

PRESBYTERIAN HOMES, INC.

Financial Statements
and Schedule

December 31, 2007 and 2006

(With Independent Auditor's Report Thereon)

PRESBYTERIAN HOMES, INC.

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Certification of Chief Executive and Chief Financial Officers

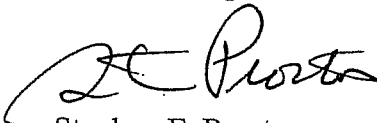
We are responsible for the financial statements and supporting information of Presbyterian Homes, Inc., as of December 31, 2007 and 2006, and attest that they are accurate, complete and fairly presented.

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 80 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

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, 2007 and 2006, 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, 2007 and 2006, 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 10, 2008

PRESBYTERIAN HOMES, INC.

Statements of Financial Position

December 31, 2007 and 2006

Assets	2007	2006
Current assets:		
Cash and cash equivalents	\$ 823,916	769,165
Investments	34,987,183	35,059,941
Accounts receivable, net	6,548,936	7,344,009
Assets whose use is limited – required for current liabilities	381,703	463,364
Pledges receivable, current portion	396,422	303,619
Interest receivable	154,532	31,666
Inventory	185,000	203,196
Prepaid expenses and other current assets	532,772	468,705
Total current assets	<u>44,010,464</u>	<u>44,643,665</u>
Assets whose use is limited, net of current portion	7,273,147	7,136,325
Pledges receivable, net of current portion	677,250	817,445
Property and equipment (net of accumulated depreciation of \$72,451,755 and \$71,153,852, respectively)	87,474,370	88,586,882
Assets under capital leases (net of accumulated depreciation of \$120,662 and \$57,150, respectively)	106,508	131,553
Due from affiliates	12,191,422	3,430,728
Funds held in trust by others	9,250,749	9,132,476
Fair value of interest rate swaps	34,281	156,899
Other assets:		
Beneficial interest in assets of PHI	2,127,650	1,997,844
Deferred financing costs (net of accumulated amortization of \$841,104 and \$699,181, respectively)	2,642,395	2,784,319
Other receivables	10,000	6,442
Total assets	\$ <u><u>165,798,236</u></u>	<u><u>158,824,578</u></u>

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Financial Position

December 31, 2007 and 2006

Liabilities and Net Assets	2007	2006
Current liabilities:		
Accounts payable	\$ 4,144,348	5,448,659
Accrued expenses	6,419,106	6,370,115
Notes payable - line of credit	4,561,147	2,443,819
Accrued interest	283,953	314,584
Current portion:		
Annuities payable	151,687	136,884
Obligations under capital leases	73,520	62,587
Long-term debt	1,917,022	1,835,015
Total current liabilities	17,550,783	16,611,663
Resident deposits	893,078	580,582
Deferred revenue – entrance fees	30,173,822	30,143,530
Annuities payable, net of current portion	731,012	703,872
Long-term debt, net of current portion:		
Obligations under capital leases	27,752	69,413
Long-term debt	68,944,118	70,863,052
Total liabilities	118,320,565	118,972,112
Net assets:		
Unrestricted	32,633,206	25,180,638
Temporarily restricted	3,288,133	3,297,592
Permanently restricted	11,556,332	11,374,236
Total net assets	47,477,671	39,852,466
Total liabilities and net assets	\$ 165,798,236	158,824,578

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Activities and Changes in Net Assets

Year ended December 31, 2007

(with comparative December 31, 2006 totals)

	2007			2006
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains and other support:				
Resident services, including amortization of entrance fees of \$4,401,581 and \$4,192,320, respectively	\$ 79,902,898	—	—	79,902,898
Interest and dividend income	1,912,355	—	—	1,912,355
Realized gains on investments	1,408,668	—	—	1,408,668
Gain on sale of property, plant and equipment	—	—	—	—
Gifts and bequests	1,237,316	259,240	50,369	1,546,925
Net assets released from restrictions	614,823	(614,823)	—	—
Total revenues, gains and other support	85,076,060	(355,583)	50,369	84,770,846
Expenses:				
Nursing services	26,092,472	—	—	26,092,472
Rehabilitation	3,504,802	—	—	3,504,802
Recreation and special services	2,634,272	—	—	2,634,272
Pharmacy	1,980,042	—	—	1,980,042
Social services	307,473	—	—	307,473
Physician services	235,261	—	—	235,261
Food services	8,418,945	—	—	8,418,945
Building operations and maintenance	8,189,242	—	—	8,189,242
Housekeeping	2,075,765	—	—	2,075,765
Laundry and linen	869,627	—	—	869,627
General and administrative	12,731,701	—	—	12,731,701
Employee benefits	5,237,132	—	—	5,237,132
Interest	3,292,492	—	—	3,292,492
Depreciation	5,516,244	—	—	5,516,244
Amortization	139,159	—	—	139,159
Unrealized loss (gain) on fair value of interest rate swap	122,618	—	—	122,618
Total expenses	81,347,247	—	—	81,347,247
Change in net assets before loss on abandoned project, discontinued operations and unrealized gain (loss) on investments and assets held in trust by others	3,728,813	(355,583)	50,369	3,423,599
Loss on abandoned project	(987,144)	—	—	(987,144)
Discontinued operations, including realized gain on sale of \$4,742,912 in 2007	4,833,334	—	—	4,833,334
Unrealized gain (loss) on investments and assets held in trust by others	(122,435)	346,124	131,727	355,416
Change in net assets	7,452,568	(9,459)	182,096	7,625,205
Net assets, beginning of year	25,180,638	3,297,592	11,374,236	39,852,466
Net assets, end of year	\$ 32,633,206	3,288,133	11,556,332	47,477,671

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Activities and Changes in Net Assets

Year ended December 31, 2006

	2006			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Revenues, gains and other support:				
Resident services, including amortization of entrance fees of \$4,192,320	\$ 74,944,622	—	—	74,944,622
Interest and dividend income	1,431,312	700,995	—	2,132,307
Realized gain on investments	2,392,241	—	—	2,392,241
Gain on sale of property, plant and equipment	760,398	—	—	760,398
Gifts and bequests	810,739	256,022	1,538,775	2,605,536
Net assets released from restrictions	578,531	(578,531)	—	—
Total revenues, gains and other support	80,917,843	378,486	1,538,775	82,835,104
Expenses:				
Nursing services	23,988,691	—	—	23,988,691
Rehabilitation	2,733,688	—	—	2,733,688
Recreation and special services	2,553,200	—	—	2,553,200
Pharmacy	1,761,682	—	—	1,761,682
Social services	301,526	—	—	301,526
Physician services	214,330	—	—	214,330
Food services	8,120,516	—	—	8,120,516
Building operations and maintenance	7,560,510	—	—	7,560,510
Housekeeping	2,116,829	—	—	2,116,829
Laundry and linen	776,593	—	—	776,593
General and administrative	11,075,837	—	—	11,075,837
Employee benefits	5,602,129	—	—	5,602,129
Interest	3,264,645	—	—	3,264,645
Depreciation	5,420,800	—	—	5,420,800
Amortization	26,853	—	—	26,853
Unrealized gain on fair value of interest rate swap	(18,960)	—	—	(18,960)
Total expenses	75,498,869	—	—	75,498,869
Change in net assets before discontinued operations and unrealized gain on investments and assets held in trust by others	5,418,974	378,486	1,538,775	7,336,235
Discontinued operations	732,535	—	—	732,535
Unrealized gain on investments and assets held in trust by others	391,567	243	482,921	874,731
Change in net assets	6,543,076	378,729	2,021,696	8,943,501
Net assets, beginning of year	18,637,562	2,918,863	9,352,540	30,908,965
Net assets, end of year	\$ 25,180,638	3,297,592	11,374,236	39,852,466

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Cash Flows

Years ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Change in net assets	\$ 7,625,205	8,943,501
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	5,548,938	5,620,687
Proceeds from entrance fees and deposits	5,676,848	8,103,359
Amortization of entrance fees	(4,401,581)	(4,192,320)
Loss on early extinguishment of debt	—	—
Unrealized loss (gain) on fair value of interest rate swap	122,618	(18,960)
Unrealized gains on investments and assets held in trust by others	(355,416)	(874,731)
Realized gains on investments	(1,408,668)	(2,392,241)
Gain on sale of property, plant and equipment	(4,742,912)	(760,398)
Contributions restricted for long-term purposes	(50,369)	(1,538,775)
Change in funds held in trust by others	26,917	(1,484,538)
Amortization	141,071	141,923
Amortization of bond premium	(1,912)	(113,716)
Loss on abandoned projects	987,144	—
Change in assets and liabilities:		
Accounts receivable	795,073	(2,265,818)
Pledges receivable	47,392	175,965
Other assets	(168,736)	166,139
Other receivables	(3,558)	—
Accounts payable	(1,304,311)	1,232,096
Accrued expenses	18,359	229,146
Net cash provided by operating activities	<u>8,552,102</u>	<u>10,971,319</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(7,252,613)	(12,475,415)
Net proceeds from the sale of property and equipment	6,597,000	925,307
Purchases of investments	(25,781,544)	(71,785,136)
Proceeds from sale of investments	27,288,228	73,529,219
Net cash provided by (used) in investing activities	<u>851,071</u>	<u>(9,806,025)</u>
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(932,479)	(2,534,637)
Principal payments on long-term debt	(1,834,162)	(1,977,866)
Borrowings on notes payable	2,117,328	1,573,261
Borrowings through capital leases	20,457	103,939
Repayments on capital lease obligations	(51,185)	(52,202)
Contributions restricted for long-term purposes	50,369	1,538,775
Change in annuities payable	41,944	(26,501)
Due from affiliated entity	(8,760,694)	(495,552)
Net cash used in financing activities	<u>(9,348,422)</u>	<u>(1,870,783)</u>
Net increase (decrease) in cash and cash equivalents	54,751	(705,489)
Cash and cash equivalents, beginning of year	<u>769,165</u>	<u>1,474,654</u>
Cash and cash equivalents, end of year	<u>\$ 823,916</u>	<u>769,165</u>

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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 one stand alone skilled nursing facility, five continuing care retirement communities, one stand-alone independent living facility and two stand alone assisted living homes. In total, the Corporation includes 456 independent living units, 276 assisted living units, 651 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 2006 financial statements have been reclassified to conform with the 2007 financial presentation. These reclassifications had no effect on the change in net assets.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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, 2007 and 2006, 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, 2007 and 2006, 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>2007</u>	<u>2006</u>
Interest and dividends	\$ 1,912,355	2,132,307
Realized gains on investments	1,408,668	2,392,241
Unrealized gains on investments and assets held in trust by others	<u>355,416</u>	<u>874,731</u>
	<u>\$ 3,676,439</u>	<u>5,399,279</u>

Investment expenses of \$174,927 and \$152,171 as of December 31, 2007 and 2006, respectively have been included in general and administrative expenses.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(f) Accounts Receivable

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

	<u>2007</u>	<u>2006</u>
Total accounts receivable	\$ 8,056,964	8,339,796
Less: allowance for doubtful accounts	<u>(1,508,028)</u>	<u>(995,787)</u>
Net accounts receivable	<u>\$ 6,548,936</u>	<u>7,344,009</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 2007 and 2006 for \$320,798, and \$466,479, respectively. As of December 31, 2007, the organization has received \$1,506,673 of the gifts and the remaining balance will be paid over the next 6 years. The Corporation recorded these pledges at the net present value less a discounted uncollectible amount of 10%.

	<u>2007</u>	<u>2006</u>
Pledges receivables	\$ 1,245,194	1,393,599
Less: unamortized discount	<u>(81,522)</u>	<u>(147,048)</u>
Subtotal	1,163,672	1,246,551
Less: allowance for uncollectibles	<u>(90,000)</u>	<u>(125,487)</u>
Net pledges receivables	<u>\$ 1,073,672</u>	<u>1,121,064</u>

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(h) Pledges Receivable (continued)

Pledges receivable as of December 31, 2007 is as follows:

Amounts due in:	
Less than one year	\$ 465,209
One to five years	<u>779,985</u>
	<u>\$ 1,245,194</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 \$0 and \$24,740 was capitalized in 2007 and 2006, 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, 2007 and 2006

(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>2007</u>	<u>2006</u>
Assets held in trust by others	\$ 7,257,861	7,112,672
Contributions receivable from remainder trusts	<u>1,992,888</u>	<u>2,019,804</u>
	<u>\$ 9,250,749</u>	<u>9,132,476</u>

(m) Derivatives and Hedging Activities

The Corporation utilizes an interest rate swap agreement to hedge variable interest rates; which is 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 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. For 2007, an adjustment to the asset was recorded causing a loss of \$122,618. This adjustment represents the decrease 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, 2007 and 2006

(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, 2007 and 2006, 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 guaranteed fee refundable upon reoccupancy is amortized on a straight-line basis over the remaining useful life of the applicable independent living unit. 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 surrender of the independent living unit.

The amount of guaranteed refundable entrance fees due to residents at December 31, 2007 and 2006 under contractual refund provisions was approximately \$9,892,000 and \$9,976,000, respectively.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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, 2007 and 2006

(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.

Medicare reimbursement provided for a prospective payment system ("PPS") for skilled nursing services. 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 diagnosis 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 46% and 48% of revenues for 2007 and 2006, respectively. Medicare and Medicaid receivables represent approximately 62% and 66% of accounts receivable at December 31, 2007 and 2006, respectively.

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 periods 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.

July 1, 2006 to June 30, 2007 \$1.97 a day for continuing care retirement community non-Medicare occupied beds, and \$20.35 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 supplemental and assessment amounts per day have not yet been finalized for the period 7/1-12/31/07. The State has published proposed amounts but no amount has been included on the Corporation's financial statements for this period.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

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

For the years ended December 31, 2007 and 2006 the Corporation received \$430,083 and \$130,818 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, 2007 and 2006, was \$420,633 and \$434,998, respectively.

(z) Classification of Expenses

	2007	2006
Program activities	\$ 68,492,928	64,441,992
General and administrative	12,437,684	10,782,092
Change in fair value of interest rate swap	122,618	(18,960)
Fundraising	294,017	293,745
	\$ 81,347,247	75,498,869

(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.

(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 loss on abandoned project, discontinued operations and unrealized gain (loss) on investments and assets held in trust by others". Changes in unrestricted net assets which are excluded from this measure are: loss on abandoned project, discontinued operations and unrealized gains (losses) on investments and assets held in trust by others, and other significant adjustments which do not directly indicate operational performance.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(ac) Statement of Cash Flows

Interest paid during the years ended December 31, 2007 and 2006 was \$3,376,885 and \$3,299,722, respectively.

(3) Investments

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

	2007		2006	
	Cost	Fair value	Cost	Fair value
Money market funds	\$ 873,351	873,351	1,096,303	1,096,303
Marketable equity securities	9,996	9,996	—	—
Mutual funds - equities	20,660,746	22,841,931	20,421,324	23,036,253
Mutual funds - fixed income	10,208,364	10,457,398	9,358,264	9,541,829
Government agencies securities	—	—	1,178,501	1,164,322
Corporate debt securities	5,030,970	5,030,970	5,042,129	5,042,250
Alternate investments	2,801,887	3,287,414	2,550,000	2,632,537
Other	140,973	140,973	146,136	146,136
Totals	<u>\$ 39,726,287</u>	42,642,033	<u>39,792,657</u>	42,659,630
Less assets whose use is limited (note 5)		<u>(7,654,850)</u>		<u>(7,599,689)</u>
Total investments		<u>\$ 34,987,183</u>		<u>\$ 35,059,941</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 its agencies, corporate bonds, and common stock to a diversified portfolio of mutual funds and alternative investments. The Corporation has eighteen mutual funds, three investments in limited partnerships and two fixed income investments as of December 31, 2007. The Corporation had thirty four mutual funds, two investments in limited partnerships and thirteen fixed income investments as of December 31, 2006.

As of December 31, 2007, four mutual funds had a market value that had been below cost for less than a year, and in total, their market value was less than four percent below cost. As of December 31, 2006, three bonds and three mutual funds had a market value that had been below cost for less than a year, and in total, their market value was less than one percent below cost.

No individual holdings had a market value that had been below cost for more than a year as of December 31, 2007. Eight individual holdings had a market value that had 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 was less than three percent below cost for 2006.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(3) Investments (continued)

A summary of investments with fair values below cost as of December 31, 2007 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>
Mututal funds	\$ <u>2,835,597</u>	<u>(121,547)</u>	<u>—</u>	<u>—</u>	<u>2,835,597</u>	<u>(121,547)</u>
Total temporarily impaired securities	\$ <u><u>2,835,597</u></u>	<u><u>(121,547)</u></u>	<u><u>—</u></u>	<u><u>—</u></u>	<u><u>2,835,597</u></u>	<u><u>(121,547)</u></u>

A summary of investments with fair values below cost as of December 31, 2006 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	\$ <u>248,055</u>	<u>(2,236)</u>	<u>816,267</u>	<u>(22,541)</u>	<u>1,064,322</u>	<u>(24,777)</u>
Subtotal debt securities	<u>248,055</u>	<u>(2,236)</u>	<u>816,267</u>	<u>(22,541)</u>	<u>1,064,322</u>	<u>(24,777)</u>
Mututal funds	<u>2,493,565</u>	<u>(5,917)</u>	<u>—</u>	<u>—</u>	<u>2,493,565</u>	<u>(5,917)</u>
Total temporarily impaired securities	\$ <u><u>2,741,620</u></u>	<u><u>(8,153)</u></u>	<u><u>816,267</u></u>	<u><u>(22,541)</u></u>	<u><u>3,557,887</u></u>	<u><u>(30,694)</u></u>

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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, 2007 and 2006, the Corporation incurred management fees and other expenses under the management agreement totaling \$4,751,473 and \$4,901,467, 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. PHI is a minority shareholder in CCRx Holdings, Inc., the parent corporation of Continuing Care Rx, Inc. Total purchases from Continuing Care Rx, Inc. for 2007 and 2006 were approximately \$1,935,146 and \$1,845,769, respectively, of which \$354,898 and \$363,748 is included in accounts payable as of December 31, 2007 and 2006, 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 2008.

Prelude Systems, Inc. (Prelude), is a joint venture between PHI 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. During 2007 and 2006, respectively, the Corporation paid Prelude approximately \$657,531 and \$745,153 for information services provided by Prelude.

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, the Corporation purchased services from Alliance Rehab for \$2,623,636, of which \$652,095 was included in accounts payable as of December 31, 2006.

Amounts due from affiliate entities, principally PHI, as of December 31, 2007 and 2006 are \$12,191,422 and \$3,430,728, respectively.

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

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(4) Related Party Transactions (continued)

The Corporation also has a beneficial interest in assets held in trust by PHI of \$2,127,650 and \$1,997,844 at December 31, 2007 and 2006, respectively.

(5) Assets Whose Use is Limited

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

	<u>2007</u>	<u>2006</u>
Permanently restricted investments	\$ 1,916,450	1,912,685
Debt service reserve fund	5,356,697	5,223,640
Bond fund	<u>381,703</u>	<u>463,364</u>
	7,654,850	7,599,689
Less current portion	<u>(381,703)</u>	<u>(463,364)</u>
	<u><u>\$ 7,273,147</u></u>	<u><u>7,136,325</u></u>

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

(6) Property and Equipment

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

	<u>2007</u>		<u>2006</u>	
	<u>Cost</u>	<u>Accumulated depreciation</u>	<u>Cost</u>	<u>Accumulated depreciation</u>
Land	\$ 8,485,189		7,673,335	
Land improvements	7,703,438	4,367,169	7,559,287	4,197,304
Buildings and improvements	122,828,855	55,587,748	125,270,827	54,364,600
Departmental equipment, furniture and fixtures	12,580,092	9,937,181	13,108,491	10,116,831
Furniture	1,653,657	1,509,913	1,696,367	1,485,504
Vehicles	1,320,788	1,049,744	1,233,028	989,613
Construction-in-progress	<u>5,354,106</u>		<u>3,199,399</u>	
	<u><u>\$ 159,926,125</u></u>	<u><u>72,451,755</u></u>	<u><u>159,740,734</u></u>	<u><u>71,153,852</u></u>
Net book value		<u><u>\$ 87,474,370</u></u>		<u><u>\$ 88,586,882</u></u>

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(6) Property and Equipment (continued)

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.

On April 1, 2007, the Corporation sold Forest Park Health Center, a 114 bed nursing living facility for approximately \$6,597,000, and recognized a gain of \$4,742,912.

For the years ended December 31, 2007 and 2006, Forest Park Health Center's gain consisted of:

	<u>2007</u>	<u>2006</u>
Depreciation	\$ (32,694)	(199,887)
Interest	(18,346)	(102,492)
Amortization	(569)	(1,354)
Other expenditures, net of gain of \$4,742,912	<u>4,884,943</u>	<u>1,036,268</u>
Total gain on discontinued operations	<u>\$ 4,833,334</u>	<u>732,535</u>

During 2007, it was determined that a planned construction project at Saint Andrew's Village was determined not to be viable and \$987,144 of assets were written off as costs associated with abandoned projects.

As of December 31, 2007 and 2006, commitments for future construction totaled approximately \$996,000 and \$3,600,000, respectively.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(7) Long-term Debt

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

	<u>2007</u>	<u>2006</u>
Cumberland County Municipal Authority Bonds Series 1993A, principal due in 2018, variable interest rate, 3.40% and 3.94% at December 31, 2007 and 2006, respectively, secured by irrevocable letter of credit	\$ 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	14,920,000	16,060,000
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, 3.39% and 3.92% at December 31, 2007 and 2006, respectively, collateralized by letter of credit	8,540,000	8,660,000
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 4.48% and 4.40% at December 31, 2007 and 2006 respectively, collateralized by property and equipment and gross revenues of the Corporation	7,765,747	8,340,762

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(7) Long-term Debt (continued)

	<u>2007</u>	<u>2006</u>
Cumberland County Municipality 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
Cumberland County Municipality 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, 4.25% and 3.65% at December 31, 2007 and 2006, respectively, insured by municipal bond insurance	16,800,000	16,800,000
	70,825,747	72,660,762
Less current portion	(1,917,022)	(1,835,015)
Plus unamortized premium	344,816	363,044
Less unamortized discount	(309,423)	(325,739)
	<u>\$ 68,944,118</u>	<u>70,863,052</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, 2007.

Maturities for the five years subsequent to December 31, 2007 are as follows:

<u>Years ended December 31,</u>	<u>Aggregate maturities</u>
2008	\$ 1,917,022
2009	2,114,000
2010	2,174,000
2011	2,239,000
2012	2,329,000
Thereafter	60,052,725
	<u>\$ 70,825,747</u>

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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>Notional 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

On February 15, 2007, the Corporation increased its line of credit with a financial institution, from allowing borrowings of up to \$4,000,000 to \$6,000,000 at a new interest rate based on the prime rate of the financial institution less one hundred and fifty basis points, which was 5.75% and 6.75% as of December 31, 2007 and 2006, respectively. The line of credit is collateralized by accounts receivable on a parity basis with the Corporation's bonded debt. As of December 31, 2007 and 2006, the Corporation had amounts totaling \$4,561,147 and \$2,443,819, respectively, outstanding under this agreement. The line was extended and expires on June 30, 2009.

(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, 2007 and 2006, the gross amount of the equipment and related accumulated amortization recorded under capital leases was as follows:

	<u>2007</u>	<u>2006</u>
Medical and office equipment	\$ 227,170	188,703
Accumulated amortization	<u>(120,662)</u>	<u>(57,150)</u>
	<u>\$ 106,508</u>	<u>131,553</u>

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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, 2007 follows:

2008	\$	77,569
2009		22,642
2010		<u>6,273</u>
		106,484
Amounts representing interest		<u>(5,212)</u>
	\$	<u><u>101,272</u></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:

2008	\$	106,341
2009		69,852
2010		12,848
2011		990
2012		<u>—</u>
	\$	<u><u>190,031</u></u>

Rental expense under operating leases was \$160,944 and \$249,313 for the years ended December 31, 2007 and 2006, 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 \$882,699 and \$840,756 at December 31, 2007 and 2006, 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 \$1,074,172 and \$993,615 as of December 31, 2007 and 2006, respectively to satisfy annuities.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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 2006, the Corporation maintained a letter of credit for \$2 million in connection with this self-insurance program. In addition, the Corporation maintained a restricted investment account in the amount of \$1,280,599 as collateral for this self-insurance program for 2006. In 2007, the Corporation maintains a letter of credit for \$4,180,000 in connection with this self-insurance program. At December 31, 2007 and 2006, the Corporation has recorded an accrued expense of approximately \$3.7 million and \$3 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>2007</u>	<u>2006</u>
Beneficial interest in assets of PHI	\$ 1,297,564	1,167,758
Charity care and/or equipment, including pledges receivable	1,336,169	1,413,286
Contributions receivable from remainder trust	<u>654,400</u>	<u>716,548</u>
	<u>\$ 3,288,133</u>	<u>3,297,592</u>

Net assets of \$614,823 and \$578,531 were released from restriction during 2007 and 2006 respectively in satisfaction of the above restrictions.

PRESBYTERIAN HOMES, INC.

Notes to Financial Statements

December 31, 2007 and 2006

(13) Permanently Restricted Net Assets

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

	<u>2007</u>	<u>2006</u>
Beneficial interest in assets of PHI	\$ 830,086	830,086
Contribution receivables from remainder trust	1,338,487	1,303,257
Charity care and/or equipment, including pledges receivable	2,129,898	2,128,222
Benefit in perpetual trusts; charity care	<u>7,257,861</u>	<u>7,112,671</u>
	<u>\$ 11,556,332</u>	<u>11,374,236</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 \$8.6 million and \$8.0 million for the years ended December 31, 2007 and 2006, respectively, of which the amount of charges foregone for services and supplies was approximately \$1.2 million and \$1.1 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, 2007 and 2006, retirement plan expense totaled approximately \$640,000 and \$599,000, 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, 2007 and 2006

(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 based on quoted market prices for same or similar issues.

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, 2007 and 2006 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.

(18) Subsequent Events

In February 2008, Presbyterian Homes purchased land in Newville, adjacent to Green Ridge Village for approximately \$1.6 million. The land will be used for future expansion.

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 financial 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 10, 2008

PRESBYTERIAN HOMES, INC.

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

As of December 31, 2007

2008 Budgeted Operating Expenses	\$ 85,005,945
Less: depreciation expense	<u>(5,347,035)</u>
Expenses subject to minimum liquid assets requirement	79,658,910
Percentage of residents subject to residence and care arrangements at December 31, 2007	<u>7%</u>
	5,576,124
Statutory requirement	<u>10%</u>
Statutory minimum liquid reserve requirement	\$ <u><u>557,612</u></u> (a)
Next 12 months debt service payments:	
Principal payments	\$ 1,917,022
Interest payments	<u>3,539,150</u>
Total debt service for next 12 months	<u>5,456,172</u>
Percentage of residents subject to residence and care arrangements at December 31, 2007	<u>7%</u>
Statutory minimum liquid reserve requirement	\$ <u><u>381,932</u></u> (b)
Assets satisfying statutory minimum liquid reserve requirement	
Unrestricted cash and investments	\$ <u>34,736,927</u>
Greater of (a) or (b)	<u>557,612</u>
Assets in excess of statutory minimum liquid reserve requirement	\$ <u><u>34,179,315</u></u>