



PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Financial Statements

December 31, 2008 and 2007

(With Independent Auditor's Report Thereon)

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Table of Contents

	Page
Certification of Chief Executive and Chief Financial Officers	1
Independent Auditor's Report	2
Financial Statements:	
Consolidated Statements of Financial Position	3
Consolidated Statements of Operations and Changes in Net Assets (Liabilities)	5
Consolidated Statements of Cash Flows	7
Notes to Consolidated Financial Statements	8



PRESBYTERIAN
SENIOR LIVING

Certification of Chief Executive and Chief Financial Officers

We are responsible for the financial statements and supporting information of Presbyterian Senior Living Services, Inc., as of December 31, 2008 and 2007, 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 Presbyterian Senior Living 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 82 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 Presbyterian Senior Living's mission.

Stephen E. Proctor
Chief Executive Officer
Presbyterian Senior Living

Jeffrey J. Davis
Chief Financial Officer
Presbyterian Senior Living



Independent Auditor's Report

The Board of Directors
Presbyterian Senior Living Services, Inc.:

We have audited the accompanying consolidated statements of financial position of Presbyterian Senior Living Services, Inc. (an affiliate of PHI, doing business as Presbyterian Senior Living) as of December 31, 2008 and 2007, and the related consolidated statements of operations and changes in net assets (liabilities), 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Presbyterian Senior Living Services, Inc. as of December 31, 2008 and 2007, and the changes in its net assets (liabilities), 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, Pennsylvania
March 20, 2009

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Financial Position

December 31, 2008 and 2007

Assets	2008	2007
Current assets:		
Cash and cash equivalents	\$ 12,430	388,446
Investments	233,000	241,482
Accounts receivable, net	508,756	699,297
Current portion, assets whose use is limited	509,017	707,700
Interest receivable	—	9,700
Prepaid expenses and other current assets	149,393	149,523
Total current assets	<u>1,412,596</u>	<u>2,196,148</u>
Assets whose use is limited, net of current portion	1,724,578	1,731,157
Property and equipment (net of accumulated depreciation of \$19,023,884 and \$17,423,371, respectively)	32,580,950	32,927,143
Assets under capital leases (net of accumulated depreciation of \$15,718 and \$8,024, respectively)	39,189	4,012
Deferred financing costs (net of accumulated amortization of \$151,030 and \$134,801, respectively)	<u>313,640</u>	<u>329,869</u>
Total assets	<u>\$ 36,070,953</u>	<u>37,188,329</u>

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Financial Position

December 31, 2008 and 2007

Liabilities and Net Liabilities	2008	2007
	<hr/>	<hr/>
Current liabilities:		
Accounts payable	\$ 477,755	982,657
Accrued expenses	530,372	471,828
Note payable	153,463	—
Current portion:		
Annuities payable	17,975	17,975
Obligations under capital leases	13,843	4,234
Bonds payable	405,000	375,000
Total current liabilities	<hr/> 1,598,408	<hr/> 1,851,694
Resident deposits	71,105	211,660
Deferred revenue – entrance fees	15,762,997	17,241,272
Due to affiliates	11,432,160	9,754,198
Fair value of interest rate swaps	573,587	—
Annuities payable, net of current portion	53,846	58,116
Long-term debt, net of current portion		
Obligations under capital leases	25,275	—
Bonds payable	17,620,000	18,025,000
Total liabilities	<hr/> 47,137,378	<hr/> 47,141,940
Net (liabilities) assets:		
Unrestricted	(11,534,440)	(10,401,230)
Temporarily restricted	132,165	111,769
Permanently restricted	335,850	335,850
Total net liabilities	<hr/> (11,066,425)	<hr/> (9,953,611)
Total liabilities and net liabilities	<hr/> \$ 36,070,953	<hr/> 37,188,329

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Operations and Changes in Net Assets (Liabilities)

Years ended December 31, 2008 and 2007

	2008	2007
Operating revenues, gains, and other support:		
Resident services, including amortization of entrance fees of \$1,553,692 and \$1,321,464	\$ 11,871,237	11,504,102
Interest and dividend income	72,009	73,853
Realized (losses) gains on investments	(8,868)	52,375
Net assets released from restrictions	16,078	46,942
Total operating revenues, gains, and other support	11,950,456	11,677,272
Expenses:		
Nursing services	2,255,428	2,200,087
Rehabilitation	267,310	241,126
Recreation and special services	362,815	376,776
Pharmacy	69,813	95,679
Social services	59,169	52,248
Physician services	33,324	43,799
Food services	1,679,225	1,588,625
Building operations and maintenance	2,148,711	1,897,691
Housekeeping	394,375	383,139
Laundry and linen	48,229	43,949
General and administrative	1,268,302	1,957,730
Employee benefits	479,787	488,049
Interest	987,132	1,223,502
Depreciation	1,608,207	1,509,755
Amortization	16,229	16,229
Total expenses	11,678,056	12,118,384
Operating income (loss)	272,400	(441,112)
Decrease in fair value of interest rate swaps	(573,587)	-
Deficit of operating revenues, gains and other support over expenses	(301,187)	(441,112)
Other changes:		
Unrealized (loss) gains on investments	(832,023)	13,947
Decrease in unrestricted net liabilities	(1,133,210)	(427,165)

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Operations and Changes in Net Assets (Liabilities)

Years ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Temporarily restricted net assets:		
Contributions, gifts and bequests	14,881	22,733
Interest and dividend income	21,593	20,234
Net assets released from restrictions	<u>(16,078)</u>	<u>(46,942)</u>
Change in temporarily restricted net assets	<u>20,396</u>	<u>(3,975)</u>
Change in net (liabilities) assets	(1,112,814)	(431,140)
Net (liabilities) assets, beginning of year	<u>(9,953,611)</u>	<u>(9,522,471)</u>
Net (liabilities) assets, end of year	<u>\$ (11,066,425)</u>	<u>(9,953,611)</u>

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Change in net liabilities	\$ (1,112,814)	(431,140)
Adjustments to reconcile change in net liabilities to net cash provided by operating activities:		
Depreciation	1,608,207	1,509,755
Proceeds from entrance fees and deposits	2,884,775	2,667,268
Amortization of entrance fees	(1,553,692)	(1,321,464)
Change in fair value of interest rate swaps	573,587	—
Unrealized losses (gains) on investments	832,023	(13,947)
Realized losses (gains) on investments	8,868	(52,375)
Amortization	16,229	16,229
Change in assets and liabilities:		
Accounts receivable	190,541	(339,666)
Prepaid expenses and other current assets	9,830	(8,156)
Accounts payable	(504,902)	(21,084)
Accrued expenses	58,544	110,971
Net cash provided by operating activities	<u>3,011,196</u>	<u>2,116,391</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(1,297,191)	(1,597,190)
Purchases of investments	(1,731,165)	(1,947,745)
Proceeds from sale of investments	1,104,018	1,816,462
Net cash used in investing activities	<u>(1,924,338)</u>	<u>(1,728,473)</u>
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(2,949,913)	(2,337,984)
Principal payments and redemptions of bonds	(375,000)	(350,000)
Borrowings through note payable	153,463	—
Borrowings through capital lease obligations	42,872	—
Repayments on capital lease obligations	(7,988)	(4,008)
Change in annuities payable	(4,270)	(4,470)
Change in due to affiliates	1,677,962	2,660,223
Net cash used in financing activities	<u>(1,462,874)</u>	<u>(36,239)</u>
Net (decrease) increase in cash and cash equivalents	(376,016)	351,679
Cash and cash equivalents, beginning of year	<u>388,446</u>	<u>36,767</u>
Cash and cash equivalents, end of year	\$ <u>12,430</u>	<u>388,446</u>

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(1) General Information

Presbyterian Senior Living Services, Inc. (the Corporation) is a not-for-profit corporation, which operates Glen Meadows Retirement Community, a Continuing Care Retirement Community (the Community) located in Glen Arm, Maryland, which provides housing, health care, and other related services to the elderly. The Corporation is also the parent company to a fully controlled affiliate Glen Meadows Retirement Community, Inc. (GMRCI). The Glen Meadows Foundation (the Foundation) was established for the exclusive benefit of the Community and certain assets held by the Corporation are designated for the Foundation. The consolidated financial statements of the Corporation include the financial position and operations of GMRCI and the Foundation. The Corporation and Foundation are governed by independent Boards of Directors, who are elected by the Board of Trustees of PHI, doing business as Presbyterian Senior Living, the Corporation's parent organization, the residents of Glen Meadows and the Presbytery of Baltimore.

The Community contains 114 independent living cottages, 88 independent living apartments, 29 assisted living units and a 31-bed skilled nursing facility. The facility covers approximately 60 acres of the 483-acre site owned by the Corporation.

The Corporation was formed on July 1, 1999 whereby all operations of Presbyterian Senior Services, Inc. (PSSI) were transferred to Presbyterian Senior Living Services, Inc. and Glen Meadows Retirement Community, Inc. PSSI's corporate existence was discontinued. Under this new structure, the property, plant and certain equipment of PSSI was transferred to Glen Meadows Retirement Community, Inc., and the operations, other assets, and all liabilities of PSSI were transferred to Presbyterian Senior Living Services, Inc. Presbyterian Senior Living Services, Inc. is a fully controlled subsidiary of Presbyterian Senior Living, located in Dillsburg, Pennsylvania.

(2) Summary of Significant Accounting Policies

(a) *Basis of Consolidation*

These consolidated financial statements have been prepared to focus on Presbyterian Senior Living Services, Inc. as a whole. All material intercompany transactions have been eliminated.

(b) *Basis of Accounting*

These consolidated 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.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(b) Basis of Accounting (continued)

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.

(c) Income Taxes

The Corporation and its subsidiaries are tax exempt under Section 501(c)(3) of the Internal Revenue Code.

In December 2008, the Financial Accounting Standards Board issued FASB Staff Position (FSP) FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*. The FSP defers the effective date of FASB Interpretation No 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, to be effective for fiscal years beginning after December 15, 2008 for certain nonpublic enterprises. The FSP requires a nonpublic enterprise that elects to defer the application of FIN 48 to explicitly disclose that fact and also requires the disclosure of the enterprise's accounting policy for evaluation uncertain tax positions for each set of financial statements where the deferral applies.

The Corporation has elected to defer the application of FIN 48. For the years ended December 31, 2008 and 2007, the Corporation has accounted for uncertain tax positions in accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*.

(d) 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.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(e) *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. The Corporation's cash and cash equivalents are insured by the Federal Deposit Insurance Corporation for up to \$250,000 and \$100,000 per bank as of December 31, 2008 and 2007, respectively. At December 31, 2008 the Corporation's cash balances did not exceed the FDIC coverage. At December 31, 2007, the Corporation's cash balances exceeded the FDIC coverage by \$154,995.

(f) *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. 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, 2008 and 2007, 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>2008</u>	<u>2007</u>
Interest and dividends	\$ 93,602	94,087
Realized (losses) gains on investments	(8,868)	52,375
Unrealized (losses) gains on investments	<u>(832,023)</u>	<u>13,947</u>
	<u>\$ (747,289)</u>	<u>160,409</u>

Investment expenses of \$8,357 and \$10,430 as of December 31, 2008 and 2007, respectively have been included in general and administrative expenses.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(g) Accounts Receivable

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

	<u>2008</u>	<u>2007</u>
Total accounts receivable	\$ 578,258	735,676
Less: allowance for doubtful accounts	<u>(69,502)</u>	<u>(36,379)</u>
Net accounts receivable	<u>\$ 508,756</u>	<u>699,297</u>

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

(h) Assets Whose Use is Limited

Assets whose use is limited are measured at fair value in the statements of financial position and include money deposited with a trustee under a debt agreement, assets restricted by donors for capital improvements, and the Maryland Department of Aging Operating Reserve.

(i) 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 functioning as a group 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
Vehicles	5 years

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(j) *Derivatives and Hedging Activities*

The Corporation utilized an interest rate swap agreement to hedge variable interest rates; which was 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*.

The Corporation's interest rate swap was carried at fair value asset as determined by a third party. Changes in fair value were reported in the statement of operations and changes in net assets (liabilities) as a component of the change in net assets. For 2008, an adjustment to the liability was recorded causing a loss of \$537,587 adjustment represented the increase in the fair value (liability) of the swap.

(k) *Deferred Financing Costs*

The Corporation has deferred the costs incurred for obtaining the proceeds of the Corporation's bonds payable. These costs are being amortized over the life of the related bond using the straight-line method, which approximates the effective interest method. Amortization expense is expected to be approximately \$16,229 for each of the next five years.

(l) *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 consolidated statements of financial position. These deposits are transferred to deferred revenue upon occupancy of the related units.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(m) *Deferred Revenue – Entrance Fees*

Residents entering the Community execute a Residence and Care Agreement, which requires payment of an entrance fee, based on the unit to be occupied. Ten percent of the entrance fee, as approved by the Maryland Department of Aging, is due upon execution of the agreement and the remainder is due upon occupancy. For the 100% refundable contracts, entrance fees are refundable in full upon termination of the agreement and subsequent reoccupancy of the unit. These entrance fees are amortized into revenue using the straight-line method over the remaining useful life of the facility. The Community also offers a 25% and a 50% nonrefundable contract, as well. 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 entrance fees guaranteed to be refundable to residents at December 31, 2008 and 2007 under contractual refund provisions was approximately \$28,899,000 and \$28,257,000, respectively.

(n) *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. The Corporation's temporarily restricted net assets consist principally of funds directed for special projects and resident welfare. Net assets released from restriction consist of expenses incurred satisfying those restricted purposes. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity. Income from the permanently restricted net assets is primarily to be used for resident welfare.

(o) *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 consolidated statement of operations and changes in net assets (liabilities) 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 consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(o) Donor Restrictions (continued)

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.

(p) Resident Services Revenue and Business Concentration

Resident services revenue is reported at the estimated net realizable amount to be received from patients and others including Medicare, Maryland Medicaid (Medicaid), and other third-party payors for services rendered. The Corporation derives a significant portion of its revenues from federal and state reimbursement programs. These reimbursements are subject to audit and retroactive adjustment in future periods. The Community is certified to receive benefits under Medicare and Medicaid.

Skilled nursing services provided to Medicare beneficiaries are paid at under terms of a prospective payment system at predetermined rates based on clinical, diagnostic, and other factors.

Nursing services provided to 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 existence in Maryland exposes it to the risk of changes in Medicaid reimbursement in this state.

Revenues from Medicare and Medicaid represent approximately 9% and 10% of consolidated revenues for 2008 and 2007, respectively. Medicare and Medicaid receivables represent approximately 25% and 32% of consolidated accounts receivable at December 31, 2008 and 2007, respectively.

(q) Charity Care

The Corporation provides 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 \$252,919 and \$202,147 for the years ended December 31, 2008 and 2007, respectively, of which the amount of charges foregone for services and supplies was approximately \$210,129 and \$182,817, respectively.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(r) Classification of Expenses

	<u>2008</u>	<u>2007</u>
Program activities	\$ 10,409,754	10,160,654
General and administrative	1,268,302	1,914,323
Fundraising	—	43,407
	<u>\$ 11,678,056</u>	<u>12,118,384</u>

(s) Advertising

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2008 and 2007, was \$64,730 and \$67,587, respectively.

(t) Operating Income (Loss)

The consolidated statements of operations and changes in net assets (liabilities) include an intermediate measure of operations labeled as “operating income (loss).” Changes in the performance indicator which are excluded from this measure include changes in the fair value of interest rate swap agreements.

(u) Performance Indicator

The Corporation measures the performance of its operations using the consolidated statements of operations and changes in net assets (liabilities), which includes a performance indicator of operations labeled as “deficit of operating revenues, gains, and other support over expenses.” Changes in unrestricted net assets which are excluded from this measure are unrealized (losses) gains on investments.

(v) Consolidated Statements of Cash Flows

Interest paid during the years ended December 31, 2008 and 2007 was \$993,047 and \$1,230,707, respectively.

(w) Reclassifications

Certain items in the 2007 financial statements have been reclassified to conform with the 2008 financial statement presentation. These reclassifications had no effect on the change in net assets.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(3) Investments

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

	2008		2007	
	Fair Value	Cost	Fair Value	Cost
Money market funds	\$ 707,631	707,631	217,542	217,542
Equity securities	1,318,701	1,935,111	1,673,318	1,548,821
Fixed income securities	440,263	499,774	789,479	773,967
Totals	\$ 2,466,595	3,142,516	2,680,339	2,540,330
Less assets whose use is limited (note 5)	\$ (2,233,595)		(2,438,857)	
Total investments	\$ 233,000		241,482	

In 2008, the Corporation moved its investments to the operating reserve fund. These assets are invested in a diversified portfolio of mutual funds. The Corporation had sixteen and seventeen mutual funds as of December 31, 2008 and 2007. As of December 31, 2008, all sixteen mutual funds had a market value below cost. As of December 31, 2007, five mutual funds had a market value below cost.

Eleven individual holdings had market values that have been below cost for less than a year as of December 31, 2008. In total, their market value is twenty six percent below cost for 2008. Five individual holdings had market values that have been below cost for less than a year as of December 31, 2007. In total, the market value of the loss is less than four percent below cost for 2007.

Five individual holdings had market values that have been below cost for more than one year as of December 31, 2008. In total, their market value is forty-four percent below cost for 2008. There are no individual holdings that have a market value that had been below cost for more than a year as of December 31, 2007.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(3) Investments (continued)

A summary of investments with fair values below cost as of December 31, 2008 follows:

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mututal funds	\$ 1,601,726	(553,228)	157,238	(122,693)	1,758,964	(675,921)
Total temporarily impaired securities	\$ <u>1,601,726</u>	<u>(553,228)</u>	<u>157,238</u>	<u>(122,693)</u>	<u>1,758,964</u>	<u>(675,921)</u>

A summary of investments with fair values below cost as of December 31, 2007 follows:

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mututal funds	\$ 260,252	(10,046)	—	—	260,252	(10,046)
Total temporarily impaired securities	\$ <u>260,252</u>	<u>(10,046)</u>	<u>—</u>	<u>—</u>	<u>260,252</u>	<u>(10,046)</u>

(4) Related Party Transactions

The Corporation incurs a management fee payable to Presbyterian Senior Living, under a Development, Marketing, and Management Agreement (Management Agreement). Under the Management Agreement, Presbyterian Senior Living provides a full-time licensed administrator who is responsible for the facility's operation, under the direction of Presbyterian Senior Living. For the year ended December 31, 2008, Presbyterian Senior Living did not require the Corporation to pay the 2008 fees under the agreement. For the year ended December 31, 2007, the Corporation incurred fees under the agreement of \$723,442, which was classified as general and administrative expenses on the consolidated statements of operations and changes in net assets (liabilities).

Presbyterian Homes, Inc., a subsidiary of Presbyterian Senior Living, has guaranteed payment up to \$6,000,000 to the extent collateral is insufficient to satisfy the outstanding debt of the Corporation as described in Note 8.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(4) Related Party Transactions (continued)

At December 31, 2008 and 2007 the amounts payable to Presbyterian Senior Living, were \$11,432,160 and \$9,754,198, respectively. Under the Management Agreement, this is included in due to affiliated entity.

Prelude Systems, Inc. (Prelude), is a joint venture between Presbyterian Senior Living 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 Presbyterian Senior Living and Diakon as well as other healthcare and community service organizations. During 2008 and 2007, respectively, the Corporation paid Prelude approximately \$92,800 and \$87,916 for information services provided by Prelude, of which \$9,735 and \$15,889 is included in accounts payable as of December 31, 2008 and 2007, respectively.

During 2008 and 2007, the Corporation purchased pharmaceuticals of \$46,801 and \$93,372, respectively from Continuing Care Rx, Inc., of which \$0 and \$19,890 is included in accounts payable as of December 31, 2008 and 2007, respectively. Presbyterian Senior Living is a minority shareholder of CCRx Holdings, Inc., the parent corporation of Continuing Care Rx, Inc.

(5) Assets Whose Use is Limited

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

	<u>2008</u>	<u>2007</u>
Operating reserve fund	\$ 1,508,055	1,531,994
Designated for renovation and charity care	509,017	707,700
Other reserves required by financing arrangement	216,523	199,163
	<u>2,233,595</u>	<u>2,438,857</u>
Less: current portion assets whose use is limited	<u>(509,017)</u>	<u>(707,700)</u>
Assets whose use is limited, net of net of current portion	<u>\$ 1,724,578</u>	<u>1,731,157</u>

The Corporation's Board of Directors has designated certain funds toward the purpose of acquiring or renovating property and equipment and for providing charity care.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(5) Assets Whose Use is Limited (continued)

The Corporation is required by the Maryland Department of Aging to maintain and fund an operating reserve based on the Corporation's operating expenses for the most recent fiscal year, excluding depreciation and amortization. The Department of Aging requires the Corporation to build the level of this operating reserve over a period not to exceed ten years beginning in 1997. Annual contributions to the operating reserve equaling at least 10% of the calculated reserve amount are required. For the year ended December 31, 2008 the fund balance was \$1,508,055, representing cumulative contributions and earnings in satisfaction of the minimum operating reserve amount. No additional contributions are anticipated to be made during 2009 based on the following computation:

	<u>2008</u>
Total operating expenses:	\$ 11,678,056
Less: Depreciation	(1,608,207)
Amortization	<u>(16,229)</u>
Total expenses subject to operating reserve computation	(A) 10,053,620
Operating reserve requirement – 15% of (A)	1,508,043
Operating reserve fund, December 31, 2008	<u>(1,508,055)</u>
Contributions required for year ended December 31, 2009	<u>\$ (12)</u>

(6) Commitments and Contingencies

The Corporation is involved in legal proceedings arising from its activities in the health care industry. Although it is not possible to presently determine the 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 SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(7) Property and Equipment

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

	2008		2007	
	Cost	Accumulated depreciation	Cost	Accumulated depreciation
Land	\$ 14,800,000	—	14,800,000	—
Land improvements	2,085,423	1,269,790	2,085,423	1,184,857
Buildings and improvements	31,964,776	15,843,739	30,922,959	14,443,629
Departmental equipment, furniture and fixtures	2,161,921	1,706,895	2,108,916	1,608,347
Vehicles	233,298	203,460	233,298	186,538
Construction-in-progress	359,416	—	199,918	—
	\$ 51,604,834	19,023,884	50,350,514	17,423,371
Net book value		\$ 32,580,950		\$ 32,927,143

Land consists of 483 acres, of which 60 acres are utilized for the facility. The remaining land is leased to independent parties and may be available for future expansion. Commitments for future constructions was approximately \$557,000 as of December 31, 2008.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(8) Bonds payable

Bonds payable as of December 31 consisted of the following:

	<u>2008</u>	<u>2007</u>
Maryland Health and Higher Educational Facilities Authority Revenue Bonds Series 1999A, tax exempt variable rate debenture bonds, principal maturities in varying amounts from 2012 to 2029, interest adjusted weekly, 2.05% and 3.55% at December 31, 2008 and 2007, respectively, collateralized by letter of credit	\$ 3,340,000	3,340,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds Series 1999B, taxable variable rate debenture bonds, principal maturities in varying amounts from 2001 to 2029, interest adjusted weekly, 2.5% and 5.11% at December 31, 2008 and 2007, respectively, collateralized by letter of credit	<u>14,685,000</u>	<u>15,060,000</u>
	18,025,000	18,400,000
Less: current portion bonds payable	<u>(405,000)</u>	<u>(375,000)</u>
	<u>\$ 17,620,000</u>	<u>18,025,000</u>

Under the terms of the Corporation's 1999 Maryland Health and Higher Educational Facility 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 were met as of December 31, 2008 and 2007.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(8) Bonds payable (continued)

Maturities for the five years subsequent to December 31, 2008 and thereafter are as follows:

<u>Years ended December 31,</u>	
2009	\$ 405,000
2010	435,000
2011	465,000
2012	500,000
2013	535,000
Thereafter	<u>15,685,000</u>
	<u>\$ 18,025,000</u>

The Corporation has an outstanding letter of credit of \$18,767,000 at December 31, 2008 and 2007, respectively as required by the bonds. This letter of credit requires the Corporation to pay an annual fee approximating 1.15% of the principal balance of bonds outstanding. This letter of credit expires August 26, 2010 and is collateralized by property and equipment and gross revenues of the Corporation.

In July 2008, the Corporation entered into a swap agreement on the Series B bonds for a notational amount of \$14,685,000 at 3.702%, which expires on July 1, 2010.

Pursuant to this agreement 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.

(9) Note Payable

The Corporation has available a line of credit with a financial institution. Borrowings under this line of credit arrangement vary with the prime rate of 1.75% and 8.25% at December 31, 2008 and 2007. Under the line of credit agreement, the Corporation had available maximum borrowings of \$1,250,000. As of December 31, 2008 and 2007, the Corporation had outstanding borrowings under the line of credit agreement of \$153,463 and \$0, respectively. The line of credit expires on June 30, 2009.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(10) Leases

The Corporation is obligated under capital leases for computer equipment that expire in 2011. At December 31, 2008 and 2007, the gross amount of the equipment and related accumulated amortization recorded under capital leases was as follows:

	<u>2008</u>	<u>2007</u>
Computer equipment	\$ 54,907	12,036
Accumulated amortization	<u>(15,718)</u>	<u>(8,024)</u>
	<u>\$ 39,189</u>	<u>4,012</u>

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, 2008 follows:

2009	\$ 15,224
2010	15,225
2011	<u>11,056</u>
	41,505
Amounts representing interest	<u>(2,387)</u>
Present value of minimum lease payments	<u>\$ 39,118</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:

2009	\$ 19,249
2010	6,612
2011	<u>2,197</u>
	<u>\$ 28,058</u>

Rental expense under operating leases was \$37,218 and \$37,935 for the years ended December 31, 2008 and 2007, respectively.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(11) 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 \$71,821 and \$76,091 at December 31, 2008 and 2007, respectively. The Corporation uses published mortality-rate tables adopted by the United States Internal Revenue Service and an assumed discount rate of approximately four percent to determine the present value of the actuarially determined liability. The Corporation has assets included in investments of \$233,000 and \$227,993 as of December 31, 2008 and 2007, respectively to satisfy annuities.

(12) Retirement Plan

The Corporation participates in the defined-contribution retirement plan of Presbyterian Senior Living. This 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 Presbyterian Senior Living, and employees have the ability to direct how their contributions are invested. For the years ended December 31, 2008 and 2007, retirement plan expense totaled approximately \$72,100 and \$62,100, respectively.

(13) Temporarily Restricted Net Assets

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

	<u>2008</u>	<u>2007</u>
Endowment:		
Benevolent Care	\$ 91,318	72,146
Scholarships	3,801	4,610
	<u>95,119</u>	<u>76,756</u>
Scholarships	31,528	29,984
Other	5,518	5,029
	<u>\$ 132,165</u>	<u>111,769</u>

Net assets of \$16,078 and \$46,942 were released from restriction during 2008 and 2007, respectively in satisfaction of the above restrictions.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(14) Permanently Restricted Net Assets

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

	<u>2008</u>	<u>2007</u>
Benevolent Care	\$ 326,253	326,253
Scholarship	<u>9,597</u>	<u>9,597</u>
	<u>\$ 335,850</u>	<u>335,850</u>

(15) Endowment

The endowments consist of donor restricted funds established for a variety of purposes supporting the Corporation. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of relevant law

The Board of Trustees of the Corporation has interpreted the relevant state law as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Corporation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as unrestricted and temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by the relevant state law and donor imposed stipulations. Unless specifically defined, a donor-restricted endowment fund that is required by donor stipulation to accumulate or appropriate endowment funds, the Organization considers the following factors:

- (1) The duration and preservation of the fund
- (2) The purposes of the organization and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and appreciation of investments
- (6) Other resources of the organization
- (7) The investment policies of the organization

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(15) Endowment (continued)

The following schedule represents the changes in endowment net asset for the year ended December 31, 2008:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 76,756	335,850	412,606
Investment return:			
Investment income	19,363	-	19,363
Appropriation of endowment assets for expenditures	<u>(1,000)</u>	<u>-</u>	<u>(1,000)</u>
Endowment net assets, end of year	\$ <u>95,119</u>	<u>335,850</u>	<u>430,969</u>

The following schedule represents the changes in endowment net asset for the year ended December 31, 2007:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 68,034	335,850	403,884
Investment return:			
Investment income	18,171	-	18,171
Appropriation of endowment assets for expenditures	<u>(9,449)</u>	<u>-</u>	<u>(9,449)</u>
Endowment net assets, end of year	\$ <u>76,756</u>	<u>335,850</u>	<u>412,606</u>

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(15) Endowment (continued)

Funds with Deficiencies

The fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the relevant state law requires the Corporation to retain as a fund of perpetual duration. In accordance with generally accepted accounting principles, these deficiencies are reported as unrestricted net assets. There were no such deficiencies reported at December 31, 2008 or 2007.

Return Objectives and Risk Parameters

The Corporation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Corporation must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of a composite of public market indexes based on the mix of investments held, while assuming a moderate level of investment risk. The Corporation expects its endowment funds, over time, to provide an average rate of return of approximately the consumer price index plus the investment spending percentage plus one percent annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

The Corporation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Corporation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(15) Endowment (continued)

Endowment Spending Policy and How the Investment Objectives Relate to the Spending Policy

The Corporation has a total return policy for calculating the amounts available for distribution each year a percent of its endowment fund's average fair value over the prior three calendar year ends. This percentage was 4.0% for 2008 and 2007. Actual distributions are for specific projects approved by the Board of Directors. If the total return amount exceeds the actual earnings of the Endowment Funds in any one year, then the amount needed to fund such excess will first be taken from the accumulated excess earnings from prior years, then from the accumulated net capital gains of Endowment Funds and, conversely, any undistributed income after the allocation of the total return distribution is added back to the unrestricted or temporarily restricted fund balance. In establishing this policy, the Corporation considered the long-term expected return on its endowment. Accordingly, over the long term, the Corporation expects the current spending policy to allow its endowment to grow at an average of inflation plus one percent annually. For 2008 and 2007 an allocation of four percent of the prior year's balance was used to calculate restricted funds available balance. This is consistent with the Corporation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

(16) Financial Instruments

(a) Fair Values of Financial Instruments

The following valuation techniques were used to measure the fair value of assets and liabilities in the table on page 30 on a recurring basis as of December 31, 2008:

Money market funds, equity and fixed income securities: Fair value of money market funds, and equity and fixed income securities was based on quoted market prices for the identical security.

Long-term debt: Long-term debt is carried at cost in the statements of financial position for bonds payable and mortgages payable at December 31, 2008 and 2007. Fair value is based on quoted market prices for the same or similar issues. The total outstanding was \$18,025,000 and \$18,400,000 at December 31, 2008 and 2007, respectively, and its fair values at December 31, 2008 and 2007 approximates \$14,363,900 and \$18,039,625, respectively.

Interest rate swap: Fair value of the interest rate swap was based on the net present value of expected future cash flows of the difference between the fixed interest rate of the interest rate swap and the counterparty's forward LIBOR curve. The forward LIBOR curve is readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Corporation has categorized the interest rate swap as Level 2.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(16) Financial Instruments (continued)

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, 2008 and 2007 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying statements of financial position.

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007.

The primary effect of SFAS 157 on the Organization was to expand the required disclosures pertaining to the methods used to determine fair values.

SFAS 157 established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under SFAS 157 are as follows:

- Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities
- Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.
- Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported with little or no market activity).

An asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(16) Financial Instruments (continued)

For assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2008 are as follows:

<u>Description</u>	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>
Money market funds	\$ 707,631	707,631	—
Equity securities	1,318,701	1,318,701	—
Fixed income securities	440,263	440,263	—
Total investments	<u>2,466,595</u>	<u>2,466,595</u>	<u>—</u>
Interest rate swap	<u>(573,587)</u>	<u>—</u>	<u>(573,587)</u>

(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.