipt. For the years ended June 30, 2018 and 2017, USPC recognized revenue in contributed reference standard materials of $1,763,063 and $1,751,327, respectively.

USPC has established a formal inventory reserve for slow moving inventories. The replacement of inventory may take considerable time and due to technical requirements, USPC may package product to last for a period of seven years so it is important that these long lead times to replenish stock are maintained. It was determined this reserve would exclude any product that was in its first two years of release for sale. In addition, given that the inventory for reference materials must be maintained when there is a monograph need, it was determined that a seven year target inventory level is appropriate, based on sales levels and age of the material. This reserve will be reviewed routinely and adjusted based on sales and inventory levels. Total reserve as of June 30, 2018 and 2017 was $8,520,857 and $6,996,344, respectively.

NOTE D—INVESTMENTS

USPC's investments, by type, consisted of the following at June 30:

	2018		2017	
June 30,	**Cost**	**Market**	**Cost**	**Market**
Money market	$ 5,730,820	$ 5,730,820	$ 9,515,863	$ 9,515,863
Asset-backed securities	2,772,497	2,767,680	2,576,846	2,580,296
Corporate bonds	14,735,928	14,002,937	4,894,812	4,788,710
Mutual funds	131,111,428	135,559,847	87,407,743	91,384,342
Government obligations	7,818,045	7,726,119	6,952,639	6,951,703
Mortgage-backed securities	231,760	229,130	679,613	673,405
Alternative investments	11,658,441	15,360,608	9,558,441	11,989,231
Transamerica 457(b) plan	1,761,089	2,509,285	1,733,286	2,354,409
Total investments	$175,820,008	183,886,426	$123,319,243	$130,237,959

Investment income is comprised of the following for the years ended June 30:

June 30,	**2018**	**2017**
Interest and dividend income	$ 3,024,939	$ 2,649,059
Net realized and unrealized gains	4,779,927	9,287,740
Investment fees	(379,779)	(344,490)
Total net investment income	$ 7,425,087	$ 11,592,309

NOTE E—FAIR VALUE MEASUREMENTS

The following table sets forth by level within the fair value hierarchy, USPC's assets at fair value as of June 30, 2018.

	Level 1	Level 2	Level 3	Reported at NAV [(a)]	Total
Money market	$ 5,730,820	$ —	$ —	$ —	$ 5,730,820
Asset-backed securities	—	2,767,680	—	—	2,767,680
Corporate bonds	611,852	13,391,085	—	—	14,002,937
Mutual funds	135,559,847	—	—	—	135,559,847
Government obligations	4,551,707	3,174,412	—	—	7,726,119
Mortgage-backed securities	—	229,130	—	—	229,130
Transamerica 457(b) plan	2,509,285	—	—	—	2,509,285
Alternative investments	—	—	—	15,360,608	15,360,608
Total investments	$148,963,511	$ 19,562,307	$ —	$15,360,608	$183,886,426

The following table sets forth by level within the fair value hierarchy, USPC's assets at fair value as of June 30, 2017.

	Level 1	Level 2	Level 3	Reported at NAV [(a)]	Total
Money market	$ 9,515,863	$ —	$ —	$ —	$ 9,515,863
Asset-backed securities	435,076	2,145,220	—	—	2,580,296
Corporate bonds	950,229	3,838,481	—	—	4,788,710
Mutual funds	91,384,342	—	—	—	91,384,342
Government obligations	3,174,297	3,777,406	—	—	6,951,703
Mortgage-backed securities	—	673,405	—	—	673,405
Transamerica 457(b) plan	2,354,409	—	—	—	2,354,409
Alternative investments	—	—	—	11,989,231	9,515,863
Total investments	$107,814,216	$ 10,434,512	$ —	$11,989,231	$130,237,959

Below is a summary of the investment objectives of the alternative investment as well as any restrictions on that investment.

(a) *Hedge Fund:* This security invests in long/short term equity hedge funds, which typically comprise 70% –85% of the total portfolio; the balance of the portfolio is invested opportunistically, which may include, but is not limited to, distressed/credit sector or commodity-related funds, or other thematic investment opportunities. Written notice of partial or full withdrawal/redemption requests must be received by March 15th for a June 30th redemption and December 15th for a December 31st redemption.

NOTE F—PROPERTY AND EQUIPMENT - NET

USPC property and equipment consisted of the following at June 30:

2018	Cost	Accumulated Depreciation	Net
Land	$ 9,389,846	$ —	$ 9,389,846
Buildings and improvements	158,530,507	(42,003,929)	116,526,578
Furniture and equipment	58,676,828	(39,152,316)	19,524,512
Computer hardware and software	42,806,778	(34,995,833)	7,810,945
Assets not in service	3,688,804	—	3,688,804
Total	$ 273,092,763	$ (116,152,078)	$ 156,940,685

2017	Cost	Accumulated Depreciation	Net
Land	$ 9,389,846	$ —	$ 9,389,846
Buildings and improvements	158,249,209	(37,488,622)	120,760,587
Furniture and equipment	59,274,610	(35,129,418)	24,145,192
Computer hardware and software	40,140,297	(30,832,605)	9,307,692
Assets not in service	2,909,365	—	2,909,365
Total	$ 269,963,327	$ (103,450,645)	$ 166,512,682

Depreciation and amortization of fixed assets was $16,426,529 and $15,065,886 for the years ended June 30, 2018 and 2017, respectively.

NOTE G—LONG-TERM DEBT

On March 29, 2012, USPC borrowed the proceeds of MEDCO's economic development revenue refunding bond Series 2012 for $109,360,000. Proceeds of the borrowing were used to refinance the $98,650,000 under Series 2008 Note Series 2008A and B, $10,600,000 under Series 2009 and a prepayment cost of $110,000. The Series 2012 Bond carries a fixed interest rate of 3.46%. The interest rate was amended in 2018 as a result of the changes in the corporate tax rate structure. The bond requires interest only payments through June 30, 2018 with scheduled annual principal payments commencing July 1, 2019. Final payment on the bond is due July 1, 2038. The outstanding principal balance for the years ending June 30, 2018 and 2017 was $109,360,000 and $109,360,000, respectively. Additionally, the balance of unamortized debt financing costs related to the MEDCO bond were $732,145 and $851,818 as of June 30, 2018 and 2017, respectively. Total interest incurred for the years ending June 30, 2018 and 2017 was $3,490,771 and $3,177,364, respectively.

On March 29, 2012, USPC entered into a $7,925,000 term loan agreement with JP Morgan Chase Bank, N.A. The proceeds of the loan were used to refinance the outstanding $6,890,000 2008 term loan, that was issued to finance the termination of the interest rate swap, and the costs associated with refinancing USPC's debt. The 2012 USPC term loan carries a variable interest rate of LIBOR plus 0.85%. The note has scheduled quarterly principal payments commencing on July 1, 2012 with the final payment due July 1, 2018. The outstanding balance for the years ending June 30, 2018 and 2017 was $335,183 and $1,660,300 respectively. Total interest incurred for both the years ending June 30, 2018 and 2017 was $19,126 and $34,274, respectively.

On March 29, 2012, USP Holding LLC entered into a $6,300,000 term loan agreement with JP Morgan Chase Bank, N.A. The proceeds of the loan were used to refinance the outstanding $6,300,000 borrowed for the expansion of the USP India operation. The 2012 USP Holding Term Loan carries a variable interest rate of LIBOR plus 0.85%. In May 2013, an additional drawdown of $17,000,000 was executed to support the build out of the USP China II headquarters and laboratory space in the Shanghai Waigaogiao Free Trade Zone. The note has scheduled quarterly principal payments commencing on July 1, 2012 with the final payment due July 1, 2018. The outstanding balance for the years ending June 30, 2018 and 2017 was $1,061,776 and $5,275,725, respectively. Total interest incurred for the years ending June 30, 2018 and 2017 was $60,676 and $108,321, respectively.

The three loans above are collateralized by a security interest in USPC's revenues and the Deed of Trust in the real estate records of Montgomery County, Maryland.

There are covenant requirements associated with these loans which USPC was in compliance with as of June 30, 2018 and 2017.

NOTE G—LONG-TERM DEBT—Continued

Minimum future maturities and sinking fund requirements under long-term debt are as follows:

Year ending June 30,	Principal Amount
2019	$ 1,396,959
2020	4,115,000
2021	4,225,000
2022	4,360,000
2023	4,485,000
Thereafter	92,175,000
Total	$110,756,959

NOTE H—COMMITMENTS AND CONTINGENCIES

Leases

In October 2005, USP Holding, LLC entered into a cancelable operating lease for office space in Basel, Switzerland. USPC renewed the lease for an additional term of five years and it was set to expire in September 2015. In February 2015, the lease was renewed for an additional five year term and expires in September 2020. There is a renewal option of an additional five years as long as written notice to renew is provided by March 31, 2019. Monthly rent payments are approximately $2,635.

In October 2007, USP Brazil entered into a non-cancelable lease for laboratory and office space in Sao Paulo (Alphaville), Brazil. The lease is for a term of five years and was renewed in September 2012 for an additional term of five years to expire in September 2017. Monthly lease payments are approximately $24,340 and can be adjusted annually according to the monthly percentage variance of the IPCA-IBGE rate in Brazil every October. USP Brazil may terminate the lease with at least sixty days written notice and with paying liquidated damages equal to three months' rent. In June 2017, USP Brazil renewed the lease for an additional five years through June 2022 and the terms and conditions are similar except for receiving a 10% discount in rental payments per month for renewing three months earlier than expected.

NOTE H—COMMITMENTS AND CONTINGENCIES—Continued

In June 2008, USP India entered into a cancelable operating lease agreement with ICICI Knowledge Park for 4.17 acres of land for future site expansion. This lease agreement is for a period of 33 years and is renewable for another 18 years. All sums paid are being expensed over the term of the lease.

In August 2010, USPC entered into a non-cancelable operating lease for office space in Addis Ababa, Ethiopia. The lease was renewed in August 2016 and expires in August 2018. Additionally, the lease was renewed in January 2018 and expires in September 2019. Monthly lease payments are approximately $1,070.

In March 2011, USP India entered into a cancelable operating lease agreement with ICICI Knowledge Park for 1.45 acres of land for the purpose of construction of future site expansion. This lease agreement is for a period of 33 years and is renewable for future periods as mutually agreed to by the parties. All sums paid are being expensed over the term of the lease.

In June 2011, USPC entered into a non-cancelable operating lease for additional warehousing located in Frederick, Maryland. This site will also serve as an emergency distribution and back up office space. The lease is for a term of fifteen years with a renewal option for an additional five years. Rental payments for the first calendar year following commencement of the lease are $22,507 per month. In June 2015, USPC signed a Second Amendment to this lease in order to rent additional space to be utilized for Customer Service, Distribution, and Reference Standard Production. The new lease term is for fifteen years and expires in May 2021. Monthly lease payments are approximately $92,427 per month. This lease agreement includes a tenant improvement allowance of $4,211,736. The tenant improvement allowance balance was $3,626,773 and $3,907,555 as of June 30, 2018 and 2017, respectively. The allowance utilized is included within deferred rent and is being amortized on a straight-line basis over the lease term as a reduction to rent expenses.

In February 2012, USP India entered into a cancelable operating lease agreement with ICICI Knowledge Park for 3.468 acres of land for the purpose of future site expansions. In 2018 USP India gave back 1.5 acres of land and reduced the lease to 1.968 acres. USP India received $104,779 as a result of the 1.5 acres of land that was given back. This lease agreement is for a period of 33 years and is renewable for future periods. All sums paid are being expensed over the term of the lease.

NOTE H—COMMITMENTS AND CONTINGENCIES—Continued

Leases—Continued

In August 2012, USPC entered into a non-cancelable operating lease for additional office space in Rockville, Maryland, located directly behind the USPC headquarters building. This site is approximately 29,890 square feet of space that will serve as office space for operational functions as well as additional laboratory space. The lease is for a term of ten years with one renewal option for five additional years. Rental payments for the first calendar year following commencement of the lease are $28,645 per month as USPC received eighteen months of discounted rent under the lease terms escalating to $58,858 per month with an annual escalation clause of 2.75% thereafter. On March 15, 2018, USPC signed a First Amendment to this lease which reduced the term of the lease and resulted in an increase in the monthly lease payments. In addition to the monthly rent increase, USP also recognized a penalty related to the change in the amount of $377,062 per the terms and conditions of the lease agreement. The new lease term expires in November 2020.

In January 2013, USP Ghana entered into an operating lease of office and laboratory space in Accra, Ghana. The lease is for a term of three years and was due to be terminated in December 2015. Monthly lease payments were approximately $17,918 per month. In January 2016, the lease was renewed for an additional two years and expires in December 2017. In December 2017, the lease was renewed for an additional one year and expires in December 2018. Monthly lease payments are approximately $6,622.

In May 2014, USP China I entered into a non-cancelable operating lease for additional office space in Shanghai, China for term of two years. Rent payments are approximately $326 per month for the life of the lease. In August 2014, USP China II entered into a non-cancelable operating lease for additional office space in Shanghai, China for a term of three years. In August 2018, USP China II renewed the existing lease for 12 months. Monthly rent payments are approximately $4,077.

In September 2014, USPC entered into an operating lease for office space in Lagos, Nigeria. In September 2016, the lease was renewed to expire in August 2017. Prior to expiration, in June 2017, the operating lease was renewed for a term of one year and expires in August 2018. In August 2018, the operating lease was renewed for a term of one year and expires in August 2019. Monthly lease payments are approximately $1,675.

In June 2015, USP Indonesia entered into a non-cancelable operating lease for office space in Jakarta, Indonesia which expired in December 2016. In January 2017, the lease was renewed for an additional seven months and expired in July 2017. In June 2017, the lease was combined with the lease entered into by USP Indonesia in March 2017. The combined lease is set to expire in September 2019. Monthly lease payments are approximately $5,760.

NOTE H—COMMITMENTS AND CONTINGENCIES—Continued

Leases—Continued

In July 2015, USP Philippines entered into a non-cancelable operating lease for office space in Manila, Philippines for two years which expired in June 2017. In June 2017, USP Philippines renewed the existing lease for three months which expired in September 2017 and has not been renewed. Monthly lease payments were approximately $1,225.

In January 2016, USPC entered into an assignment and assumption of sublease agreement for additional office space in Rockville, Maryland located next to the USPC headquarters building for eight months which expired in August 2016. Monthly lease payments are approximately $31,952 per month. In June 2016 USPC entered into a non-cancelable operating lease for the same space with a term of eleven years which expires in October 2027. The terms of the lease agreement provide for an abatement of rent for a total of 14 months, from September 2016 to October 2017. As such, in accordance with the lease agreement, there were no lease payments made in 2017 for this time period. Also included in this lease agreement is a tenant improvement allowance of $1,327,950. The tenant improvement allowance balance was $1,109,928 and $1,228,849 as of June 30, 2018 and 2017, respectively. The allowance utilized is included within deferred rent and is being amortized on a straight-line basis over the lease term as a reduction of rent expenses.

In June 2016, USPC entered into a non-cancelable operating lease in Washington D.C. in order to secure office space in close proximity to many of its key stakeholders. The lease term is for five and one-half years and expires in November 2021. Monthly lease payments are approximately $8,263.

In May 2017, USPC entered into a non-cancelable operating lease for office space in Dhaka, Bangladesh for 28 months which expires in September 2019. Monthly lease payments are approximately $1,429.

In July 2017, USP Singapore entered into a non-cancelable operating lease for office space in Singapore for two years which expires in June 2018. Prior to expiration, in May 2018, USP Singapore renewed its existing lease for 14 months which expires in June 2019. Monthly lease payments are approximately $7,221.

Rent expense for the years ended June 30, 2018 and 2017 was $4,102,864 and $4,349,611, respectively.

NOTE H—COMMITMENTS AND CONTINGENCIES—Continued

Leases—Continued

Minimum future rental payments under these non-cancelable leases are as follows:

Year ending June 30,	**Amount**
2019	$ 3,662,001
2020	3,531,140
2021	2,854,992
2022	2,442,592
2023	2,208,286
Thereafter	15,748,058
Total	$ 30,426,771

Health and Retirement Plans

USPC sponsors a 401(k), defined contribution plan, which covers substantially all U.S. based employees of USPC. These employees are eligible for the plan after working for at least 1,000 hours in a plan year, completing one year of service and attaining age twenty-one. USPC contributes an amount equal to ten percent (10%) of each employee's compensation of such plan year.

USPC established a nonqualified deferred compensation 457(f), Supplemental Executive Retirement Plan (SERP), on August 1, 1994, for the purpose of making additional retirement plan contributions to eligible staff on their earnings in excess of the Internal Revenue Code limit under Section 401(a)(17) of the Code. Key features of the plan are initial and subsequent vesting. Participants initially vest when they reach age 50, complete 5 years of services and accumulate at least $25,000 in their respective account. USPC pension expense for the 401(k) and 457(f) plans for the years ended June 30, 2018 and 2017 was $8,692,804 and $8,010,746, respectively.

USPC established a deferred compensation plan on July 1, 2007 in accordance with the requirements under the Internal Revenue Code Section 457(b). Participation in the plan is limited to employees who hold positions of Vice President or higher. Participants may contribute the lesser of 100% of compensation or the maximum dollar amount permitted of $18,500 for 2018, as well as an additional $6,000 if participants over age 50. Participants are fully vested in the Plan upon entry. For the years ending June 30, 2018 and 2017, the market value of the plan was $2,509,285 and $2,354,409, respectively.

NOTE H—COMMITMENTS AND CONTINGENCIES—Continued

Health and Retirement Plans—Continued

USPC's U.S. group health benefits are self-insured for claims up to $175,000, per participant per plan year. USPC carries stop-loss coverage for claims in excess of $175,000 per participant, per plan year. In FY16 the plan included one exception for a single member participant with an individual stop loss (ISL) amount set at $500,000 for the plan year.

Line of Credit

On March 29, 2012, USPC entered into a revolving line of credit agreement with JP Morgan Chase, N.A. for $7,000,000. Under the terms of this agreement interest on any outstanding balance is payable at LIBOR plus 0.40% on a monthly basis; the agreement also includes a commitment fee of 0.10% on the daily average unused amount of the revolver that is payable quarterly. The agreement is renewable annually and USPC must fully pay down any outstanding balance at maturity, March 29, 2019. At June 30, 2018 and 2017, USPC did not have an outstanding balance on the revolving line of credit.

Contingencies

In the normal course of business, USPC may from time to time be subject to various claims and lawsuits. Certain lawsuits may be covered, in full or in part, by external insurance coverage. In the opinion of management, there are no lawsuits outstanding that would have a material adverse effect on the consolidated financial statements of USPC. Additionally, USPC voluntarily disclosed concerns relating to possible misconduct by a former employee to USAID. For the year ended June 30, 2018 this matter is still being reviewed by USAID.

NOTE I—CONTRIBUTED SERVICES

The utilization of volunteers is fundamental to USPC's mission and product development. For the years ended June 30, 2018 and 2017, a total of 797 and 779 volunteers, respectively, have made significant contributions of time. These volunteers are composed of health care practitioners, academicians, and other professionals. The value of these volunteer services has been computed by multiplying the average number of hours per volunteer with the number of volunteers and a rate per hour equal to that of a qualified employee who would have been paid for their services. The value of these contributed services is reflected in the accompanying statement of activities as both program revenue and expense in the amount of $15,465,011 and $15,479,399, for the years ended June 30, 2018 and 2017, respectively.

NOTE J—SUBSEQUENT EVENTS

USPC evaluated all events and transactions from July 1, 2018 through November 14, 2018, the date in which the consolidated financial statements were available for release. Management is not aware of the any subsequent events which would require recognition or disclosure in the consolidated financial statements.