



**Moving your  
vision forward.™**

**PHI**

**Consolidated Financial Statements**

**December 31, 2005 and 2004**

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

## **PHI**

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RETIREMENT AND SENIOR  
CARE SERVICES

1217 Slate Hill Road • Camp Hill, Pennsylvania 17011

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

We are responsible for the financial statements and supporting information of PHI, as of December 31, 2005 and 2004, 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 78 years.

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

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

Stephen Proctor  
Chief Executive Officer  
PHI

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

Jeffrey J. Davis  
Chief Financial Officer  
PHI

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

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

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



## Independent Auditor's Report

The Board of Trustees  
PHI:

We have audited the accompanying consolidated statements of financial position of PHI and affiliates (collectively the Corporation), as of December 31, 2005 and 2004, and the related consolidated statement of activities and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Geneva House, Inc., and Presbyterian Apartments, Inc., affiliates of PHI, which statements reflect total assets constituting .73 and .80 percent and total revenues constituting .97 percent and .95 percent, of the related 2005 and 2004 consolidated totals, respectively. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for Geneva House, Inc., and Presbyterian Apartments, Inc. is based solely on the reports of the other auditors. We also did not audit the 2004 financial statements of Presbyterian Homes in the Presbytery of Huntingdon. Those financial statements were audited by other auditors whose report thereon has been furnished to us and our opinion, insofar as it relates to the amounts included for the 2004 Presbyterian Homes in the Presbytery of Huntingdon is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PHI and affiliates as of December 31, 2005 and 2004 and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Beard Miller Company LLP*

Beard Miller Company LLP  
Lancaster, PA  
February 25, 2006

**PHI**

Consolidated Statements of Financial Position

December 31, 2005 and 2004

Assets	2005	2004
Current assets:		
Cash and cash equivalents	\$ 4,472,009	3,040,134
Investments	65,952,881	62,429,816
Accounts receivable, net	8,053,980	8,132,407
Assets whose use is limited - current portion	1,692,137	1,651,075
Pledges receivable, current portion	483,353	138,000
Interest receivable	155,215	162,519
Inventory	306,925	306,894
Prepaid expenses and other current assets	1,182,083	1,237,714
Total current assets	82,298,583	77,098,559
Assets whose use is limited, net of current portion	12,353,500	12,493,176
Assets whose use is limited, construction funds held by trustee	-	3,503,982
Pledges receivable, net of current portion	849,975	893,632
Property and equipment (net of accumulated depreciation of \$128,286,025 and \$117,943,248, respectively)	179,940,681	174,119,824
Assets under capital leases (net of accumulated depreciation of \$42,409 and \$18,415, respectively)	156,534	62,553
Assets held in trust by others	7,843,612	8,066,217
Fair value of interest rate hedges	164,599	-
Unamortized deferred costs:		
Deferred marketing costs, net of accumulated amortization of \$2,003,518 and \$2,148,786	168,995	365,786
Deferred financing costs, net of accumulated amortization of \$1,095,549 and \$962,631	4,533,854	3,932,999
Other assets	6,442	7,942
Total assets	\$ 288,316,775	280,544,670

See accompanying notes to consolidated financial statements.

**PHI**

Consolidated Statements of Financial Position

December 31, 2005 and 2004

Liabilities and Net Assets	2005	2004
Current liabilities:		
Accounts payable	\$ 8,375,107	7,112,173
Accrued expenses - other	11,442,469	11,323,713
Notes payable	3,309,437	813,347
Accrued interest	595,757	719,754
Current portion:		
Annuities payable	187,044	154,150
Obligations on capital leases	62,615	27,933
Long-term debt	4,500,622	4,569,590
Total current liabilities	28,473,051	24,720,660
Resident deposits	1,846,040	1,281,025
Deferred revenue - entrance fees	70,636,514	68,565,698
Fair value of interest rate hedges	-	214,607
Annuities payable	1,014,175	908,249
Long-term debt, less current maturities:		
Obligations on capital leases	73,534	23,035
Long-term debt	149,416,050	148,862,415
Total liabilities	251,459,364	244,575,689
Net assets:		
Unrestricted	22,138,526	21,518,620
Temporarily restricted	3,250,970	3,226,839
Permanently restricted	11,467,915	11,223,522
Total net assets	36,857,411	35,968,981
Total liabilities and net assets	\$ 288,316,775	280,544,670

See accompanying notes to consolidated financial statements.

PHI

Consolidated Statements of Activities and Changes in Net Assets

Years ended December 31, 2005 and 2004

	2005	2004
Revenues, gains, and other support:		
Resident services, including amortization of entrance fees of \$8,129,363 and \$7,703,489	\$ 131,842,538	124,553,626
Sales of other services and materials	60,194	52,405
Net rental income	1,287,828	1,270,963
Interest and dividend income	3,124,985	1,958,230
Realized gains on investments	687,248	728,698
Gifts and bequests	1,360,478	1,981,504
Net assets released from restrictions	1,102,629	1,335,284
Total revenues, gains, and other support	139,465,900	131,880,710
Expenses:		
Nursing services	40,336,329	39,844,592
Rehabilitation	5,007,003	4,213,649
Recreation and special services	4,011,801	3,500,182
Pharmacy	2,865,374	701,808
Social services	579,354	552,122
Physician services	368,323	261,345
Food services	15,234,744	14,682,790
Building operations and maintenance	14,653,708	13,036,674
Housekeeping	3,699,224	3,595,506
Laundry and linen	1,630,934	1,575,608
General and administrative	21,420,655	18,977,018
Employee benefits	10,041,492	10,080,700
Interest	6,978,520	6,450,511
Depreciation	10,418,516	10,111,434
Amortization	414,891	774,437
Change in fair value of interest rate hedges	(379,205)	(490,967)
Loss on early extinguishment of debt	1,816,514	—
Total expenses	139,098,177	127,867,409
Change in unrestricted net assets before unrealized gains on investments and discontinued operations	367,723	4,013,301
Unrealized gains on investments	188,874	343,169
Discontinued operations, including realized gain on sale of \$20,258,500 in 2004	63,309	23,051,951
Change in unrestricted net assets	619,906	27,408,421

See accompanying notes to consolidated financial statements.

(Continued)

**PHI**

Consolidated Statements of Activities and Changes in Net Assets

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Temporarily restricted net assets:		
Contributions, grants and bequests	855,586	338,189
Interest and dividend income	92,521	46,991
Unrealized gain on investments	178,653	212,922
Net assets released from restrictions	<u>(1,102,629)</u>	<u>(1,335,284)</u>
Change in temporarily restricted net assets	<u>24,131</u>	<u>(737,182)</u>
Permanently restricted net assets:		
Contributions	308,386	279,463
Change in fair value of assets held in trust by others	<u>(63,993)</u>	<u>311,029</u>
Change in permanently restricted net assets	<u>244,393</u>	<u>590,492</u>
Change in net assets	888,430	27,261,731
Net assets, beginning of year	<u>35,968,981</u>	<u>8,707,250</u>
Net assets, end of year	<u>\$ 36,857,411</u>	<u>35,968,981</u>

See accompanying notes to consolidated financial statements.



PHI

Consolidated Statements of Cash Flows

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Change in net assets	\$ 888,430	27,261,731
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	10,418,516	10,111,434
Proceeds from entrance fees and deposits	17,708,506	14,127,991
Amortization of entrance fees	(8,129,363)	(7,703,489)
Loss on early extinguishment of debt	1,816,514	—
Change in assets held in trust by others	158,612	(497,020)
Change in fair value of interest rate hedges	(379,205)	(469,434)
Unrealized gains on investments and change in fair value of assets held in trust	(303,534)	(867,120)
Realized gains on investments	(687,248)	(728,698)
Realized gain on sale of property, plant and equipment	—	(20,258,500)
Contributions restricted for long-term purposes	(308,386)	(279,463)
Amortization of deferred costs	384,541	732,060
Amortization of bond discount	30,350	42,377
Changes in assets and liabilities:		
Decrease in accounts receivable	78,427	4,418,074
(Increase) decrease in pledges receivable	(301,696)	104,568
Decrease in other assets	64,404	2,419,486
Increase (decrease) in accounts payable	1,262,934	(3,174,355)
Swap termination fee payable	—	(1,795,000)
(Decrease) increase in accrued expenses and deferred revenue-other	(5,241)	2,455,481
Net cash provided by operating activities	<u>22,696,561</u>	<u>25,900,123</u>
Cash flows from investing activities:		
Acquisition of property and equipment, net of disposals	(16,333,353)	(17,413,199)
Net proceeds from sale of property and equipment	—	25,500,000
Purchases of investments	(67,053,222)	(66,061,299)
Proceeds from sale of investments	64,584,932	40,233,037
Cash provided by assets whose use is limited	<u>3,602,596</u>	<u>6,190,244</u>
Net cash used in investing activities	<u>(15,199,047)</u>	<u>(11,551,217)</u>

See accompanying notes to consolidated financial statements.

(Continued)

**PHI**

Consolidated Statements of Cash Flows

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(6,943,313)	(6,852,013)
Principal payments on and redemptions of long-term debt	(36,258,238)	(4,221,331)
Proceeds from issuance of long-term debt	35,633,551	—
Financing costs incurred	(1,526,116)	—
Net borrowings (repayments) of notes payable	2,496,090	(5,504,876)
Borrowings through capital leases	119,037	—
Repayments on capital leases	(33,856)	—
Contributions restricted for long-term purposes	308,386	279,463
Increase in annuities payable	138,820	124,357
	<u>(6,065,639)</u>	<u>(16,174,400)</u>
Net cash used in financing activities		
	(6,065,639)	(16,174,400)
Net increase (decrease) increase in cash and cash equivalents	1,431,875	(1,825,494)
Cash and cash equivalents, beginning of year	<u>3,040,134</u>	<u>4,865,628</u>
Cash and cash equivalents, end of year	<u>\$ 4,472,009</u>	<u>3,040,134</u>

See accompanying notes to consolidated financial statements.

**PHI**  
Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

**(1) General Information**

PHI (Corporation), a not-for-profit corporation, is the parent corporation of Presbyterian Homes, Inc. (Pres Homes), Presbyterian Housing and Services Corporation (PHSC), Presbyterian Senior Living Services, Inc. (PSLSI), Presbyterian Apartments, Inc. (PAI), and Geneva House, Inc. (GHI), which are controlled affiliates of PHI. The Corporation also owns 46 percent of Prelude Systems, Inc., a technical services organization, 6 percent of CCRx Holdings, Inc., a pharmaceutical company, and owns 10 percent of a limited liability corporation called Alliance Rehab HVA, LLC. (Note 5).

As of April 1, 2005 the board of directors, of the Presbyterian Homes in the Presbytery of Huntingdon (PHPH) amended the bylaws of that corporation to become a controlled affiliated of PHI. This affiliation has been accounted for as a pooling of interest, and as such, PHI's 2004 financial statements have been amended to include the results of PHPH. PHI's financial statements for 2005 include the results of PHPH as if it had been part of PHI for the full year starting in January 1, 2005. A summary of the changes to the 2004 statements is as follows:

	<u>Original Audit</u> <u>2004</u>	<u>PHPH Audited</u> <u>2004</u>	<u>Amended</u> <u>2004</u>
Assets	\$ 242,915,530	37,629,140	280,544,670
Liabilities	219,681,509	24,894,180	244,575,689
Net assets	23,234,021	12,734,960	35,968,981
Results of operations:			
Total revenue	\$ 104,715,836	27,164,874	131,880,710
Total expenses	100,776,028	27,091,381	127,867,409
Change in net assets	26,877,786	383,945	27,261,731

The Corporation serves as a management company for the above affiliates and is governed by a Board of Trustees. Some of the members of the Board of Trustees are also members of the Board of Directors of certain affiliated corporations. The Corporation's affiliates do business primarily in Pennsylvania, but also in Maryland, Ohio and Delaware.

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Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

**(1) General Information (continued)**

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

	<u>Total</u>	<u>Pres Homes</u>	<u>PHSC</u>	<u>PSLSI</u>	<u>PHPH</u>	<u>PAI</u>	<u>GHI</u>
Nursing beds	1,230	763	60	31	376	—	—
Assisted living units	477	276	33	29	139	—	—
Independent living units	911	450	164	210	87	—	—
HUD housing units	228	—	—	—	—	164	64
Total	<u>2,846</u>	<u>1,489</u>	<u>257</u>	<u>270</u>	<u>602</u>	<u>164</u>	<u>64</u>

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Accounting**

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

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

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

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

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

**(c) Donor Restrictions**

The Corporation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or the purpose to which the donation is restricted is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities 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.

**PHI**

Notes to Consolidated Financial Statements

December 31, 2005 and 2004

**(c) 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.

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

**(d) Cash and Cash Equivalents**

The Corporation considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents for purposes of the statements of cash flows. At times during the years ended December 31, 2005 and 2004, cash balances may have exceeded the federally insured limit of \$100,000.

**(e) Accounts Receivable**

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

	<u>2005</u>	<u>2004</u>
Total accounts receivable	\$ 9,348,862	9,249,845
Less: allowance for doubtful accounts	<u>(1,294,882)</u>	<u>(1,117,438)</u>
Net accounts receivable	<u>\$ 8,053,980</u>	<u>8,132,407</u>

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

**(f) Pledges Receivable**

During 2003, a pledge was made to Presbyterian Homes, Inc. for \$1,500,000. Additional pledges for Presbyterian Homes, Inc. and Presbyterian Housing and Services Corporation were received during 2005 for \$536,157. As of December 31, 2005, the organizations have received \$468,169 of the gifts and the remaining balance will be paid over the next eight years. The Corporation recorded this pledge at the net present value less a discounted uncollectible amount of 5%.

**PHI**  
Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

**(f) Pledges Receivable**

	<u>2005</u>	<u>2004</u>
Pledges receivables	\$ 1,567,988	1,298,000
Less: unamortized discount	<u>(195,804)</u>	<u>(224,526)</u>
Subtotal	1,372,184	1,073,474
Less: allowance for uncollectibles	<u>(38,856)</u>	<u>(41,842)</u>
Net pledges receivables	<u>\$ 1,333,328</u>	<u>1,031,632</u>

Pledges receivable as of December 31, 2005 is as follows:

Amounts due in:	
Less than one year	\$ 492,133
One to five years	827,855
More than five years	<u>248,000</u>
	<u>\$ 1,567,988</u>

**(g) Statements of Cash Flows**

Interest paid during the years ended December 31, 2005 and 2004 was \$7,102,517 and \$6,387,330, respectively. Interest of \$250,465 and \$133,717 was capitalized in 2005 and 2004, respectively. Purchases of assets under capital lease arrangements during the year ended December 31, 2005 and 2004 were \$117,975 and \$4,100, respectively.

**(h) Deferred Costs**

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

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

**PHI**  
Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

**(i) Property and Equipment**

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

Depreciable lives are determined as follows:

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

**(j) Investments**

Investments in marketable equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statements of financial position. A decline in market value of any investment below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to realized loss and a new cost basis for the investment is established. For the years ended December 31, 2005 and 2004, no amounts were charged to realized loss.

Investment income consisted of the following:

	<u>2005</u>	<u>2004</u>
Interest and dividends	\$ 3,124,985	1,958,230
Realized gains on investments	687,248	728,698
Unrealized gains on investments	367,527	556,091
	<u>\$ 4,179,760</u>	<u>3,243,019</u>

Investment expenses of \$246,671 and \$158,292 as of December 31, 2005 and 2004, respectively have been included in general and administrative expenses.

**(k) Inventories**

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

**PHI**

Notes to Consolidated Financial Statements

December 31, 2005 and 2004

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

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

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>2005</u>	<u>2004</u>
Assets held in trust by others	\$ 6,987,326	6,817,053
Contributions receivable from remainder trusts	<u>856,286</u>	<u>1,249,164</u>
	<u>\$ 7,843,612</u>	<u>8,066,217</u>

**(m) Costs of Borrowing**

Interest cost incurred on borrowed funds less interest income on these funds during the period of construction of capital assets is capitalized as a component of construction-in-progress. Interest of \$250,465 and \$133,717 was capitalized in 2005 and 2004, respectively.

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

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



**PHI**  
Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

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

Entrance fees collected from residents at move-in pursuant to a resident and care agreement are initially recorded as deferred revenue. The non-refundable portion of the fees is amortized to income over the estimated remaining life expectancy of each resident. The portion of the fee refundable upon reoccupancy is amortized on a straight-line basis over the remaining useful life of the applicable facility. For PHPH only, the portion of the fee refundable upon reoccupancy or six months, whichever is sooner, is amortized on a straight-line basis over the remaining useful life of the applicable facility. The agreements provide for potential death or termination refunds of the non-refundable portion if reoccupancy occurs before the contractual amortization is completed in accordance with the terms of the agreements. The remaining amount of unamortized, nonrefundable entrance fees is recorded as revenue upon a resident's death or termination of the contract.

The amount of entrance fees refundable to residents at December 31, 2005 and 2004 under contractual refund provisions was approximately \$63,400,000 and \$60,500,000, respectively.

**(p) *Resident Deposits***

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

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

At certain Continuing Care Retirement Communities, the Corporation provides health care coverage for certain residents under the terms of a Residence and Care Agreement. The Corporation annually estimates the present value of the net cost of future services and the use of facilities to be provided to current residents covered by Residence and Care Agreements and compares that amount to the balance of deferred entrance fees. If the present value of the net cost of future services and the use of facilities exceeds the deferred entrance fees, a liability is recorded (estimated obligation to provide future services to continuing care residents, in excess of amounts received or to be received). Management's assumptions used in the estimate may vary by facility. Assumptions made in these estimates include a 4% inflation rate for nursing costs, a 4% inflation rate for other operating costs, and 6% discount rate based on the approximate cost of borrowing for the Corporation. At December 31, 2005 and 2004, management's estimation resulted in no obligation in excess of recorded amounts to provide future services to continuing care residents.

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

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

**PHI**

**Notes to Consolidated Financial Statements**

December 31, 2005 and 2004

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

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

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

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

Revenues from Medicare and Pennsylvania, Maryland and Delaware Medicaid (Medicaid) represent approximately 45% of consolidated revenues for both December 31, 2005 and 2004. Medicare and Medicaid receivables represent approximately 54% and 55% of consolidated accounts receivable at both December 31, 2005 and 2004.

In January 2005, the Commonwealth of Pennsylvania (the State) received approval from the Federal Center for Medicare Services (CMS), to retroactively assess a nursing bed assessment for the State's July 1, 2003 to June 30, 2004 fiscal year. The assessment is \$1.50 a day for continuing care retirement community non-Medicare occupied beds, and \$15.91 a day for stand alone nursing facility non-Medicare occupied beds. As a part of this, nursing home providers received an additional supplement of \$5.17 a day, based on a number of factors, including their Medicaid utilization. The net effect of this assessment and supplement resulted in \$845,000 in additional revenues for the Corporation in 2004. The State was to pay this amount during 2005, and was included in accounts receivable as of December 31, 2004. The Corporation actually received an additional \$2.9 million in additional revenue from the net effect of the supplement and assessment which is recorded as resident service revenue.

**(s) Fundraising Expenses**

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

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**(t) 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.

**(u) Tax Status**

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

**(v) 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.

**(w) Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles 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.

**(x) Advertising**

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2005 and 2004, was \$826,260 and \$703,917, respectively.

**(y) Classification of Expenses**

	<u>2005</u>	<u>2004</u>
Program activities	\$ 116,240,213	109,381,358
General and administrative	20,849,846	18,325,125
Change in fair value of interest rate swap	(379,205)	(490,967)
Loss on extinguishment of debt	1,816,514	—
Fundraising	570,809	651,893
	<u>\$ 139,098,177</u>	<u>127,867,409</u>

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Notes to Consolidated Financial Statements  
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**(z) *Derivatives and Hedging Activities***

In accordance with Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities* as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, the Corporation recorded an asset of \$164,599, representing the fair value asset of the swaps as of December 31, 2005 and a liability of \$214,607, representing the fair value (liability) of the swaps as of December 31, 2004. For 2004, an adjustment to the liability was recorded causing a gain of \$490,967. This adjustment represented the decrease in the fair value (liability) of the swaps. For 2005, an adjustment was recorded causing a gain of \$379,205 and creating an asset rather than a liability for the swaps. This adjustment represents the increase in the fair value asset of the swaps.

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

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

**(aa) *Reclassification***

Certain amounts in the 2004 financial statements have been reclassified to conform with the 2005 financial presentation. These reclassifications had no effect on the change 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 unrestricted net assets before unrealized gains on investments and discontinued operations." Changes in unrestricted net assets which are excluded from this measure are: unrealized gains on investments, discontinued operations and other significant adjustments which do not directly indicate operational performance.

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Notes to Consolidated Financial Statements  
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**(3) Investments**

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

	2005		2004	
	Market	Cost	Market	Cost
Certificates of deposit	\$ 1,168,200	1,175,175	2,888,438	2,892,169
Money market funds	2,843,767	2,843,767	23,426,821	23,426,821
Marketable equity securities	40,855,529	37,340,290	21,441,535	15,029,580
Mutual Funds	2,056,581	1,742,158	1,584,234	1,386,590
Other equity securities	218,502	237,163	85,277	78,805
U.S. Government securities	14,416,765	14,689,063	10,704,071	10,784,156
Corporate bonds and notes	7,540,803	7,748,387	5,285,289	4,735,693
Other	271,408	277,261	158,697	158,697
Totals	\$ 69,371,555	<u>66,053,264</u>	65,574,362	<u>58,492,511</u>
Less permanently restricted investments (note 4)	<u>(3,418,674)</u>		<u>(3,144,546)</u>	
Total investments	\$ <u>65,952,881</u>		\$ <u>62,429,816</u>	

The Corporation invests in a wide variety of individual fixed income and equity investments including bonds issued by the US Government and its agencies, corporate bonds, and common stock. The Corporation has approximately five hundred ten and four hundred fifty four of such individual holdings as of December 31, 2005 and 2004 respectively.

As of December 31, 2005 and 2004, two hundred and one hundred twenty eight, individual holdings have a market value that has been below cost for less than a year, respectively. These are both equity and fixed income investments, and in total, their market value is less than four and six percent below cost for 2005 and 2004, respectively. The Corporation believes the decline in market value of these holdings is temporary in nature as they reflect general market conditions for bond and other fixed income securities instead of a permanent decline in the value of the individual securities.

One hundred twelve and twenty eight individual holdings have a market value that has been below cost for more than a year as of December 31, 2005 and 2004 respectively. These are both equity and fixed income funds, and in total, their market value is less than five and six percent below cost for 2005 and 2004, respectively. The Corporation believes the decline in market value of these holdings is temporary in nature as they reflect general market conditions for bond and other fixed income securities instead of a permanent decline in the value of the individual securities.

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Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

**(3) Investments (continued)**

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

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	\$ 8,255,181	(170,283)	4,727,291	(123,565)	12,982,472	(293,848)
Corporate bonds	4,575,595	(102,348)	2,539,609	(116,349)	7,115,204	(218,697)
Subtotal debt securities	12,830,776	(272,631)	7,266,900	(239,914)	20,097,676	(512,545)
Mutual Funds	363,740	(27)	44,600	(6)	408,340	(33)
Common stocks	9,428,941	(815,474)	926,654	(288,490)	10,355,595	(1,103,964)
Subtotal securities	9,792,681	(815,501)	971,254	(288,496)	10,763,935	(1,103,997)
Certificates of Deposit	254,510	(590)	393,992	(6,385)	648,502	(6,975)
Total temporarily impaired securities	\$ 22,877,967	(1,088,722)	8,632,146	(534,795)	31,510,113	(1,623,517)

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

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	\$ 6,088,225	(75,595)	1,184,946	(26,181)	7,273,171	(101,776)
Corporate bonds	2,055,006	(40,757)	701,768	(16,779)	2,756,774	(57,536)
Subtotal debt securities	8,143,231	(116,352)	1,886,714	(42,960)	10,029,945	(159,312)
Common stocks	2,291,807	(206,813)	241,520	(26,904)	2,533,327	(233,717)
Subtotal securities	2,291,807	(206,813)	241,520	(26,904)	2,533,327	(233,717)
Certificates of Deposit	89,547	(617)	290,350	(2,679)	379,897	(3,296)
Total temporarily impaired securities	\$ 10,524,585	(323,782)	2,418,584	(72,543)	12,943,169	(396,325)

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Notes to Consolidated Financial Statements  
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**(4) Assets Whose Use is Limited**

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

	<u>2005</u>	<u>2004</u>
Permanently restricted investments	\$ 3,418,674	3,144,546
Debt service reserve funds	7,065,053	7,127,635
Operating reserve fund	1,229,344	1,109,789
Bond funds	1,324,797	1,772,098
Assets designated to renovation and charity care	542,104	502,698
Other reserves required under financing arrangements	465,665	487,485
	<u>14,045,637</u>	<u>14,144,251</u>
Less current portion	<u>(1,692,137)</u>	<u>(1,651,075)</u>
	<u>\$ 12,353,500</u>	<u>12,493,176</u>

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

As described in note 7, in January 2003 Presbyterian Homes, Inc. issued Cumberland County Municipal Authority Revenue Bonds, Series 2003 A and B, part of the proceeds of which provided for the establishment of a construction fund to fund capital expenditures. The construction funds, of \$0 and \$3,503,982 at December 31, 2005 and 2004, respectively, which are also classified as assets whose use is limited, are held by a trustee and distributed when specific requirements of the bond indentures have been met.

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

**(5) Related Party Transactions**

Prelude Systems, Inc. (Prelude), is a joint venture between the Corporation and Diakon Lutheran Social Ministries. Prelude is a technical services organization with a wide range of programs designed to support the information systems needs of both PHI and Diakon as well as other healthcare and community service organizations. PHI's investment in Prelude is included in investments in marketable equity securities as of December 31, 2005 and 2004. During 2005 and 2004, respectively, PHI paid Prelude approximately \$1,660,000 and \$1,059,000 for information services provided by Prelude.

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Notes to Consolidated Financial Statements  
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**(5) Related Party Transactions (continued)**

In addition, the Corporation's affiliates purchase medications from Continuing Care Rx Holding Company, Inc. As of December 29, 2004 the Corporation sold its majority interesting Continuing Care Rx, Inc. and remains a minority shareholder. Total purchases by affiliates from Continuing Care Rx Holding Company, Inc. for 2005 and 2004 were approximately \$2,352,760 and \$1,942,770, respectively, of which \$447,334 and \$332,670 is included in accounts payable as of December 31, 2005 and 2004, respectively.

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. PHI's investment in Alliance Rehab HVA, L.L.C. is included in investments in marketable equity securities as of December 31, 2005 and 2004. The Corporation received \$94,000 in dividends from Alliance Rehab in 2005. During 2005 and 2004, the Corporation purchased services from Alliance Rehab for \$3,581,738 and \$1,085,275, respectively, of which \$635,136 and \$571,538 is included in accounts payable as of December 31, 2005 and 2004, respectively.

**(6) Property and Equipment**

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

	<u>2005</u>	<u>2004</u>
Land	\$ 22,871,566	22,871,566
Land improvements	13,266,946	12,712,071
Buildings and improvements	232,639,448	214,667,541
Building equipment	114,494	114,494
Departmental equipment, furniture and fixtures	27,355,518	25,564,450
Furniture	4,221,433	4,187,505
Vehicles	2,210,922	2,122,400
Construction-in-progress	5,546,379	9,823,045
	<u>308,226,706</u>	<u>292,063,072</u>
Accumulated depreciation	<u>(128,286,025)</u>	<u>(117,943,248)</u>
	<u>\$ 179,940,681</u>	<u>174,119,824</u>

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

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

As of December 31, 2005 and 2004, commitments for future construction totaled approximately \$6,423,600 and \$4,850,000, respectively.



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

In October 2005, PHI received an allocation from the Pennsylvania Housing Finance Agency of approximately \$6.4 million in tax credits payable over ten years. The credits are to be used for the construction of a fifty unit senior apartment building at a total cost of approximately \$8 million which will be rent and income restricted for lower income seniors for a period of 25 years. PHI expects to exchange the tax credits at approximately face value with a for-profit limited partner in exchange for partial project funding. Contracts for construction are expected to be finalized in the first quarter of 2006.

In December 2004, PHI sold Continuing Care Rx, a pharmaceutical company, for approximately \$25.5 million, and a recognized gain of \$20,258,500.

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

	<u>2004</u>
Gross profit	\$ 15,929,426
Depreciation and amortization	(297,283)
Interest	(324,925)
Income taxes	(1,652,195)
Other expenditures	<u>(11,227,724)</u>
Total discontinued operations	<u>\$ 2,427,299</u>

Additional discontinued operations consist of remaining costs of Presbyterian Health Center which was sold in 2003.

**(7) Long-term Debt**

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

	<u>2005</u>	<u>2004</u>
Cumberland County Municipal Authority Bonds Series 1993A, principal due in 2018, variable interest rate, 3.55% and 2% at December 31, 2005 and 2004, respectively, secured by irrevocable letter of credit with an annual fee of 0.95%, which expires December 15, 2010	\$ 6,000,000	6,000,000
Cumberland County Municipal Authority Revenue Bonds Series 1996, principal due in varying annual amounts from 2002 to 2026, interest rate set at 6.0%, net of unamortized discount, collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.	-	31,585,000

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Notes to Consolidated Financial Statements  
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**(7) Long-term Debt**

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

	<u>2005</u>	<u>2004</u>
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 Presbyterian Homes, Inc.	17,175,000	18,265,000
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, 3.5% and 1.24% at December 31, 2005 and 2004, respectively, collateralized by letter of credit with an annual fee of 0.95% which expires on December 15, 2010	8,765,000	8,855,000
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 3.65% and 1.94% at December 31, 2005 and 2004, respectively, collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.	8,898,628	9,437,794
Cumberland County Municipal Authority Revenue Bonds Series 2005A, tax exempt 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	—
Cumberland County Municipal Authority Revenue Bonds Series 2005B, taxable variable rate bonds, principal maturities in varying amounts from 2013 to 2026, interest adjusted weekly after first year, 4.25% at December 31, 2005, insured by municipal bond insurance.	16,800,000	—
Northampton County Industrial Development Authority Series 1998 First Mortgage Revenue Refunding Bonds, principal due in varying annual amounts through 2023, interest rate at 5.625%	14,045,000	14,045,000
Northampton County Industrial Development Authority Series 2002 First Mortgage Revenue Refunding Bonds, principal due in varying annual amounts through 2030, interest adjusted weekly, 3.5 % and 1.98% at December 31, 2005 and 2004, respectively, collateralized by a letter of credit	25,595,000	26,500,000
Fannie Mae mortgage payable executed on March 29, 1973, amortization of principal from May 1, 1973 through September 2013, interest rate of 7% effective rate of 0% in 2003 due to FHA subsidy	774,635	852,771

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Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

**(7) Long-term Debt**

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

	<u>2005</u>	<u>2004</u>
HUD Flexible Subsidy Loans payable, principal balance due upon sale of the project building or upon full payment of the HUD mortgage, simple interest of 1% payable at time of principal payments	1,672,491	1,672,491
Mortgage payable for building loan provided by HUD, monthly installments of principal and interest, interest rate of 3%	1,059,530	1,123,893
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 3.35 and 2% at December 31, 2005 and 2004, 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 4.37% and 2.4% at December 31, 2005 and 2004, respectively, collateralized by letter of credit	15,740,000	16,045,000
Term Loan with S&T Bank, bearing interest at a variable rate of 7.25% and 5.25% at December 31, 2005 and 2004, respectively, principal and interest payments due monthly, collateralized by property and equipment of corporate office of PHI	796,987	1,016,679
Term Loan with S&T Bank, bearing interest at a variable rate of 7.07% and 5.08% at December 31, 2005 and 2004, respectively, principal and interest payments due monthly collateralized by Dillsburg property of PHI	419,296	523,856
1985 Series Bonds, principal and interest payable quarterly, with a floating interest rate to December 1, 2005. At December 31, 2004, the interest rate was 2.75%. The bonds were used to construct the Windy Hill facility and are collateralized by certain property	-	150,000
1995 Series A revenue note to Omega Financial, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to July 10, 2026. The note bears a floating rate which was 3.95% and 3.00% at December 31, 2005 and 2004, respectively. The note is collateralized by certain receivables and property at Westminster Woods, Woodland Retirement Center and Hollidaysburg Home	3,291,353 -	3,436,055 88,115

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Notes to Consolidated Financial Statements  
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**(7) Long-term Debt (continued)**

	<u>2005</u>	<u>2004</u>
1997 Series A Montgomery County Higher Education and Health Authority Demand Revenue Bonds payable in monthly installments of principal and interest sufficient to amortize the principal balances to April 2017. The bonds bear a floating interest rate, which was 3.57% and 1.74% at December 31, 2005 and 2004, respectively. These bonds are collateralized by all or portions of the following facilities: Westminster Woods, Woodland Retirement Center, and Hollidaysburg Home	8,545,000	9,055,000
Series 2002 Huntingdon County Industrial Development Authority, Mortgage Revenue Note, payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to April 2023. The note bears a floating interest rate, which was 2.69% at both December 31, 2005 and 2004. The note is collateralized by a second lien position on the Westminster Woods facility.	894,931	931,716
Series 2005 College Township Revenue Bonds, payable upon completion of the Windy Hill Village assisted living facility. Payments of \$24,474 per month to include principal and interest. Interest accrues on the loan commencing with each construction draw at rate based on 69.6% of prime rate, 5.04% as of December 31, 2005.	2,008,551	-
Management Services Office ("MSO") mortgage. Principal and interest of \$6,107 are due monthly through June 2023. The note bears interest at a variable rate, which was 3.33% at both December 31, 2005. The note is collateralized by the MSO facility	896,050	938,710
Presbytery of Huntingdon revolving loan with no interest payable in 5 annual installments of \$5,000	25,000	5,000
Other notes and mortgages, primarily paying interest only as of December 31, 2005; interest rates ranging from 0% to 8.25% as of December 31, 2005	<u>317,250</u>	<u>481,555</u>
	153,859,702	154,348,635
Less: Current portion	(4,500,622)	(4,569,590)
Unamortized discount	(436,106)	(916,630)
Plus: Unamortized premium	<u>493,076</u>	<u>—</u>
	<u>\$ 149,416,050</u>	<u>148,862,415</u>

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Notes to Consolidated Financial Statements  
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**(7) Long-term Debt (continued)**

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

In December 2005, the Corporation issued Cumberland County Municipal Authority Series A and B bonds totaling \$33,600,000. The bonds were used to refund the remaining Cumberland County Series 1996 bonds, provide approximately \$543,000 for capital improvements, and to pay for issuance and bond insurance costs.

Under the terms of Presbyterian Homes, Inc.'s, PHSC's, PHPH's and PSLSI's bond indentures, the Corporations are required to maintain certain deposits with a trustee. These deposits are included in assets whose use is limited. The indentures also place limits on additional borrowings and require the Corporations to satisfy certain measures of financial performance as long as the bonds are outstanding. These covenants have been met at December 31, 2005.

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

Maturities for the five years subsequent to December 31, 2005 and thereafter are as follows:

<u>Years ended December 31,</u>	<u>Aggregate maturities</u>
2006	\$ 4,500,622
2007	4,844,560
2008	5,069,086
2009	5,161,006
2010	5,200,187
Thereafter	<u>129,084,241</u>
	<u>\$ 153,859,702</u>

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

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

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

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

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

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

**(8) Notes Payable**

The Corporation has available various lines of credit with financial institutions. Interest rates on these lines of credit are variable based on the prime rate of the various financial institutions or the LIBOR rate. As of December 31, 2005 and 2004, under the line of credit agreements, the Corporation had available a maximum of \$9,100,000 and \$9,300,000 from the financial institutions. As of December 31, 2005 and 2004, the Corporation had amounts totaling \$3,309,437 and \$813,347 outstanding under these agreements at interest rates ranging from 2.8% to 7.25%.

**(9) Leases**

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

	<u>2005</u>	<u>2004</u>
Medical and office equipment	\$ 198,943	80,968
Accumulated amortization	<u>(42,409)</u>	<u>(18,415)</u>
	<u>\$ 156,534</u>	<u>62,553</u>

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**(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, 2005 follows:

2006	\$ 68,320
2007	43,225
2008	<u>34,147</u>
	145,692
Amounts representing interest	<u>(9,543)</u>
	<u>\$ 136,149</u>

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

2006	\$ 377,016
2007	219,077
2008	103,406
2009	<u>24,473</u>
	<u>\$ 723,972</u>

Rental expense under operating leases was \$742,271 and \$807,305 for the years ended December 31, 2005 and 2004, 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. Total annuities payable were \$1,201,219 and \$1,062,399 at December 31, 2005 and 2004, respectively. The Corporation uses published mortality rate tables adopted by the Internal Revenue Service and an assumed discount rate of approximately 4% to 6% to determine the present value of the actuarially determined liability. The Corporation has assets included in investments of \$1,553,391 and \$1,341,874 as of December 31, 2005 and 2004, respectively to satisfy annuities.

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Notes to Consolidated Financial Statements

December 31, 2005 and 2004

**(11) Workers' Compensation Insurance**

The Corporation has a self-insured Workers' Compensation program as allowed by the Commonwealth of Pennsylvania and the State of Delaware Bureau of Workers' Compensation. This program provides for self payment of work related injuries and illnesses as opposed to utilizing an insurance carrier. The Corporation has contracted with major insurance carriers for excess insurance coverage, loss control services and administration. The Corporation maintains a letter of credit for \$2.3 million in connection with this self-insurance program. At December 31, 2005 and 2004, the Corporation has recorded an accrued expense of approximately \$4.05 million and \$2.8 million, respectively for workers' compensation claims which includes known case reserves and an estimate of the Corporation's liability for incurred but not reported claims.

**(12) Temporarily Restricted Net Assets**

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

	<u>2005</u>	<u>2004</u>
Purchase of buildings and equipment	\$ 4,091	4,091
Educational	31,365	3,518
Charity care and/or equipment, including pledges receivable	2,173,152	1,738,971
Assets held in charitable trust for charity care	856,286	1,249,164
Various resident activities	186,076	231,095
	<u>\$ 3,250,970</u>	<u>3,226,839</u>

Net assets of \$1,102,629 and \$1,335,284 were released from restriction during 2005 and 2004 respectively in satisfaction of the above restrictions.

**(13) Permanently Restricted Net Assets**

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

	<u>2005</u>	<u>2004</u>
Charity care/equipment	\$ 4,470,992	4,396,872
Educational	9,597	9,597
Perpetual trusts, income restricted for charity care	6,987,326	6,817,053
	<u>\$ 11,467,915</u>	<u>11,223,522</u>



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**(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 \$9.8 and \$6.2 million for the years ended December 31, 2005 and 2004, respectively, of which the amount of charges foregone for services and supplies was approximately \$1,851,000 and \$1,049,000, respectively.

**(15) Retirement Plan**

The Corporation has a defined-contribution retirement plan covering all employees that have completed one year of service and have reached the age of 21. Vesting occurs after five years of service. Contributions to the plan are at the discretion of the Board of Trustees of PHI. For the years ended December 31, 2005 and 2004, retirement plan expense totaled approximately \$1,496,000 and \$1,269,700, respectively. Starting in 2006, the Corporation will be allowing employee the ability to direct how their contributions are invested. Also in 2006, the vesting period will change from 5 years to 3 years.

**(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.

**(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, commercial bonds and equity securities are estimated based on quoted market prices for those or similar investments.

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

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**(17) 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, 2005 and 2004 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying statement of financial position.

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

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