

**PHI**

**Consolidated Financial Statements**

**December 31, 2004 and 2003**

**(With Independent Auditor's Report Thereon)**

# **PHI**

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RETIREMENT AND SENIOR  
CARE SERVICES

1217 Slate Hill Road • Camp Hill, Pennsylvania 17011

**Certification of Chief Executive and Chief Financial Officers**

We are responsible for the financial statements and supporting information of PHI, as of December 31, 2004 and 2003, and attest that they are accurate, complete and fairly presented.

The accuracy and completeness of financial information depends on our systems, process, and most importantly our integrity. Our commitment to integrity is reflected in the code of conduct that the leadership of PHI has established as the standard for the entire organization. We believe that this commitment, our processes and internal controls produce financial information that can be trusted.

Financial statements report our financial position and results using numbers and prescribed rules. They also include a significant amount of information that is required by financial reporting standards. We believe these financial statements disclose information that is important to create a complete picture of our stewardship of financial resources.

Financial statements alone can never reflect the breadth and depth of our stewardship of this ministry. They do not report on our most significant assets, our employees and volunteers. They also do not reflect our most important stewardship role; our commitment to provide Christian understanding and compassion to those seniors entrusted to our care. We believe that we continue to successfully fulfill the financial and non-financial aspects of our mission, extending a proud tradition of ministry that has served older persons in the name of Christ for the past 77 years.

Finally, we believe in openly and honestly sharing information. Please feel free to contact either of us if you have questions on any part of this report, or if we can be of further assistance in understanding PHI's mission.

A handwritten signature in black ink, appearing to read "Stephen Proctor".

Stephen Proctor  
Chief Executive Officer  
PHI

A handwritten signature in black ink, appearing to read "Jeffrey J. Davis".

Jeffrey J. Davis  
Chief Financial Officer  
PHI

Phone (717) 737-9700 • (800) 382-1385 • Fax (717) 763-7617

Presbyterian Homes, Inc. • Presbyterian Housing & Services Corporation • Presbyterian Senior Living Services, Inc.  
Presbyterian Apartments, Inc. • Geneva House, Inc. • Continuing Care Rx

[www.phihomes.org](http://www.phihomes.org)

## **Independent Auditor's Report**

The Board of Trustees  
PHI:

We have audited the accompanying consolidated statements of financial position of PHI and affiliates (collectively the Corporation), as of December 31, 2004 and 2003, and the related consolidated statement of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Geneva House, Inc., and Presbyterian Apartments, Inc., affiliates of PHI, which statements reflect total assets constituting 1.09 and 1.23 percent and total revenues constituting .57 and .92 percent, of the related 2004 and 2003 consolidated totals, respectively. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for Geneva House, Inc., and Presbyterian Apartments, Inc. is based solely on the reports of the other auditors.

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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PHI and affiliates as of December 31, 2004 and 2003 and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Beard Miller Company LLP*

Lancaster PA  
February 23, 2005

**PHI**

Consolidated Statements of Financial Position

December 31, 2004 and 2003

Assets	2004	2003
Current assets:		
Cash and cash equivalents	\$ 2,492,531	4,098,528
Investments	57,097,770	29,293,698
Accounts receivable, net	6,037,855	10,076,711
Assets whose use is limited - current portion	1,141,075	1,177,213
Pledges receivable, current portion	138,000	123,922
Interest receivable	162,519	182,278
Inventory	179,855	2,409,421
Prepaid expenses and other current assets	1,111,885	1,068,071
Total current assets	68,361,490	48,429,842
Assets whose use is limited, net of current portion	10,208,050	9,962,848
Assets whose use is limited, construction funds held by trustee	3,503,982	9,927,751
Pledges receivable, net of current portion	893,632	1,012,699
Property and equipment (net of accumulated depreciation of \$99,292,095 and \$92,057,494)	148,370,868	146,328,745
Assets held in trust by others	7,547,865	6,771,590
Unamortized deferred costs:		
Deferred marketing costs, net of accumulated amortization of \$2,148,786 and \$1,741,496	365,786	773,076
Deferred financing costs, net of accumulated amortization of \$754,771 and \$562,978	3,655,915	3,961,662
Goodwill, net of accumulated amortization of \$21,737	-	194,950
Other assets	7,942	34,901
Total assets	\$ 242,915,530	227,398,064

See accompanying notes to consolidated financial statements.

**PHI**

## Consolidated Statements of Financial Position

December 31, 2004 and 2003

<b>Liabilities and Net Assets (Liabilities)</b>	<b>2004</b>	<b>2003</b>
Current liabilities:		
Accounts payable	\$ 6,156,798	8,829,868
Swap termination fee payable	—	1,795,000
Accrued expenses - other	9,148,777	7,462,646
Notes payable	487,320	5,228,136
Current portion of annuities payable	154,150	136,922
Accrued interest	718,821	641,600
Current maturities of long-term debt	3,395,730	2,870,846
Total current liabilities	20,061,596	26,965,018
Resident deposits	1,278,625	1,717,217
Deferred revenue - entrance fees	61,947,548	62,067,004
Deferred revenue - other	—	129,801
Fair value of interest rate hedges	214,607	705,573
Annuities payable	908,249	801,120
Long-term debt, less current maturities:	135,270,884	138,656,096
Total liabilities	219,681,509	231,041,829
Net assets (liabilities):		
Unrestricted	10,973,296	(16,067,488)
Temporarily restricted	3,056,320	3,793,923
Permanently restricted	9,204,405	8,629,800
Total net assets (liabilities)	23,234,021	(3,643,765)
Total liabilities and net assets (liabilities)	\$ 242,915,530	227,398,064

See accompanying notes to consolidated financial statements.

**PHI**

Consolidated Statements of Activities

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Revenues, gains, and other support:		
Resident services, including amortization of entrance fees of \$7,079,220 and \$7,743,552	\$ 98,067,873	93,628,986
Sales of other services and materials	52,405	283,045
Net rental income	1,270,963	1,213,328
Interest and dividend income	1,811,360	1,382,257
Realized gains (losses) on investments	728,698	(123,792)
Gifts and bequests	1,449,253	672,667
Net assets released from restrictions	1,335,284	342,139
Total revenues, gains, and other support	<u>104,715,836</u>	<u>97,398,630</u>
Expenses:		
Nursing services	29,607,356	29,667,823
Rehabilitation	3,024,715	3,055,841
Recreation and special services	3,051,331	3,076,144
Pharmacy	215,462	140,379
Social services	396,242	384,198
Physician services	261,345	232,469
Food services	11,688,528	11,341,585
Building operations and maintenance	10,660,951	9,883,232
Housekeeping	2,798,250	2,781,485
Laundry and linen	1,174,286	1,139,606
General and administrative	16,219,541	14,427,349
Employee benefits	6,902,762	5,073,073
Interest	6,106,910	6,897,527
Depreciation	8,409,126	8,444,409
Amortization	750,190	603,419
Change in fair value of interest rate hedges	(490,967)	(2,574,626)
Loss on extinguishment of debt	-	76,944
Realized loss on interest rate swap termination	-	1,795,000
Change in estimated life of goodwill	-	1,734,123
Total expenses	<u>100,776,028</u>	<u>98,179,980</u>
Change in unrestricted net assets (liabilities) before unrealized gains on investments, gain (loss) on discontinued operations	<u>3,939,808</u>	<u>(781,350)</u>
Unrealized gains on investments	49,025	1,203,060
Gain (loss) on discontinued operations	23,051,951	(1,687,197)
Change in unrestricted net assets (liabilities)	<u>27,040,784</u>	<u>(1,265,487)</u>

See accompanying notes to consolidated financial statements.

(Continued)

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Consolidated Statements of Activities

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Temporarily restricted net assets:		
Contributions, grants and bequests	338,189	1,771,602
Interest and dividend income	46,991	72,005
Unrealized gain on investments	212,501	84,454
Net assets released from restrictions	<u>(1,335,284)</u>	<u>(342,139)</u>
Change in temporarily restricted net assets	<u>(737,603)</u>	<u>1,585,922</u>
Permanently restricted net assets:		
Contributions	279,463	433,884
Change in fair value of assets held in trust by others	<u>295,142</u>	<u>228,503</u>
Change in permanently restricted net assets	<u>574,605</u>	<u>662,387</u>
Change in net assets (liabilities)	26,877,786	982,822
Net liabilities, beginning of year	<u>(3,643,765)</u>	<u>(4,626,587)</u>
Net assets (liabilities), end of year	<u>\$ 23,234,021</u>	<u>(3,643,765)</u>

See accompanying notes to consolidated financial statements.



PHI

Consolidated Statements of Cash Flows

Years ended December 31, 2004 and 2003

	2004	2003
Cash flows from operating activities:		
Change in net assets (liabilities)	\$ 26,877,786	982,822
Adjustments to reconcile change in net assets (liabilities) to net cash provided by operating activities:		
Depreciation	8,409,126	8,444,409
Proceeds from entrance fees and deposits	13,373,186	13,306,217
Amortization of entrance fees	(7,079,220)	(7,743,552)
Realized gains on sale of fixed assets	—	(438,619)
Loss on extinguishment of debt	—	76,944
Change in assets held in trust by others	(481,133)	(429,082)
Change in fair value of interest rate hedges	(490,967)	(779,626)
Unrealized gains on investments and change in fair value of assets held in trust	(556,668)	(1,516,017)
Realized (gains) losses on investments	(728,698)	123,792
Realized loss on interest rate swap	—	(1,795,000)
Realized gain on sale of property, plant and equipment	(20,258,500)	—
Contributions restricted for long-term purposes	(279,463)	(433,884)
Amortization of deferred costs	713,038	561,813
Amortization of bond discount	42,377	41,606
Change in estimated life of goodwill	—	1,734,123
Changes in assets and liabilities:		
Decrease in accounts receivable	4,038,856	277,946
Decrease (increase) in pledges receivable	104,989	(1,136,621)
Decrease in other assets	2,427,420	209,844
(Decrease) increase in accounts payable	(2,673,070)	782,757
Swap termination fee payable	(1,795,000)	1,795,000
Increase in accrued expenses and deferred revenue-other	1,633,552	1,030,366
Net cash provided by operating activities	23,277,611	15,095,238
Cash flows from investing activities:		
Acquisition of property and equipment, net of disposals	(15,692,749)	(7,339,751)
Net proceeds from sale of property and equipment	25,500,000	4,007,318
Purchases of investments	(67,064,973)	(15,359,042)
Proceeds from sale of investments	40,233,037	12,318,946
Financing costs incurred	—	(1,568,729)
Cash provided by (used in) assets whose use is limited	6,232,793	(11,955,652)
Net cash used in investing activities	(10,791,892)	(19,896,910)

See accompanying notes to consolidated financial statements.

(Continued)

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Consolidated Statements of Cash Flows

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(6,852,013)	(5,721,296)
Principal payments on and redemptions of long-term debt	(2,902,707)	(17,896,035)
Proceeds from issuance of long-term debt	—	30,698,694
Net repayments of notes payable	(4,740,816)	(1,751,449)
Contributions restricted for long-term purposes	279,463	433,884
Decrease in annuities payable	124,357	222,587
Net cash (used in) provided by financing activities	<u>(14,091,716)</u>	<u>5,986,385</u>
Net (decrease) increase in cash and cash equivalents	(1,605,997)	1,184,713
Cash and cash equivalents, beginning of year	<u>4,098,528</u>	<u>2,913,815</u>
Cash and cash equivalents, end of year	<u>\$ 2,492,531</u>	<u>4,098,528</u>

Supplemental disclosure of noncash investing and financing activities:

During 2003, the Corporation refunded the Kent County Series 1996, Series 1998 and Series 1999 bonds by issuing the \$10,000,000 Series 2003 bonds.

See accompanying notes to consolidated financial statements.

# PHI

## Notes to Consolidated Financial Statements

December 31, 2004 and 2003

### (1) General Information

PHI (Corporation), a not-for-profit corporation, is the parent corporation of Presbyterian Homes, Inc., Presbyterian Housing and Services Corporation (PHSC), Presbyterian Senior Living Services, Inc. (PSLSI), Presbyterian Apartments, Inc. (PAI), and Geneva House, Inc. (GHI), which are 100 percent controlled affiliates of PHI. The Corporation also owns 46 percent of Prelude Systems, Inc., a technical services organization, and owns 10 percent of a limited liability corporation called Alliance Rehab HVA, LLC. (Note 5). The Corporation serves as a management company for the above affiliates and is governed by a Board of Trustees. Some of the members of the Board of Trustees are also members of the Board of Directors of certain affiliate corporations. The Corporation provides management services to its various affiliates, which do business primarily in Pennsylvania, but also in Maryland, Ohio and Delaware. The Corporation owned 100 percent of Continuing Care Rx, Inc. during 2003. In December 2004, the Corporation sold its ownership in Continuing Care Rx.

The following table details the number of beds/units that operate under each entity:

	<u>Total</u>	<u>Pres. Homes</u>	<u>PHSC</u>	<u>PSLSI</u>	<u>PAI</u>	<u>GHI</u>
Nursing beds	768	677	60	31	—	—
Assisted living units	310	248	33	29	—	—
Independent living units	814	438	164	212	—	—
HUD housing units	<u>228</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>164</u>	<u>64</u>
Total	<u>2,120</u>	<u>1,363</u>	<u>257</u>	<u>272</u>	<u>164</u>	<u>64</u>

### (2) Summary of Significant Accounting Policies

#### (a) Basis of Accounting

These consolidated financial statements have been prepared to focus on the Corporation as a whole. All material intercompany transactions have been eliminated.

These financial statements, which are presented on the accrual basis of accounting, have been prepared to focus on the Corporation as a whole and to present balances and transactions according to the existence or absence of donor-imposed restrictions.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law.

## **PHI**

### **Notes to Consolidated Financial Statements**

December 31, 2004 and 2003

**(b) *Temporarily and Permanently Restricted Net Assets***

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. Net assets released from restriction consist of expenses incurred satisfying those restricted purposes. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity, the interest and dividend income from which is used for the charitable purpose.

**(c) *Donor Restrictions***

The Corporation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or the purpose to which the donation is restricted is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the accompanying financial statements.

The Corporation reports non-cash gifts as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Corporation reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Contributions, including unconditional promises to give, are recognized as revenues when the promise to give is first made. Conditional promises to give are not recognized until they become unconditional, that is when the conditions upon which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value as of the date of contribution.

**(d) *Cash and Cash Equivalents***

The Corporation considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents for purposes of the statements of cash flows. At times during the years ended December 31, 2004 and 2003, cash balances may have exceeded the federally insured limit of \$100,000.

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Notes to Consolidated Financial Statements

December 31, 2004 and 2003

**(e) Accounts Receivable**

Accounts receivable are shown net of an estimated allowance for doubtful accounts, as follows:

	<u>2004</u>	<u>2003</u>
Total accounts receivable	\$ 6,992,793	11,812,492
Less: allowance for doubtful accounts	<u>(954,938)</u>	<u>(1,735,781)</u>
Net accounts receivable	<u>\$ 6,037,855</u>	<u>10,076,711</u>

The allowance for doubtful accounts is established based on management's assessment of the collectibility of specific resident's accounts and the aging of accounts receivable.

**(f) Pledges Receivable**

During 2003, a pledge was made to Presbyterian Homes, Inc. for \$1,500,000. As of December 31, 2004, the organization has received \$202,000 of the gift and the remaining balance will be paid over the next eight years. The Corporation recorded this pledge at the net present value less a discounted uncollectible amount of 5%.

	<u>2004</u>	<u>2003</u>
Pledges receivables	\$ 1,298,000	1,448,219
Less: unamortized discount	<u>(224,526)</u>	<u>(266,566)</u>
Subtotal	1,073,474	1,181,653
Less: allowance for uncollectibles	<u>(41,842)</u>	<u>(45,032)</u>
Net pledges receivables	<u>\$ 1,031,632</u>	<u>1,136,621</u>

Pledges receivable as of December 31, 2004 is as follows:

Amounts due in:	
Less than one year	\$ 150,000
One to five years	750,000
More than five years	<u>398,000</u>
	<u>\$ 1,298,000</u>

**(g) Statements of Cash Flows**

Interest paid during the years ended December 31, 2004 and 2003 was \$6,025,673 and \$6,888,484, respectively. Interest of \$133,717 and \$341,400 was capitalized in 2004 and 2003, respectively. Purchases of assets under capital lease arrangements during the year ended December 31, 2004 and 2003 were \$0 and \$118,316, respectively. Cash paid for income taxes during the years ended December 31, 2004 and 2003 were \$1,747,035 and \$1,222,934, respectively.

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Notes to Consolidated Financial Statements

December 31, 2004 and 2003

**(h) *Deferred Costs***

The Corporation has deferred the marketing costs incurred in connection with acquiring initial continuing care contracts for its independent living facilities. When the independent living units are substantially occupied, these costs are amortized on a straight-line basis over a period approximating the average life expectancy of the initial residents occupying the units.

The Corporation has deferred the costs incurred for obtaining the proceeds of its long-term debt arrangements. These costs are being amortized over the term of the related financings using the straight-line method which approximates the effective interest method.

**(i) *Property and Equipment***

Property and equipment are stated at cost or, if donated, at fair market value on the date of donation. The Corporation's policy is to capitalize items in excess of \$1,500 or for a group of items totaling \$2,000 or more. Depreciation is being provided on the straight-line method over the estimated useful lives of the assets.

Depreciable lives are determined as follows:

Land improvements	15-25 years
Buildings and improvements	10-45 years
Departmental equipment, furniture and fixtures	5-25 years
Furniture	5-15 years
Vehicles	5 years

**(j) *Investments***

Investments in marketable equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statements of financial position. A decline in market value of any investment below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to realized loss and a new cost basis for the investment is established. For the years ended December 31, 2004 and 2003, no amounts were charged to realized loss.

**(k) *Inventories***

Inventories consist of medical and dietary supplies. Inventory is valued at the lower of cost or market using the first-in, first-out method of inventory costing.

**(l) *Assets Held in Trust by Others***

The Corporation has been named as a beneficiary of several trusts which are administered and controlled by independent trustees. The trusts are recorded as contribution revenue when the Corporation is notified of the trust's existence. The Corporation receives the earnings from these trusts whose principal is to be held in perpetuity. The earnings from the trust are reported as investment income, increasing unrestricted net assets.

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Notes to Consolidated Financial Statements

December 31, 2004 and 2003

**(l) Assets Held in Trust by Others (continued)**

Assets held in trust by others are valued at the estimated fair value of the underlying investments. The change in the fair value of assets held in trust by others is reported as permanently restricted unrealized gains or losses on investments.

Also included in funds held in trust by others are contributions receivable from charitable remainder trusts that are held by independent trustees. Periodic payments are made to annuitants and the remaining corpus will revert to the Corporation upon the death of the annuitant. These annuities are recorded at the present value of the annuity amount discounted at the contract rate over the estimated remaining life of the annuitant.

A summary of these funds at December 31 is as follows:

	<u>2004</u>	<u>2003</u>
Assets held in trust by others	\$ 6,469,220	5,956,725
Contributions receivable from remainder trusts	<u>1,078,645</u>	<u>814,865</u>
	<u>\$ 7,547,865</u>	<u>6,771,590</u>

**(m) Costs of Borrowing**

Interest cost incurred on borrowed funds less interest income on these funds during the period of construction of capital assets is capitalized as a component of construction-in-progress. Interest of \$133,717 and \$341,400 was capitalized in 2004 and 2003, respectively.

**(n) Assets Whose Use is Limited**

Assets whose use is limited primarily include assets held by a trustee under the terms of various bond indentures. Amounts required to meet current obligations of the Corporation have been reclassified in the statement of financial position as current assets.

**(o) Deferred Revenue – Entrance Fees**

Entrance fees collected from residents at move-in pursuant to a resident and care agreement are initially recorded as deferred revenue. The non-refundable portion of the fees is amortized to income over the estimated remaining life expectancy of each resident. The portion of the fee refundable upon reoccupancy is amortized on a straight-line basis over the remaining useful life of the applicable facility. The agreements provide for potential death or termination refunds of the non-refundable portion if reoccupancy occurs before the contractual amortization is completed in accordance with the terms of the agreements. The remaining amount of unamortized, nonrefundable entrance fees is recorded as revenue upon a resident's death or termination of the contract. In November 2003, the Maryland Department of Aging approved for single residents both 25% nonrefundable and 50% nonrefundable entrance fee contracts. In January 2004, the Maryland Department of Aging approved both 25% nonrefundable and 50% nonrefundable entrance fee contracts to married couples. The Community has adopted these contracts for both single and married residents in 2004, in addition to continued use of the 100% refundable contract.

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Notes to Consolidated Financial Statements

December 31, 2004 and 2003

**(o) *Deferred Revenue – Entrance Fees (continued)***

The amount of entrance fees refundable to residents at December 31, 2004 and 2003 under contractual refund provisions was approximately \$53,884,000 and \$55,617,500, respectively.

**(p) *Resident Deposits***

Entrance fees and waiting list deposits received from prospective residents prior to occupancy under Residence and Care Agreements are included in resident deposits in the statement of financial position. These deposits are transferred to deferred revenue upon occupancy of the related units.

**(q) *Goodwill***

Goodwill, which represents the excess of purchase price over fair value of net assets acquired from Presbyterian Senior Services Inc., was being amortized on a straight-line basis over the expected period to be benefited. Generally accepted accounting standards require management to periodically evaluate amortization to determine whether later events and circumstances warrant revised estimates of useful lives. During 2003, it was determined that the goodwill had no remaining useful life and the remaining unamortized balance of \$1,734,123 was written off.

Goodwill, primarily arising from CCRx's original purchase of an existing business, was amortized on a straight-line basis over an estimated life of forty years. Due to the Company's adoption of Statement of Financial Accounting Standards No. 142 (SFAS 142), *Goodwill and Other Intangible Assets*, amortization of goodwill under the straight-line method ceased beginning January 1, 2002. In accordance with SFAS 142, the Company tested its goodwill annually for impairment losses. Based on the Company's testing, no impairment loss was recorded during the year ended December 31, 2003.

**(r) *Estimated Obligation to Provide Future Services to Continuing Care Residents***

At certain Continuing Care Retirement Communities, the Corporation provides health care coverage for certain residents under the terms of a Residence and Care Agreement. The Corporation annually estimates the present value of the net cost of future services and the use of facilities to be provided to current residents covered by Residence and Care Agreements and compares that amount to the balance of deferred entrance fees. If the present value of the net cost of future services and the use of facilities exceeds the deferred entrance fees, a liability is recorded (estimated obligation to provide future services to continuing care residents, in excess of amounts received or to be received). Management's assumptions used in the estimate may vary by facility. Assumptions made in these estimates include a 4% inflation rate for nursing costs, a 4% inflation rate for other operating costs, and 6% discount rate based on the approximate cost of borrowing for the Corporation. At December 31, 2004 and 2003, management's estimation resulted in no obligation in excess of recorded amounts to provide future services to continuing care residents.



## PHI

### Notes to Consolidated Financial Statements

December 31, 2004 and 2003

(s) ***Resident Services Revenue and Business Concentration***

Resident services revenue is reported at the estimated net realizable amount to be received from patients and others including Medicare, Delaware Medicaid, Maryland Medicaid and Pennsylvania Medicaid and other third party payors for services rendered. The Corporation derives a significant portion of its revenue from federal and state reimbursement programs with a significant majority of state reimbursement from Pennsylvania Medicaid. All of the skilled nursing facilities operated by the Corporation are certified to receive benefits under Medicare and Medicaid.

The reimbursement methodology for a variety of health care providers has changed significantly as a result of provisions contained in the Balanced Budget Act of 1997 ("Budget Act"). The Budget Act provides for a prospective payment system ("PPS") for Medicare reimbursement for skilled nursing services (rather than the retrospective cost-based methodology in place prior to July 1, 1998). Skilled nursing facilities are paid a federal per diem rate for covered services, which include routine and ancillary services and most capital-related costs. Medicare reimbursement is subject to audit and retroactive adjustment in future periods. In conjunction with PPS, consolidated billing for Medicare Part A Services is required for skilled nursing facilities. Under consolidated billing for Medicare Part A Services, facilities must bill Medicare for all of the services residents receive, including all therapy services.

Nursing services provided to Pennsylvania Medicaid beneficiaries are paid at prospectively determined rates per day. These rates vary according to a resident classification system that is based on clinical diagnostic and other factors and the reimbursement methodology is subject to various limitations and adjustments. The Corporation's current concentration of skilled nursing facilities in Pennsylvania exposes it to the risk of changes in Medicaid reimbursement in this state.

Nursing services provided to Maryland Medicaid beneficiaries are cost-reimbursed to the extent of established ceiling limits. These rates vary according to a resident classification system that is based on clinical diagnosis and other factors. The Corporation's existence in Maryland exposes it to the risk in Medicaid reimbursement in this state.

Revenues from Medicare and Pennsylvania, Maryland and Delaware Medicaid (Medicaid) represent approximately 40% of consolidated revenues for both 2004 and 2003. Medicare and Medicaid receivables represent approximately 54% of consolidated accounts receivable at both December 31, 2004 and 2003.

In January 2005, the Commonwealth of Pennsylvania (the State) received approval from the Federal Center for Medicare Services (CMS), to retroactively assess a nursing bed assessment for the State's July 1, 2003 to June 30, 2004 fiscal year. The assessment is \$1.50 a day for continuing care retirement community non-Medicare occupied beds, and \$15.91 a day for stand alone nursing facility non-Medicare occupied beds. As a part of this, nursing home providers received an additional supplement of \$10.66 a day, based on a number of factors, including their Medicaid utilization. The net effect of this assessment and supplement resulted in \$845,000 in additional revenues for the Corporation in 2004. This amount is scheduled to be paid by the State over the next few months, and is included in accounts receivable as of December 31, 2004.

**PHI**  
Notes to Consolidated Financial Statements  
December 31, 2004 and 2003

**(s) Resident Services Revenue and Business Concentration (continued)**

The status of the bed tax and supplement for the State's July 1, 2004 to June 30, 2005 fiscal year is uncertain, and therefore no provision has been made for the potential effects of such subsequent to July 1, 2004. In addition, the State has not released or committed to July 1, 2004 market basket and acuity rate adjustments, pending further decisions on the bed tax and supplements.

**(t) Fundraising Expenses**

Fundraising expenses incurred by the Corporation are included in general and administrative on the statement of activities.

**(u) Charity Care**

The Corporation provides care to residents, who meet certain criteria under its charity care policy, at amounts less than its established rates. Charity care is recorded as a reduction of revenue.

**(v) Tax Status**

PHI is tax exempt under Section 501(c)(3) of the Internal Revenue Code.

For the year ended December 31, 2003, CCRx's deferred income taxes were recorded in accordance with Financial Accounting Standards Board (FASB) Statement No. 109, "Accounting for Income Taxes," and result from temporary differences in recognition of income and expense for tax and financial statement purposes. The source of those temporary differences were related to depreciation methods, bad debt reserves, inventory reserves, accrued vacation, prepaid expenses and deferred compensation. CCRx had a deferred tax asset of \$43,452 for 2003. This amount was included in prepaid expense and other current assets.

**(w) Workers' Compensation**

Accrued expenses include a provision for estimated self-insured workers' compensation claims for both reported claims not yet paid and claims incurred but not reported.

**(x) Use of Estimates**

The preparation of 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 financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**(y) Advertising**

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2004 and 2003, was \$580,150 and \$459,270, respectively.

**PHI**

Notes to Consolidated Financial Statements

December 31, 2004 and 2003

(z) *Classification of Expenses*

	<u>2004</u>	<u>2003</u>
Program activities	\$ 85,047,454	84,532,258
General and administrative	15,571,958	13,894,845
Change in fair value of interest rate swap	(490,967)	(779,626)
Fundraising	<u>647,583</u>	<u>532,503</u>
	<u>\$ 100,776,028</u>	<u>98,179,980</u>

(aa) *Derivatives and Hedging Activities*

In accordance with Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities* as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, the Corporation recorded a liability of \$214,607, and \$705,573, representing the fair value (liability) of the swap as of December 31, 2004 and 2003, respectively. For 2004 and 2003, an adjustment to the liability was recorded causing a gain of \$490,967 and \$2,574,626, representing the decrease in the fair value (liability) of the swaps.

In December 2002, Statement of Position 02-2, *Accounting for Derivative Instruments and Hedging Activities by Not-for-Profit Health Care Organizations, and Clarification of the Performance Indicator*, (SOP 02-2) was issued. This statement clarifies that the performance indicator reported by not-for-profit health care organizations is analogous to income from continuing operations of a for-profit enterprise. The provisions of the statement are to be applied prospectively. The Corporation chose early adoption of the provisions of SOP 02-2 for the year ending December 31, 2003. At that time the Corporation chose not to elect hedge accounting for its derivative instruments.

All of the Corporations' interest rate swaps are carried at fair value (liability) as determined by a third party. Changes in fair value are reported in the consolidated statement of activities as a component of the change in net assets.

The terms of the various interest rate swaps are described in note 7.

In 2003, Presbyterian Senior Living Services, Inc. terminated two of the interest rate swaps. These swaps totaled approximately \$10,000,000, expired in 2010, and carried interest rates of 6.94% and 6.61%. Termination fees for these swaps were \$1,795,000.

# PHI

## Notes to Consolidated Financial Statements December 31, 2004 and 2003

### (ab) *Reclassification*

Certain amounts in the 2003 financial statements have been reclassified to conform with the 2004 financial presentation.

### (ac) *Performance Indicator*

The Corporation measures the performance of its operations using the statement of activities, which includes a performance indicator of operations labeled as “changes in unrestricted net assets (liabilities) before unrealized gains on investments, (loss) on discontinued operations.” Changes in unrestricted net assets which are excluded from this measure are: unrealized gains and losses on investments, gain (loss) on discontinued operations and other significant adjustments which do not directly indicate operational performance.

### (3) **Investments**

The cost and market value of investments at December 31 are as follows:

	<b>2004</b>		<b>2003</b>	
	<b>Market</b>	<b>Cost</b>	<b>Market</b>	<b>Cost</b>
Certificates of deposit	\$ 2,157,791	2,157,791	157,670	157,670
Money market funds	22,691,581	22,691,581	1,979,330	1,979,330
Marketable equity securities	19,233,607	12,800,158	8,924,146	6,432,835
Other equity securities	85,277	78,805	—	—
U.S. Government securities	9,149,373	9,214,484	12,515,480	12,531,434
Corporate bonds and notes	5,094,706	4,543,009	7,010,502	6,812,479
Other	158,697	158,697	163,764	163,764
Totals	\$ 58,571,032	<u>51,644,525</u>	30,750,892	<u>28,077,512</u>
Less permanently restricted investments (note 4)	<u>(1,473,262)</u>		<u>(1,457,194)</u>	
Total investments	\$ <u>57,097,770</u>		\$ <u>29,293,698</u>	

The Corporation invests in a wide variety of individual fixed income and equity investments including bonds issued by the US Government and it's agencies, corporate bonds, and common stock. The Corporation has approximately 350 of such individual holdings.

# PHI

## Notes to Consolidated Financial Statements

December 31, 2004 and 2003

### (3) Investments (continued)

As of December 31, 2004, one hundred twelve individual holdings have a market value that has been below cost for less than a year. These are both equity and fixed income funds, and in total, their market value is less than four percent below cost. The Corporation believes the decline in market value of these holdings is temporary in nature as they reflect general market conditions for bond and other fixed income securities instead of a permanent decline in the value of the individual securities.

Twenty one individual holdings have a market value that has been below cost for more than a year. These are both equity and fixed income funds, and in total, their market value is less than three percent below cost.

A summary of investments with fair values below cost as of December 31, 2004 follows:

	<u>Less than 12 Months</u>		<u>More than 12 Months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
U.S. Treasury obligations and direct obligations of U.S. Government agencies	\$ 6,088,225	75,595	1,184,946	26,181	7,273,171	101,776
Corporate bonds	<u>2,055,006</u>	<u>40,757</u>	<u>701,768</u>	<u>16,779</u>	<u>2,756,774</u>	<u>57,536</u>
Subtotal debt securities	<u>8,143,231</u>	<u>116,352</u>	<u>1,886,714</u>	<u>42,960</u>	<u>10,029,945</u>	<u>159,312</u>
Common stocks	<u>2,247,211</u>	<u>206,684</u>	<u>218,830</u>	<u>21,472</u>	<u>2,466,041</u>	<u>228,156</u>
Total temporarily impaired securities	\$ <u><u>10,390,442</u></u>	<u><u>323,036</u></u>	<u><u>2,105,534</u></u>	<u><u>64,432</u></u>	<u><u>12,495,976</u></u>	<u><u>387,468</u></u>

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Notes to Consolidated Financial Statements  
December 31, 2004 and 2003

**(4) Assets Whose Use is Limited**

At December 31 assets whose use is limited which are carried at market value consisted of the following:

	<u>2004</u>	<u>2003</u>
Permanently restricted investments	\$ 1,473,262	1,457,194
Debt service reserve funds	7,127,635	7,104,990
Operating reserve fund	1,109,789	927,711
Bond funds	648,256	761,898
Assets designated to renovation and charity care	502,698	425,175
Other reserves required under financing arrangements	<u>487,485</u>	<u>463,093</u>
	11,349,125	11,140,061
Less current portion	<u>(1,141,075)</u>	<u>(1,177,213)</u>
	<u>\$ 10,208,050</u>	<u>9,962,848</u>

The Corporation's assets whose use is limited are primarily comprised of deposits held with trustees that Presbyterian Homes, Inc., PHSC and PSLSI are required to maintain to satisfy certain covenants included in their bond indentures.

As described in note 7, in January 2003 Presbyterian Homes, Inc. issued Cumberland County Municipal Authority Revenue Bonds, Series 2003 A and B, part of the proceeds of which provided for the establishment of a construction fund to fund capital expenditures. The construction funds, of \$3,503,982 and \$9,927,751 at December 31, 2004 and 2003, respectively, which are also classified as assets whose use is limited, are held by a trustee and distributed when specific requirements of the bond indentures have been met.

Amounts included in assets whose use is limited have been invested in government agency securities, fixed rate investment contracts with financial institutions, certificates of deposit and money market funds. The cost of these funds approximate their fair values.

**(5) Related Party Transactions**

Prelude Systems, Inc. (Prelude), is a joint venture between the Corporation and Diakon Lutheran Social Ministries. Prelude is a technical services organization with a wide range of programs designed to support the information systems needs of both PHI and Diakon as well as other healthcare and community service organizations. PHI's investment in Prelude is included in investments in marketable equity securities as of December 31, 2004 and 2003. During 2004 and 2003, respectively, PHI paid Prelude approximately \$1,059,000 and \$1,004,000 for information services provided by Prelude.

**PHI**

Notes to Consolidated Financial Statements

December 31, 2004 and 2003

**(5) Related Party Transactions (continued)**

In September 2004, PHI invested in Alliance Rehab HVA, L.L.C., obtaining a ten percent ownership in the limited liability company. Alliance Rehab HVA, L.L.C. will operate a post acute rehabilitation delivery system and senior fitness programs primarily directed at nursing homes, assisted living facilities, independent living facilities, home Healthcare care provider, and community and fitness centers. PHI's investment in Alliance Rehab HVA, L.L.C. is included in investments in marketable equity securities as of December 31, 2004.

**(6) Property and Equipment**

A summary of property and equipment and accumulated depreciation at December 31 is as follows:

	<u>2004</u>	<u>2003</u>
Land	\$ 22,001,819	20,951,669
Land improvements	9,650,624	9,421,622
Buildings and improvements	183,731,862	180,454,323
Building equipment	114,494	117,078
Departmental equipment, furniture and fixtures	19,055,608	20,080,194
Furniture	2,813,254	2,792,943
Vehicles	1,678,015	1,600,952
Construction-in-progress	<u>8,617,287</u>	<u>2,967,458</u>
	247,662,963	238,386,239
Accumulated depreciation	<u>(99,292,095)</u>	<u>(92,057,494)</u>
	<u>\$ 148,370,868</u>	<u>146,328,745</u>

As the Corporation undertakes expansion projects, costs are included in construction-in-progress. As projects are completed, the costs are transferred to buildings and building improvements. Ongoing improvement and expansion is anticipated in the normal course of operations.

Construction-in-progress consists of construction costs incurred for various renovation and expansion projects at the Corporation's existing facilities.

As of December 31, 2004 and 2003, commitments for future construction totaled approximately \$4,850,000 and \$2,000,000, respectively.

In December 2004, PHI sold Continuing Care Rx, a pharmaceutical company, for approximately \$25 million, and a recognized gain of \$20,258,500.

**PHI**  
Notes to Consolidated Financial Statements  
December 31, 2004 and 2003

**(6) Property and Equipment (continued)**

For the year ended December 31, 2004 and 2003, Continuing Care Rx's gains consisted of:

	<u>2004</u>	<u>2003</u>
Gross profit	\$ 15,929,426	13,562,824
Depreciation and amortization	(297,283)	(281,121)
Interest	(324,925)	(203,005)
Income taxes	(1,652,195)	(1,279,623)
Other expenditures, net of gain	<u>(11,227,724)</u>	<u>(10,266,728)</u>
Total gain on discontinued operations	<u>\$ 2,427,299</u>	<u>1,532,347</u>

In December 2003, PHI sold Presbyterian Health Center, an 84 bed skilled nursing facility, for approximately \$4 million, and a recognized gain of \$445,937.

For the year ended December 31, 2003, Presbyterian Health Center's losses consisted of:

	<u>2003</u>
Depreciation	\$ 156,157
Interest	72,161
Amortization	2,360
Other expenditures, net of gain	<u>1,742,685</u>
Total loss on discontinued operations	<u>\$ 1,973,363</u>



**PHI**  
Notes to Consolidated Financial Statements  
December 31, 2004 and 2003

**(7) Long-term Debt**

Long-term debt as of December 31 consisted of the following:

	<u>2004</u>	<u>2003</u>
Cumberland County Municipal Authority Bonds Series 1993A, principal due in 2018, variable interest rate, 2% and 1.25% at December 31, 2004 and 2003, respectively, secured by irrevocable letter of credit with an annual fee of 1.25%, which expires December 15, 2005	\$ 6,000,000	6,000,000
Cumberland County Municipal Authority Revenue Bonds Series 1996, principal due in varying annual amounts from 2002 to 2026, interest rate set at 6.0%, net of unamortized discount, collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.	31,585,000	31,585,000
Cumberland County Municipal Authority Revenue Bonds Series 2003A, tax exempt debenture bonds, principal due in varying annual amounts from 2003 to 2026, interest rates ranging from 1.8% to 5%, insured by municipal bond insurance and property and equipment and gross revenues of Presbyterian Homes, Inc.	18,265,000	19,335,000
Cumberland County Municipal Authority Revenue Bonds Series 2003B, taxable variable rate debenture bonds, principal maturities in varying amounts from 2004 to 2032, interest adjusted weekly, 1.98% and 1.24% at December 31, 2004 and 2003, respectively, collateralized by letter of credit with an annual fee of 1.25% which expires on December 15, 2005	8,855,000	8,935,000
Kent County Delaware Economic Development Revenue Bond Series 2003, principal and interest payable monthly on a 15-year amortization period, final principal payment due October 31, 2018, variable interest of 1.94% and 1.60% at December 31, 2004 and 2003, respectively, collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.	9,437,794	9,957,067
Northampton County Industrial Development Authority Series 1998 First Mortgage Revenue Refunding Bonds, principal due in varying annual amounts through 2023, interest rate at 5.625%	14,045,000	14,045,000
Northampton County Industrial Development Authority Series 2002 First Mortgage Revenue Refunding Bonds, principal due in varying annual amounts through 2030, interest adjusted weekly, 1.98% at December 31, 2004 collateralized by a letter of credit	26,500,000	27,200,000
Fannie Mae mortgage payable executed on March 29, 1973, amortization of principal from May 1, 1973 through September 2013, interest rate of 7% effective rate of .0% in 2003 due to FHA subsidy	852,771	925,640

**PHI**  
Notes to Consolidated Financial Statements  
December 31, 2004 and 2003

**(7) Long-term Debt (continued)**

	<u>2004</u>	<u>2003</u>
HUD Flexible Subsidy Loans payable, principal balance due upon sale of the project building or upon full payment of the HUD mortgage, simple interest of 1% payable at time of principal payments	1,672,491	1,672,491
Mortgage payable for building loan provided by HUD, monthly installments of principal and interest, interest rate of 3%	1,123,893	1,186,357
Maryland Health and Higher Educational Facilities Authority Revenue Bonds Series 1999A, tax exempt variable rate debenture bonds, principal maturities in varying amounts from 2012 to 2029, interest adjusted weekly 2% at December 31, 2004, collateralized by letter of credit	3,340,000	3,340,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds Series 1999B, taxable variable rate debenture bonds, principal maturities in varying amounts from 2001 to 2029, interest adjusted weekly 2.4% at December 31, 2004, collateralized by letter of credit	16,045,000	16,325,000
Term Loan with S&T Bank, bearing interest at a variable rate of 5.25% at December 31, 2004, principal and interest payments due monthly collateralized by property and equipment of corporate office of PHI	1,016,679	-
Term Loan with S&T Bank, bearing interest at a variable rate of 5.0813% at December 31, 2004, principal and interest payments due monthly collateralized by Dillsburg property of PHI	523,856	-
Term Loan with Waypoint Bank, bearing interest at a fixed rate of 4.49%, interest payments due monthly, principal payments due July 2005 and 2006 in the amounts of \$500,000 and \$1,000,000 respectively	-	1,500,000
Other notes and mortgages, primarily paying interest only as of December 31, 2004; interest rates ranging from 0% to 8.25% as of December 31, 2004	<u>320,760</u>	<u>479,396</u>
	139,583,244	142,485,951
Less: Current portion	(3,395,730)	(2,870,846)
Unamortized discount	<u>(916,630)</u>	<u>(959,009)</u>
	<u>\$ 135,270,884</u>	<u>138,656,096</u>

All of the obligations above are collateralized by either property, plant and equipment and gross revenues of the Corporation's consolidated affiliates, or by a letter of credit.

**PHI**

Notes to Consolidated Financial Statements

December 31, 2004 and 2003

**(7) Long-term Debt (continued)**

Under the terms of the remaining 1998 revenue bond indentures and the 2002 revenue bond indentures, the Corporation is required to maintain certain deposits with a trustee. These deposits are included in assets whose use is limited. The indenture also places limits on the incurrence of additional borrowings and requires the Corporation to satisfy certain measures of financial performance as long as the bonds are outstanding. These covenants have been met as of December 31, 2004. The bonds and the letter of credit are secured by a first mortgage lien on the Kirkland Village Project and a security interest in the gross revenues of the Corporation.

On November 6, 2003, the Corporation issued the \$10,000,000 Kent County Economic Development Revenue Refunding Bonds Series 2003. Proceeds from the bonds were used to refund the Series 1996, Series 1998 and the Series 1999 bonds.

In January 2003, the Corporation issued Cumberland County Municipal Authority Series A and B bonds totaling \$29,420,000. The bonds were used to refund \$11.1 million of the Cumberland County Series 1996 bonds, provide approximately \$15 million for future capital improvements, increase debt service reserves by \$1.7 million, and to pay for issuance and bond insurance costs.

As a result of the sale of Presbyterian Health Center, the Corporation wrote off \$76,944 in unamortized bond issuance costs.

Under the terms of Presbyterian Homes, Inc.'s, PHSC's, and PSLSI's bond indentures, the Corporations are required to maintain certain deposits with a trustee. These deposits are included in assets whose use is limited. The indentures also place limits on additional borrowings and require the Corporations to satisfy certain measures of financial performance as long as the bonds are outstanding. These covenants have been met at December 31, 2004.

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Notes to Consolidated Financial Statements  
December 31, 2004 and 2003

**(7) Long-term Debt (continued)**

***Current Maturities of Long-term Debt***

Maturities for the five years subsequent to December 31, 2004 and thereafter are as follows:

<u>Years ended December 31,</u>	<u>Aggregate maturities</u>
2005	\$ 3,395,730
2006	3,667,946
2007	3,836,298
2008	4,015,013
2009	4,056,066
Thereafter	<u>120,612,191</u>
	<u>\$ 139,583,244</u>

In 2003, Presbyterian Senior Living Services, Inc. terminated two of the swap agreements that had been entered into on September 13, 2000. These two swap agreements had notional amounts of approximately \$10,000,000 which were to expire in 2010, and carried interest rates of 6.94% and 6.61%. Termination fees for these swaps were \$1,795,000. Presbyterian Senior Living Services, Inc. remains in a swap agreement with a financial intermediary which fixes the interest rate to be paid by Presbyterian Senior Living Services, Inc. on a portion of the taxable bonds as follows:

<u>Notional Amount</u>	<u>Expiration Date</u>	<u>Interest Rate</u>
\$6,000,000	September 15, 2005	6.88%

In June 2002, the Corporation entered into an additional swap agreement on a notational amount of \$18,000,000 at 2.54%, which expired on December 15, 2003. Also, in October 2003, the Corporation extended its a swap agreement with a new financial intermediary, which fixes the interest rate to be paid by the Corporation on a portion of the 2002 bonds as follows:

<u>Notional Amount</u>	<u>Expiration Date</u>	<u>Interest Rate</u>
\$9,200,000	May 1, 2006	2.41%

In September 2003, Presbyterian Homes, Inc. entered into a swap agreement with a financial intermediary, which fixes the interest rate to be paid by Presbyterian Homes, Inc. on a portion of the Kent County 2003 bonds as follows:

<u>Notional Amount</u>	<u>Expiration Date</u>	<u>Interest Rate</u>
\$10,000,000	November 28, 2008	3.39%

**PHI**

Notes to Consolidated Financial Statements

December 31, 2004 and 2003

**(7) Long-term Debt (continued)**

Pursuant to all these agreements the intermediary assumes the risk of varying interest rates, with the difference between the weekly variable rates and the fixed rates above being either paid by, or reimbursed to, the Corporations. As discussed in Note 2, swap agreements are reported at fair value.

**(8) Notes Payable**

The Corporation has available various lines of credit with financial institutions. Interest rates on these lines of credit are variable based on the prime rate of the various financial institutions or the LIBOR rate. As of December 31, 2004 and 2003, under the line of credit agreements, the Corporation had available a maximum of \$7,600,000 and \$12,000,000 from the financial institutions. As of December 31, 2004 and 2003, the Corporation had amounts totaling \$487,320 and \$5,228,136 outstanding under these agreements at interest rates ranging from 2.8% to 5.25%.

**(9) Leases**

The Corporation, through CCRx was obligated under various capital leases for medical carts, infusion pumps and other equipment that would have expired at various dates during the next three years. At December 31, 2003, the gross amount of the equipment and related accumulated amortization recorded under capital leases was as follows:

	<u>2003</u>
Medical and office equipment	\$ 748,365
Accumulated amortization	<u>(406,442)</u>
	<u>\$ 341,923</u>

The Corporation leases several offices, certain equipment and automobiles under operating leases, which expire at various dates through 2009. The future minimum lease payments under these operating leases are as follows:

2005	\$ 617,150
2006	312,753
2007	155,002
2008	78,976
2009	<u>22,702</u>
	<u>\$ 1,186,583</u>

Rental expense under operating leases was \$799,075 and \$1,546,756 for the years ended December 31, 2004 and 2003, respectively.

**PHI**

Notes to Consolidated Financial Statements

December 31, 2004 and 2003

**(10) Annuities**

The Corporation has a gift annuity program. In return for their gifts, donors are paid a fixed annuity amount during the lifetime of the donor and/or the donor's beneficiary. Total annuities payable were \$1,062,399 and \$938,042 at December 31, 2004 and 2003, respectively. The Corporation uses published mortality rate tables adopted by the Internal Revenue Service and an assumed discount rate of approximately 4% to 6% to determine the present value of the actuarially determined liability. The Corporation has assets included in investments of \$1,433,109 and \$1,231,096 as of December 31, 2004 and 2003, respectively to satisfy annuities.

**(11) Workers' Compensation Insurance**

The Corporation has a self-insured Workers' Compensation program as allowed by the Commonwealth of Pennsylvania and the State of Delaware Bureau of Workers' Compensation. This program provides for self payment of work related injuries and illnesses as opposed to utilizing an insurance carrier. The Corporation has contracted with major insurance carriers for excess insurance coverage, loss control services and administration. The Corporation maintains a letter of credit for \$2 million in connection with this self-insurance program. At December 31, 2004 and 2003, the Corporation has recorded an accrued expense of approximately \$1.9 million and \$1.4 million, respectively for workers' compensation claims which includes known case reserves and an estimate of the Corporation's liability for incurred but not reported claims.

**(13) Temporarily Restricted Net Assets**

Temporarily restricted net assets as of December 31 are available for the following purposes:

	<u>2004</u>	<u>2003</u>
Purchase of buildings and equipment	\$ 4,091	4,091
Educational	3,518	3,565
Charity care and/or equipment, including pledges receivable	2,074,175	3,141,502
Assets held in charitable trust for charity care	743,441	503,246
Various resident activities	<u>231,095</u>	<u>141,519</u>
	<u>\$ 3,056,320</u>	<u>3,793,923</u>

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Notes to Consolidated Financial Statements  
December 31, 2004 and 2003

**(14) Permanently Restricted Net Assets**

Permanently restricted net assets are allocated to the following purposes at December 31:

	<u>2004</u>	<u>2003</u>
Charity care/equipment	\$ 2,725,848	2,663,533
Educational	9,337	9,542
Perpetual trusts, income restricted for charity care	<u>6,469,220</u>	<u>5,956,725</u>
	<u>\$ 9,204,405</u>	<u>8,629,800</u>

**(15) Charity Care**

The Corporation provides care to residents who meet certain criteria under its charity care policy at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. In addition, the Corporation considers contractual allowances charity care. The total amount of charity care provided under these policies was approximately \$6.2 and \$6.1 million for the years ended December 31, 2004 and 2003, respectively, of which the amount of charges foregone for services and supplies was approximately \$1,049,000 and \$1,009,000, respectively.

**(16) Retirement Plan**

The Corporation has a defined-contribution retirement plan covering all employees that have completed one year of service and have reached the age of 21. Vesting occurs after five years of service. Contributions to the plan are at the discretion of the Board of Trustees of PHI. For the years ended December 31, 2004 and 2003, retirement plan expense totaled approximately \$846,200 and \$701,300, respectively.

**(17) Commitments and Contingencies**

The Corporation is involved in several legal proceedings arising from its activities in the health care industry. Although it is not possible to presently determine the final outcome of these matters, management believes the aggregate liability, if any, resulting from such proceedings will not have a material adverse effect on the Corporation's assets, liabilities, net assets, operations or cash flows.

## PHI

### Notes to Consolidated Financial Statements

December 31, 2004 and 2003

#### (18) Financial Instruments

##### (a) *Fair Values of Financial Instruments*

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents: The carrying amount approximates fair value because of the short-term nature of those investments.

Investments: The fair values of U.S. Government securities, notes, commercial bonds and equity securities are estimated based on quoted market prices for those or similar investments.

Long-term debt: The carrying amount included in long-term debt in the statement of financial position for bonds payable and mortgages payable approximate fair market value.

The Corporation has a number of other financial instruments, none of which are held for investment purposes. The Corporation estimates that the fair value of all financial instruments at December 31, 2004 and 2003 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying statement of financial position.

##### (b) *Financial Instruments with Off-Balance-Sheet Risk*

Financial instruments with off-balance-sheet risk to the Corporation, consist of certain financial guarantees of its affiliates and letters of credit obtained from various financial institutions. The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual amount of those obligations as disclosed in the notes.

#### (19) Subsequent Events

In December 2004, the PHI Board of Directors approved the merger agreement in which Presbyterian Homes in the Presbytery of Huntingdon (PHPH) will become an affiliate of PHI as of April 1, 2005. PHI will nominate 50% of the PHPH board members. PHPH is located in southwest central PA, serving Blair, Centre and Huntingdon counties. PHPH owns, operates and manages a stand alone skilled nursing facility, three continuing care retirement communities, and one stand alone assisted living homes. In total, PHPH includes 99 independent living units, 161 assisted living units, 376 nursing beds. For the year ended December 31, 2004 PHPH had:

	<u>2004</u>
Cash and investments	\$ 906,483
Long-term debt	13,531,493
Net assets	12,977,392
Results of operations:	
Net Income	\$ 626,377