



PRESBYTERIAN HOMES, INC.

Financial Statements
and Schedule

December 31, 2006 and 2005

(With Independent Auditor's Report Thereon)

PRESBYTERIAN HOMES, INC.

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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 Presbyterian Homes, Inc., as of December 31, 2006 and 2005, 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 79 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.



Stephen E. Proctor
Chief Executive Officer
PHI



Jeffrey J. Davis
Chief Financial Officer
PHI

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Presbyterian Homes, Inc. • Presbyterian Housing & Services Corporation • Presbyterian Senior Living Services, Inc.
Presbyterian Apartments, Inc. • Geneva House, Inc. • Presbyterian Homes in the Presbytery of Huntingdon • Quincy Village

www.phihomes.org



Independent Auditor's Report

The Board of Directors
Presbyterian Homes, Inc.:

We have audited the accompanying statements of financial position of Presbyterian Homes, Inc. (an affiliate of PHI) as of December 31, 2006 and 2005, and the related statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Presbyterian Homes, Inc. as of December 31, 2006 and 2005, and the changes in its net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Beard Miller Company LLP

Beard Miller Company LLP
Lancaster, PA
March 9, 2007

PRESBYTERIAN HOMES, INC.

Statements of Financial Position

December 31, 2006 and 2005

Assets	2006	2005
Current assets:		
Cash and cash equivalents	\$ 769,165	1,474,654
Investments	35,059,941	34,547,606
Accounts receivable, net	7,344,009	5,078,191
Assets whose use is limited – required for current liabilities	463,364	363,526
Pledges receivable, current portion	303,619	469,398
Interest receivable	31,666	64,619
Inventory	203,196	179,886
Prepaid expenses and other current assets	468,705	625,201
Total current assets	<u>44,643,665</u>	<u>42,803,081</u>
Assets whose use is limited, net of current portion	7,136,325	6,708,530
Pledges receivable, net of current portion	817,445	827,631
Property and equipment (net of accumulated depreciation of \$71,153,852 and \$65,909,876, respectively)	88,586,882	81,948,696
Assets under capital leases (net of accumulated depreciation of \$57,150 and \$4,483, respectively)	131,553	79,921
Due from affiliates	3,430,728	2,935,176
Funds held in trust by others	9,132,476	7,439,270
Fair value of interest rate swaps	156,899	137,939
Other assets:		
Beneficial interest in assets of PHI	1,997,844	1,723,591
Deferred financing costs (net of accumulated amortization of \$699,181 and \$557,258, respectively)	2,784,319	2,926,242
Other receivables	<u>6,442</u>	<u>6,442</u>
Total assets	<u>\$ 158,824,578</u>	<u>147,536,519</u>

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Financial Position

December 31, 2006 and 2005

Liabilities and Net Assets	<u>2006</u>	<u>2005</u>
Current liabilities:		
Accounts payable	\$ 5,448,659	4,216,563
Accrued expenses	6,370,115	6,207,666
Notes payable - lines of credit	2,443,819	870,558
Accrued interest	314,584	247,887
Current portion:		
Annuities payable	136,884	134,763
Obligations under capital leases	62,587	27,019
Long-term debt	<u>1,835,015</u>	<u>1,777,866</u>
Total current liabilities	16,611,663	13,482,322
Resident deposits	580,582	836,559
Deferred revenue – entrance fees	30,143,530	28,511,151
Annuities payable, net of current portion	703,872	732,494
Long-term debt, net of current portion:		
Obligations under capital leases	69,413	53,245
Long-term debt	<u>70,863,052</u>	<u>73,011,783</u>
Total liabilities	<u>118,972,112</u>	<u>116,627,554</u>
Net assets:		
Unrestricted	25,180,638	18,637,562
Temporarily restricted	3,297,592	2,918,863
Permanently restricted	<u>11,374,236</u>	<u>9,352,540</u>
Total net assets	<u>39,852,466</u>	<u>30,908,965</u>
Total liabilities and net assets	<u>\$ 158,824,578</u>	<u>147,536,519</u>

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Activities and Changes in Net Assets

Year ended December 31, 2006

(with comparative December 31, 2005 totals)

	2006				2005
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Revenues, gains and other support:					
Resident services, including amortization of entrance fees of \$4,192,320 and \$4,038,321, respectively	\$ 82,844,755	—	—	82,844,755	78,655,417
Interest and dividend income	1,434,770	700,995	—	2,135,765	1,819,860
Realized gains on investments	2,392,241	—	—	2,392,241	258,764
Gain on sale of property, plant and equipment	752,657	—	—	752,657	—
Gifts and bequests	817,367	256,022	1,538,775	2,612,164	1,730,592
Net assets released from restrictions	578,531	(578,531)	—	—	—
Total revenues, gains and other support	<u>88,820,321</u>	<u>378,486</u>	<u>1,538,775</u>	<u>90,737,582</u>	<u>82,464,633</u>
Expenses:					
Nursing services	27,221,274	—	—	27,221,274	25,782,196
Rehabilitation	3,009,244	—	—	3,009,244	3,113,394
Recreation and special services	2,794,836	—	—	2,794,836	2,549,425
Pharmacy	1,940,166	—	—	1,940,166	2,026,085
Social services	347,164	—	—	347,164	369,857
Physician services	236,738	—	—	236,738	241,703
Food services	8,864,048	—	—	8,864,048	8,851,585
Building operations and maintenance	7,947,981	—	—	7,947,981	7,793,317
Housekeeping	2,264,298	—	—	2,264,298	2,218,194
Laundry and linen	862,109	—	—	862,109	982,733
General and administrative	11,987,980	—	—	11,987,980	12,331,180
Employee benefits	6,195,903	—	—	6,195,903	5,515,005
Interest	3,367,137	—	—	3,367,137	3,363,661
Depreciation	5,620,687	—	—	5,620,687	5,155,346
Amortization	28,207	—	—	28,207	134,135
Unrealized gain on fair value of interest rate swap	(18,960)	—	—	(18,960)	(159,483)
Loss on early extinguishment of debt	—	—	—	—	1,816,514
Total expenses	<u>82,668,812</u>	<u>—</u>	<u>—</u>	<u>82,668,812</u>	<u>82,084,847</u>
Change in net assets before unrealized gain on investments and assets held in trust by others	<u>6,151,509</u>	<u>378,486</u>	<u>1,538,775</u>	<u>8,068,770</u>	<u>379,786</u>
Unrealized gain on investments and assets held in trust by others	<u>391,567</u>	<u>243</u>	<u>482,921</u>	<u>874,731</u>	<u>737,045</u>
Change in net assets	<u>6,543,076</u>	<u>378,729</u>	<u>2,021,696</u>	<u>8,943,501</u>	<u>1,116,831</u>
Net assets, beginning of year	<u>18,637,562</u>	<u>2,918,863</u>	<u>9,352,540</u>	<u>30,908,965</u>	<u>29,792,134</u>
Net assets, end of year	<u>\$ 25,180,638</u>	<u>3,297,592</u>	<u>11,374,236</u>	<u>39,852,466</u>	<u>30,908,965</u>

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Activities and Changes in Net Assets

Year ended December 31, 2005

	2005			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains and other support:				
Resident services, including amortization of entrance fees of \$4,038,321	\$ 78,655,417	—	—	78,655,417
Interest and dividend income	1,755,068	64,792	—	1,819,860
Realized gain on investments	258,764	—	—	258,764
Gifts and bequests	1,075,611	491,978	163,003	1,730,592
Net assets released from restrictions	562,753	(562,753)	—	—
Total revenues, gains and other support	82,307,613	(5,983)	163,003	82,464,633
Expenses:				
Nursing services	25,782,196	—	—	25,782,196
Rehabilitation	3,113,394	—	—	3,113,394
Recreation and special services	2,549,425	—	—	2,549,425
Pharmacy	2,026,085	—	—	2,026,085
Social services	369,857	—	—	369,857
Physician services	241,703	—	—	241,703
Food services	8,851,585	—	—	8,851,585
Building operations and maintenance	7,793,317	—	—	7,793,317
Housekeeping	2,218,194	—	—	2,218,194
Laundry and linen	982,733	—	—	982,733
General and administrative	12,331,180	—	—	12,331,180
Employee benefits	5,515,005	—	—	5,515,005
Interest	3,363,661	—	—	3,363,661
Depreciation	5,155,346	—	—	5,155,346
Amortization	134,135	—	—	134,135
Unrealized gain on fair value of interest rate swap	(159,483)	—	—	(159,483)
Loss on early extinguishment of debt	1,816,514	—	—	1,816,514
Total expenses	82,084,847	—	—	82,084,847
Change in net assets before unrealized gain on investments and assets held in trust by others	222,766	(5,983)	163,003	379,786
Unrealized gain on investments and assets held in trust by others	500,211	148,000	88,834	737,045
Change in net assets	722,977	142,017	251,837	1,116,831
Net assets, beginning of year	17,914,585	2,776,846	9,100,703	29,792,134
Net assets, end of year	\$ 18,637,562	2,918,863	9,352,540	30,908,965

See accompanying notes to financial statements

PRESBYTERIAN HOMES, INC.

Statements of Cash Flows

Years ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Change in net assets	\$ 8,943,501	1,116,831
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	5,620,687	5,155,346
Proceeds from entrance fees and deposits	8,103,359	6,995,572
Amortization of entrance fees	(4,192,320)	(4,038,321)
Loss on early extinguishment of debt	—	1,816,514
Unrealized gain on fair value of interest rate swap	(18,960)	(159,483)
Unrealized gains on investments and assets held in trust by others	(874,731)	(737,045)
Realized gains on investments	(2,392,241)	(258,764)
Gain on sale of property, plant and equipment	(752,657)	—
Contributions restricted for long-term purposes	(1,538,775)	(163,003)
Change in funds held in trust by others	(1,484,538)	47,365
Amortization	141,923	109,010
Amortization of bond (premium) discount	(113,716)	25,125
Change in assets and liabilities:		
Accounts receivable	(2,265,818)	192,032
Pledges receivable	175,965	(265,397)
Other assets	166,139	93,465
Other receivables	—	1,500
Accounts payable	1,232,096	232,378
Accrued expenses	229,146	(66,521)
Net cash provided by operating activities	<u>10,979,060</u>	<u>10,096,604</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(12,483,156)	(10,277,290)
Net proceeds from the sale of property and equipment	925,307	—
Purchases of investments	(71,785,136)	(31,562,471)
Proceeds from sale of investments	<u>73,529,219</u>	<u>34,646,411</u>
Net cash used in investing activities	<u>(9,813,766)</u>	<u>(7,193,350)</u>
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(2,534,637)	(1,321,493)
Principal payments on long-term debt	(1,977,866)	(33,448,655)
Proceeds on the issuance of long-term debt	—	33,600,000
Financing costs incurred	—	(1,497,367)
Borrowings on notes payable	1,573,261	870,558
Borrowings through capital leases	103,939	85,505
Repayments on capital lease obligations	(52,202)	(5,241)
Contributions restricted for long-term purposes	1,538,775	163,003
Change in annuities payable	(26,501)	106,961
Due from affiliated entity	<u>(495,552)</u>	<u>(1,663,752)</u>
Net cash used in financing activities	<u>(1,870,783)</u>	<u>(3,110,481)</u>
Net decrease in cash and cash equivalents	<u>(705,489)</u>	<u>(207,227)</u>
Cash and cash equivalents, beginning of year	<u>1,474,654</u>	<u>1,681,881</u>
Cash and cash equivalents, end of year	\$ <u><u>769,165</u></u>	<u><u>1,474,654</u></u>

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(1) General Information

Presbyterian Homes, Inc. (the Corporation) is a not-for-profit corporation, which provides services in the Presbyteries of Carlisle, Donegal, Kiskiminetas, Lackawanna, Lehigh, Northumberland, New Castle and Upper Ohio Valley in the states of Pennsylvania, Delaware, and Ohio. Presbyterian Homes, Inc. owns, operates and manages two stand alone skilled nursing facilities, five continuing care retirement communities, one stand-alone independent living facility and two stand alone assisted living homes. In total, the Corporation includes 453 independent living units, 277 assisted living units, 766 nursing beds. The Corporation is governed by a Board of Directors, all of whom are elected by the Board of Trustees of PHI, the Corporation's parent organization.

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

The Corporation has received a Certificate of Authority from the Pennsylvania Insurance Department as required by the Continuing Care Provider Registration and Disclosure Act of 1984, (the Act).

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

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.

(b) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

(c) Reclassification

Certain amounts in the 2005 financial statements have been reclassified to conform with the 2006 financial presentation. These reclassifications had no effect on the change in net assets.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(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 the purposes of the statements of financial position and cash flows, except for those included in investments or assets whose use is limited. At times during the years ended December 31, 2006 and 2005, cash balances may have exceeded the federally insured limit of \$100,000.

(e) Investments

Investments in marketable equity securities and mutual funds with readily determinable fair values and all investments in debt securities are measured at fair value, as determined by a national exchange in the statements of financial position. Other equity securities are carried at fair value as determined by management. Alternative investments – limited partnerships are not readily marketable and are presented at estimated fair value as determined by the investment managers. Management reviews, evaluates and monitors the values provided and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments – limited partnerships. 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, 2006 and 2005, no amounts were charged to realized loss as management believes the decline in value is temporary due to general economic conditions and not a permanent decline in value.

Investment income consisted of the following:

	<u>2006</u>	<u>2005</u>
Interest and dividends	\$ 2,135,765	1,819,860
Realized gains on investments	2,392,241	258,764
Unrealized gains on investments and assets held in trust by others	<u>874,731</u>	<u>737,045</u>
	<u>\$ 5,402,737</u>	<u>2,815,669</u>

Investment expenses of \$152,171 and \$124,528 as of December 31, 2006 and 2005, respectively have been included in general and administrative expenses.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(f) *Accounts Receivable*

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

	<u>2006</u>	<u>2005</u>
Total accounts receivable	\$ 8,339,796	6,007,942
Less: allowance for doubtful accounts	<u>(995,787)</u>	<u>(929,751)</u>
Net accounts receivable	<u>\$ 7,344,009</u>	<u>5,078,191</u>

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

(g) *Assets Whose Use is Limited*

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

(h) *Pledges Receivable*

During 2003, a pledge was made to the Corporation for \$1,500,000. Additional pledges were received in 2006 and 2005 for \$466,479, and \$480,609, respectively. As of December 31, 2006, the organization has received \$1,053,489 of the gifts and the remaining balance will be paid over the next 8 years. The Corporation recorded these pledges at the net present value less a discounted uncollectible amount of 10%.

	<u>2006</u>	<u>2005</u>
Pledges receivables	\$ 1,393,599	1,528,515
Less: unamortized discount	<u>(147,048)</u>	<u>(192,630)</u>
Subtotal	1,246,551	1,335,885
Less: allowance for uncollectibles	<u>(125,487)</u>	<u>(38,856)</u>
Net pledges receivables	<u>\$ 1,121,064</u>	<u>1,297,029</u>

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(h) Pledges Receivable (continued)

Pledges receivable as of December 31, 2006 is as follows:

Amounts due in:	
Less than one year	\$ 405,122
One to five years	890,477
More than five years	<u>98,000</u>
	<u>\$ 1,393,599</u>

(i) 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.

(j) Property and Equipment

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

Depreciable lives are determined as follows:

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

(k) 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 \$24,740 and \$250,465 was capitalized in 2006 and 2005, respectively.

(l) Funds 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.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(l) Funds 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>2006</u>	<u>2005</u>
Assets held in trust by others	\$ 7,112,672	6,642,256
Contributions receivable from remainder trusts	<u>2,019,804</u>	<u>797,014</u>
	<u>\$ 9,132,476</u>	<u>7,439,270</u>

(m) Derivatives and Hedging Activities

The Corporation utilizes interest rate swap agreements to hedge variable interest rates; which are accounted for using 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*. For 2005, an adjustment to the liability was recorded causing a gain of \$159,483. This adjustment represented the decrease in the fair value (liability) of the swap and created an asset on the Statements of Financial Position. For 2006, an adjustment to the asset was recorded causing a gain of \$18,960. This adjustment represents the increase in the fair value asset of the swap.

The Corporation's interest rate swap is carried at fair value asset (liability) as determined by a third party. Changes in fair value are reported in the statement of activities and changes in net assets as a component of the change in net assets.

(n) Deferred Costs

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. Amortization expense is expected to be approximately \$141,923 for each of the next five years.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(o) *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.

(p) *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). Assumptions made in the calculation 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, 2006 and 2005, management's estimate resulted in no obligation in excess of recorded amounts to provide future services to continuing care residents.

(q) *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.

(r) *Deferred Revenue – Entrance Fees*

Entrance fees collected from residents at move-in pursuant to a Residence 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.

The amount of entrance fees refundable to residents at December 31, 2006 and 2005 under contractual refund provisions was approximately \$20,939,254 and \$17,860,377, respectively.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(s) *Statutory Liquid Reserve*

The Continuing Care Provider Registration and Disclosure Act requires a working capital reserve equivalent to the greater of the total debt service payments due during the next 12 months on account of any loan or long-term financing, or 10% of the projected annual operating expenses of the Corporation exclusive of depreciation. The reserve is computed on only the proportional share of financing or operating expenses that are applicable to Residence and Care Agreements. The reserve requirement is considered to be fulfilled by the Corporation's unrestricted cash and investments.

(t) *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. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity. The interest and dividend income from these restricted assets is used for the charitable purpose.

(u) *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 and changes in net assets 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 on 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.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(v) ***Resident Service Revenue and Business Concentration***

Resident service revenue is reported at the estimated net realizable amount to be received from patients and others including Medicare, Pennsylvania Medicaid, Delaware Medicaid, and other third-party payors for services rendered. The Corporation derives a portion of its revenues 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 capital-related costs. 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, with several exceptions, including all therapy services. The Corporation's skilled nursing facilities began utilizing this new rate methodology in January 1999.

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.

Revenues from Medicare and Pennsylvania and Delaware Medicaid (Medicaid) represent approximately 48% of revenues for 2006 and 2005. Medicare and Medicaid receivables represent approximately 66% and 51% of accounts receivable at December 31, 2006 and 2005, respectively.

The Commonwealth of Pennsylvania (the State) received approval from the Federal Center for Medicare Services (CMS), to retroactively assess a nursing bed assessment as follows:

July 1, 2004 to June 30, 2005: \$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 \$7.05 a day, based on a number of factors, including their Medicaid utilization.

July 1, 2005 to June 30, 2006 \$1.54 a day for continuing care retirement community non-Medicare occupied beds, and \$15.95 a day for stand alone nursing facility non-Medicare occupied beds. As a part of this, nursing home providers received an additional supplement of \$5.17 a day, based on a number of factors, including their Medicaid utilization.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(v) Resident Service Revenue and Business Concentration (continued)

The supplemental and assessment amounts per day have not yet been finalized for the period 7/1-12/31/06. The State has published proposed amounts but no amount has been included on the Corporation's financial statements for this period.

For the years ended December 31, 2006 and 2005 the Corporation received approximately \$130,818 and \$787,345 additional revenue, respectively for the net effect of this assessment and supplement.

(w) 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.

(x) Donated Services

Donated services are reflected in the financial statements at the fair value of the service donated. The Corporation pays for most services requiring specific expertise.

(y) Advertising

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2006 and 2005, was \$434,998 and \$601,643, respectively.

(z) Classification of Expenses

	<u>2006</u>	<u>2005</u>
Program activities	\$ 70,699,792	68,096,636
General and administrative	11,694,235	12,144,871
Change in fair value of interest rate swap	(18,960)	(159,483)
Loss on early extinguishment of debt	—	1,816,514
Fundraising	293,745	186,309
	<u>\$ 82,668,812</u>	<u>82,084,847</u>

(aa) Fundraising Expense

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

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(ab) Performance Indicator

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

(ac) Statement of Cash Flows

Interest paid during the years ended December 31, 2006 and 2005 was \$3,435,182 and \$3,312,255, respectively.

(3) Investments

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

	2006		2005	
	Cost	Fair value	Cost	Fair value
Money market funds	\$ 1,096,303	1,096,303	1,614,878	1,614,878
Marketable equity securities	—	—	22,451,944	25,433,030
Mutual funds	29,779,588	32,578,082	—	—
Government agencies securities	1,178,501	1,164,322	5,747,806	5,641,123
Corporate debt securities	5,042,129	5,042,250	8,748,067	8,659,223
Alternate investments	2,550,000	2,632,537	—	—
Other	146,136	146,136	277,261	271,408
Totals	<u>\$ 39,792,657</u>	42,659,630	<u>38,839,956</u>	41,619,662
Less assets whose use is limited (note 5)		<u>(7,599,689)</u>		<u>(7,072,056)</u>
Total investments		<u>\$ 35,059,941</u>		<u>\$ 34,547,606</u>

During 2006, the Corporation moved the majority of its investments from individual fixed income and equity investments including bonds issued by the US Government and it's agencies, corporate bonds, and common stock to a diversified portfolio of mutual funds and alternative investments. The Corporation has thirty four mutual funds, two investments in limited partnerships and thirteen fixed income investments as of December 31, 2006. The Corporation had approximately two hundred and seventy seven individual fixed income, equity investments, corporate bonds, and common stock as of December 31, 2005.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(3) Investments (continued)

As of December 31, 2006, three bonds and three mutual funds have a market value that has been below cost for less than a year, and in total, their market value is less than one percent below cost. As of December 31, 2005, one hundred and four individual holdings had a market value that had been below cost for less than a year. These were both equity and fixed income securities, and in total, their market value was less than five percent below cost.

Eight individual holdings have a market value that has been below cost for more than a year as of December 31, 2006. These were all fixed income securities, and in total, their market value is less than three percent below cost for 2006. Thirty eight individual holdings had a market value that had been below cost for more than a year as of December 31, 2005. These are both equity and fixed income securities, and in total, their market value is less than seven percent below cost for 2005.

A summary of investments with fair values below cost as of December 31, 2006 follows:

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	\$ 248,055	2,236	816,267	22,541	1,064,322	24,777
Subtotal debt securities	248,055	2,236	816,267	22,541	1,064,322	24,777
Mutual funds	2,493,565	5,917	—	—	2,493,565	5,917
Total temporarily impaired securities	\$ 2,741,620	8,153	816,267	22,541	3,557,887	30,694

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(3) Investments (continued)

A summary of investments with fair values below cost as of December 31, 2005 follows:

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	\$ 3,420,571	60,848	1,693,566	51,859	5,114,137	112,707
Corporate bonds	2,203,291	50,254	1,101,341	47,694	3,304,632	97,948
Subtotal debt securities	5,623,862	111,102	2,794,907	99,553	8,418,769	210,655
Common stocks	5,056,353	363,889	363,671	116,474	5,420,024	480,363
Total temporarily impaired securities	\$ 10,680,215	474,991	3,158,578	216,027	13,838,793	691,018

(4) Related Party Transactions

The Corporation incurs a management fee payable to its parent organization under a management agreement whereby PHI provides the Corporation with various management and administrative services to each of the Corporation's operating facilities. The Corporation also incurs certain operating expenses under the management agreement that are comprised primarily of the salaries and benefits of certain key management personnel provided to the Corporation by the parent organization. Under the terms of the management agreement, the Corporation shall reimburse PHI monthly in arrears by the fifteenth day of the following month in an amount equal to the cost of these management salaries and benefits plus other expenses as described in the agreement. During the years ended December 31, 2006 and 2005, the Corporation incurred management fees and other expenses under the management agreement totaling \$4,901,467 and \$4,538,026, respectively, which is classified as general and administrative expenses in the statement of activities and changes in net assets.

In addition, the Corporation purchases medications from Continuing Care Rx, Inc. As of December 29, 2004 PHI sold its majority interest in Continuing Care Rx Holdings, Inc. and remains a minority shareholder. Total purchases from Continuing Care Rx, Inc. for 2006 and 2005 were approximately \$1,845,769 and \$1,794,973, respectively, of which \$363,748 and \$329,569 is included in accounts payable as of December 31, 2006 and 2005, respectively.

The Corporation is a guarantor of certain debts of Presbyterian Senior Living Services, Inc. (Glen Meadows), an affiliate organization. In the event of a deficiency judgment from the sale of real property pledged as security for the purchase of a facility in Glen Arm, Maryland, Presbyterian Homes, Inc. has guaranteed payment up to \$6,000,000. The Corporation has also guaranteed a line of credit with a maximum available amount of \$1,250,000 for Presbyterian Senior Living Services, Inc., which is subject to renewal in May 2007.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(4) 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. operates 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. In May 2006, PHI redeemed its membership interest in Alliance Rehab HVA, L.L.C. During 2006 and 2005, the Corporation purchased services from Alliance Rehab for \$2,623,636 and \$3,100,972, respectively, of which \$652,095 and \$554,339 is included in accounts payable as of December 31, 2006 and 2005, respectively.

Amounts due from affiliate entities, principally PHI, as of December 31, 2006 and 2005 are \$3,430,728 and \$2,935,176, respectively.

The amounts receivable from the Corporation's affiliated organizations are unsecured, non-interest bearing and have no fixed repayment terms.

(5) Assets Whose Use is Limited

At December 31 assets whose use is limited consisted of the following:

	2006	2005
Permanently restricted investments	\$ 1,912,685	1,677,167
Debt service reserve fund	5,223,640	5,031,363
Bond fund	463,364	363,526
	<u>7,599,689</u>	<u>7,072,056</u>
Less current portion	<u>(463,364)</u>	<u>(363,526)</u>
	<u>\$ 7,136,325</u>	<u>6,708,530</u>

The Corporation's debt service reserve, bond and construction funds are required by certain covenants included in its bond indentures.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(6) Property and Equipment

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

	2006		2005	
	Cost	Accumulated depreciation	Cost	Accumulated depreciation
Land	\$ 7,673,335		4,074,242	
Land improvements	7,559,287	4,197,304	7,392,267	3,898,130
Buildings and improvements	125,270,827	54,364,600	118,777,298	49,943,490
Departmental equipment, furniture and fixtures	13,108,491	10,116,831	12,638,885	9,710,074
Furniture	1,696,367	1,485,504	1,721,334	1,420,724
Vehicles	1,233,028	989,613	1,216,928	937,458
Construction-in-progress	3,199,399		2,037,618	
	<u>\$ 159,740,734</u>	<u>71,153,852</u>	<u>147,858,572</u>	<u>65,909,876</u>
Net book value		<u>\$ 88,586,882</u>		<u>\$ 81,948,696</u>

As the Corporation undertakes expansion and improvement 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.

As of December 31, 2006 and 2005, commitments for future construction totaled approximately \$3,600,000 and \$1,400,000, respectively.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(7) Long-term Debt

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

	<u>2006</u>	<u>2005</u>
Cumberland County Municipal Authority Bonds Series 1993A principal due in 2018, variable interest rate, 3.94% and 3.55% at December 31, 2006 and 2005, respectively, secured by irrevocable letter of credit with an annual fee of 0.95%, which expires on December 15, 2010.	\$ 6,000,000	6,000,000
Cumberland County Municipal Authority Revenue Bonds Series 2003A, tax exempt bonds, principal due in varying annual amounts from 2005 to 2026, interest rates ranging from 2.15% to 5%, insured by municipal bond insurance and property and equipment and gross revenues of the Corporation	16,060,000	17,175,000
Cumberland County Municipal Authority Revenue Bonds Series 2003B, tax exempt variable rate bonds, principal maturities in varying amounts from 2004 to 2032, interest adjusted weekly, 3.92% and 3.5% at December 31, 2006 and 2005, respectively, collateralized by letter of credit with an annual fee of 0.95 % which expires on December 15, 2010	8,660,000	8,765,000
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 4.40% and 3.65% at December 31, 2006 and 2005 respectively, collateralized by property and equipment and gross revenues of the Corporation	8,340,762	8,898,628
Cumberland County Municiple Authority Revenue Bonds Series 2005A, tax exempt debenture bonds, principal due in varying annual amounts from 2013 to 2020, interest rates ranging from 4% to 5%, insured by municipal bond insurance	16,800,000	16,800,000

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(7) Long-term Debt (continued)

	<u>2006</u>	<u>2005</u>
Cumberland County Municiple Authority Revenue Bonds		
Series 2005B, taxable variable rate debenture bonds, principal maturities in varying amounts from 2013 to 2026, interest adjusted weekly after first year, 3.65% and 4.25% at December 31, 2006 and 2005, respectively, insured by municipal bond insurance	16,800,000	16,800,000
Note payable to Synod of the Trinity of the Presbyterian Church, U.S.A., no scheduled repayment of principal, variable interest rate based on the prime rate, 6.25% at December 31, 2005.	—	200,000
	<u>72,660,762</u>	<u>74,638,628</u>
Less current portion	(1,835,015)	(1,777,866)
Plus unamortized premium	363,044	493,076
Less unamortized discount	<u>(325,739)</u>	<u>(342,055)</u>
	<u>\$ 70,863,052</u>	<u>\$ 73,011,783</u>

Under the terms of the Corporation's 2003 and 2005 Cumberland County Municipal Authority Revenue bond indenture, 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, 2006.

Maturities for the five years subsequent to December 31, 2006 are as follows:

<u>Years ended December 31,</u>	<u>Aggregate maturities</u>
2007	\$ 1,835,015
2008	1,906,080
2009	1,995,484
2010	2,079,735
2011	869,927
Thereafter	<u>63,974,521</u>
	<u>\$ 72,660,762</u>

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(7) Long-term Debt (Continued)

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

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

Pursuant to 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 Corporation. As discussed in Note 2, swap agreements are reported at fair value.

(8) Notes Payable

The Corporation has a line of credit with a financial institution, which provides for borrowings of up to \$4,000,000 at an interest rate based on the prime rate of the financial institution, which was 6.75% and 5.75% as of December 31, 2006 and 2005, respectively. The line of credit is collateralized by accounts receivable on a parity basis with the Corporation's bonded debt. As of December 31, 2006 and 2005, the Corporation had amounts totaling \$2,443,819 and \$870,558, respectively, outstanding under this agreement. The line expires on June 29, 2007.

(9) Leases

The Corporation is obligated under various capital leases for equipment that expire at various dates during the next three years. At December 31, 2006 and 2005, the gross amount of the equipment and related accumulated amortization recorded under capital leases was as follows:

	<u>2006</u>	<u>2005</u>
Medical and office equipment	\$ 188,703	84,404
Accumulated amortization	<u>(57,150)</u>	<u>(4,483)</u>
	<u>\$ 131,553</u>	<u>79,921</u>

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(9) Leases (Continued)

A schedule of future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2006 follows:

2007	\$ 68,683
2008	63,433
2009	<u>8,514</u>
	140,630
Amounts representing interest	<u>(8,630)</u>
	<u>\$ 132,000</u>

The Corporation leases certain equipment under operating leases, which expire at various dates through 2011. The future minimum lease payments under these operating leases are as follows:

2007	\$ 150,167
2008	93,542
2009	50,222
2010	4,086
2011	<u>990</u>
	<u>\$ 299,007</u>

Rental expense under operating leases was \$249,313 and \$493,004 for the years ended December 31, 2006 and 2005, respectively.

(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, which creates a liability of the Corporation. Total annuities payable were \$840,756 and \$867,257 at December 31, 2006 and 2005, respectively. The Corporation uses published mortality-rate tables adopted by the United States Internal Revenue Service and an assumed discount rate of approximately 4% to 6% percent to determine the present value of the actuarially determined liability. The Corporation has assets included in investments of \$993,615 and \$976,580 as of December 31, 2006 and 2005, respectively to satisfy annuities.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(11) Workers' Compensation Insurance

The Corporation has instituted a self-insured Workers' Compensation program as allowed by the Commonwealth of Pennsylvania and State of Delaware Bureaus 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. In 2005, the Corporation maintained a letter of credit for \$2 million in connection with this self-insurance program, as well as a restricted investment account in the amount of \$1,233,370. In 2006, the Corporation maintains a letter of credit for \$2 million in connection with this self-insurance program. In addition, the Corporation maintains a restricted investment account in the amount of \$1,280,599 as collateral for this self-insurance program for 2006. At December 31, 2006 and 2005, the Corporation has recorded an accrued expense of approximately \$3 million and \$2.8 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.

(12) Temporarily Restricted Net Assets

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

	<u>2006</u>	<u>2005</u>
Beneficial interest in assets of PHI	\$ 1,167,758	893,505
Charity care and/or equipment, including pledges receivable	1,413,286	1,228,344
Contributions receivable from remainder trust	<u>716,548</u>	<u>797,014</u>
	<u>\$ 3,297,592</u>	<u>2,918,863</u>

Net assets of \$578,531 and \$562,753 were released from restriction during 2006 and 2005 respectively in satisfaction of the above restrictions.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(13) Permanently Restricted Net Assets

Income from the following permanently restricted net assets as of December 31 is restricted for:

	<u>2006</u>	<u>2005</u>
Beneficial interest in assets of PHI	\$ 830,086	830,086
Contribution receivables from remainder trust	1,303,256	—
Charity care and/or equipment, including pledges receivable	2,128,222	1,880,198
Benefit in perpetual trusts; charity care	<u>7,112,672</u>	<u>6,642,256</u>
	<u>\$ 11,374,236</u>	<u>9,352,540</u>

(14) 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 \$8.0 million and \$6.9 million for the years ended December 31, 2006 and 2005, respectively, of which the amount of charges foregone for services and supplies was approximately \$1.1 million and \$1 million, respectively.

(15) Retirement Plan

The Corporation participates in a defined-contribution retirement plan through PHI. The plan covers all employees that have completed one year of service and have reached the age of 21. Vesting occurs after three years of service. Contributions to the plan are at the discretion of the Board of Trustees of PHI and, employees have the ability to direct how their contributions are invested. For the year ended December 31, 2006 and 2005, retirement plan expense totaled approximately \$599,000 and \$653,000, respectively.

(16) 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.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2006 and 2005

(17) 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, corporate bonds, equity securities and mutual funds are estimated based on quoted market prices for those or similar investments. Alternate investments – limited partnerships are valued as described in Note 2(j).

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 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, 2006 and 2005 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying statements 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 note 4.



Independent Auditor's Report on Supplementary Information

To the Board of Directors
Presbyterian Homes, Inc.:

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The following supplementary information accompanying the financial statements is presented for purposes of additional analysis and is not required part of the basic financials statements. The supplementary information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and, accordingly, we express no opinion on such information.

Beard Miller Company LLP

Beard Miller Company LLP
Lancaster, PA
March 9, 2007

PRESBYTERIAN HOMES, INC.

Statutory Minimum Liquid Reserves
(See Independent Auditor's Report on Supplementary Information)

As of December 31, 2006

2007 Budgeted Operating Expenses	\$ 79,774,601
Less: depreciation expense	<u>(5,662,980)</u>
Expenses subject to minimum liquid assets requirement	74,111,621
Percentage of residents subject to residence and care arrangements at December 31, 2006	<u>12%</u>
	8,893,395
Statutory requirement	<u>10%</u>
Statutory minimum liquid reserve requirement	\$ <u><u>889,339</u></u> (a)
Next 12 months debt service payments:	
Principal payments	\$ 1,835,015
Interest payments	<u>3,311,835</u>
Total debt service for next 12 months	<u>5,146,850</u>
Percentage of residents subject to residence and care arrangements at December 31, 2006	<u>12%</u>
Statutory minimum liquid reserve requirement	\$ <u><u>617,622</u></u> (b)
Assets satisfying statutory minimum liquid reserve requirement	
Unrestricted cash and investments	\$ <u>34,835,491</u>
Greater of (a) or (b)	<u>889,339</u>
Assets in excess of statutory minimum liquid reserve requirement	\$ <u><u>33,946,152</u></u>