

PHI

Consolidated Financial Statements

December 31, 2007 and 2006

(With Independent Auditor's Report Thereon)

PHI

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Certification of Chief Executive and Chief Financial Officers

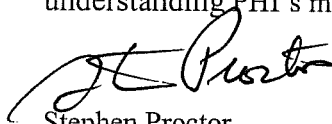
We are responsible for the consolidated financial statements and supporting information of PHI, as of December 31, 2007 and 2006, and attest that they are accurate, complete and fairly presented.

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

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

Financial statements alone can never reflect the breadth and depth of our stewardship of this ministry. They do not report on our most significant assets, our employees and volunteers. They also do not reflect our most important stewardship role; our commitment to provide Christian understanding and compassion to those seniors entrusted to our care. We believe that we continue to successfully fulfill the financial and non-financial aspects of our mission, extending a proud tradition of a combined ministry that has served older persons in the name of Christ for the more than 101 years.

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



Stephen Proctor
Chief Executive Officer
PHI



Jeffrey J. Davis
Chief Financial Officer
PHI

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, 2007 and 2006, and the related consolidated statements 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., Schartner House Apartments and Presbyterian Apartments, Inc., affiliates of PHI, which statements reflect total assets constituting 3.51 and 3.63 percent and total revenues constituting .94 percent and .92 percent, of the related 2007 and 2006 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., Schartner House Apartments and Presbyterian Apartments, Inc. is based solely on the reports of the other auditors.

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

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PHI and affiliates as of December 31, 2007 and 2006 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
March 10, 2008

PHI

Consolidated Statements of Financial Position

December 31, 2007 and 2006

Assets	2007	2006
Current assets:		
Cash and cash equivalents	\$ 3,887,940	4,445,308
Investments	66,958,962	67,045,665
Accounts receivable, net	12,890,562	13,213,622
Assets whose use is limited - current portion	1,314,345	1,649,771
Pledges receivable, current portion	583,907	328,296
Interest receivable	218,513	52,676
Inventory	254,222	267,712
Prepaid expenses and other current assets	1,441,256	1,446,478
Total current assets	87,549,707	88,449,528
Assets whose use is limited, net of current portion	18,203,102	13,697,879
Pledges receivable, net of current portion	762,021	893,725
Property and equipment (net of accumulated depreciation of \$168,933,167 and \$162,238,195, respectively)	212,602,674	209,233,303
Assets under capital leases (net of accumulated depreciation of \$238,140 and \$134,662, respectively)	245,389	376,376
Assets held in trust by others	15,737,028	14,788,692
Fair value of interest rate swaps	34,281	156,900
Unamortized deferred costs:		
Deferred marketing costs, net of accumulated amortization of \$2,144,722 and \$2,078,023	27,791	94,490
Deferred financing costs, net of accumulated amortization of \$1,547,926 and \$1,695,127	4,167,558	4,360,546
Other assets	54,452	32,819
Total assets	\$ 339,384,003	332,084,258

See accompanying notes to consolidated financial statements.

PHI

Consolidated Statements of Financial Position

December 31, 2007 and 2006

Liabilities and Net Assets	2007	2006
Current liabilities:		
Accounts payable	\$ 7,202,647	11,229,006
Accrued expenses	13,241,435	12,888,426
Notes payable	9,873,581	7,303,290
Accrued interest	641,025	717,311
Current portion:		
Annuities payable	194,610	179,807
Obligations on capital leases	158,073	166,896
Long-term debt	5,051,324	6,616,667
Total current liabilities	36,362,695	39,101,403
Resident deposits	2,331,993	1,538,249
Deferred revenue - entrance fees	78,267,914	79,776,651
Annuities payable	1,005,728	990,703
Accrued pension	360,758	302,676
Long-term debt, less current maturities:		
Obligations on capital leases	84,245	212,258
Long-term debt	148,070,941	149,813,391
Total liabilities	266,484,274	271,735,331
Net assets:		
Unrestricted (including tax credit equity of \$5,702,876 and \$3,628,892, respectively)	48,364,808	37,516,310
Temporarily restricted	3,857,425	3,609,567
Permanently restricted	20,677,496	19,223,050
Total net assets	72,899,729	60,348,927
Total liabilities and net assets	\$ 339,384,003	332,084,258

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Activities and Changes in Net Assets

Years ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Revenues, gains, and other support:		
Resident services, including amortization of entrance fees of \$9,235,083 and \$9,106,172	\$ 153,354,513	142,828,675
Sales of other services and materials	109,383	120,118
Net rental income	1,464,397	1,342,756
Interest and dividend income	3,666,707	3,348,840
Realized gains on investments	2,520,527	3,599,241
Gain on sale of property and equipment	110,850	756,505
Change in value of annuities	—	53,296
Gifts and bequests	2,583,846	1,293,804
Net assets released from restrictions	770,505	951,429
Total revenues, gains, and other support	<u>164,580,728</u>	<u>154,294,664</u>
Expenses:		
Nursing services	48,191,941	44,274,644
Rehabilitation	6,537,915	5,276,742
Recreation and special services	4,751,094	4,365,379
Pharmacy	3,589,167	3,211,226
Social services	715,580	572,498
Physician services	418,869	341,233
Food services	16,827,421	16,127,472
Building operations and maintenance	17,440,511	17,277,496
Housekeeping	4,117,501	4,055,604
Laundry and linen	1,793,125	1,643,388
General and administrative	23,856,297	20,371,077
Employee benefits	10,586,779	10,283,087
Interest	7,955,310	7,909,877
Depreciation	12,542,461	12,287,361
Amortization	292,999	193,418
Change in fair value of interest rate swaps	122,619	7,700
Loss on early extinguishment of debt	91,013	—
Total expenses	<u>159,830,602</u>	<u>148,198,202</u>
Change in unrestricted net assets before unrealized (loss) gains on investments, discontinued operations, loss on impairment of assets and equity received from tax credit limited partner	<u>4,750,126</u>	<u>6,096,462</u>

See accompanying notes to consolidated financial statements.

(Continued)

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Consolidated Statements of Activities and Changes in Net Assets

Years ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Unrealized (loss) gains on investments	(49,037)	594,436
Discontinued operations, net of gain (loss) of \$4,725,387 and (84,927), respectively	4,828,738	399,661
Loss on impairment of assets	(987,144)	(924,050)
Equity received from tax credit limited partner	<u>2,305,815</u>	<u>3,637,330</u>
Change in unrestricted net assets	<u>10,848,498</u>	<u>9,803,839</u>
Temporarily restricted net assets:		
Contributions, grants and bequests	640,799	545,419
Interest and dividend income	28,403	732,453
Unrealized gain on investments	349,161	5,102
Net assets released from restrictions	<u>(770,505)</u>	<u>(951,429)</u>
Change in temporarily restricted net assets	<u>247,858</u>	<u>331,545</u>
Permanently restricted net assets:		
Contributions	499,861	1,787,947
Change in fair value of assets held in trust by others	<u>954,585</u>	<u>824,444</u>
Change in permanently restricted net assets	<u>1,454,446</u>	<u>2,612,391</u>
Change in net assets	12,550,802	12,747,775
Net assets, beginning of year	<u>60,348,927</u>	<u>47,601,152</u>
Net assets, end of year	<u>\$ 72,899,729</u>	<u>60,348,927</u>

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

Years ended December 31, 2007 and 2006

	2007	2006
Cash flows from operating activities:		
Change in net assets	\$ 12,550,802	12,747,775
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	12,582,973	12,524,776
Proceeds from entrance fees and deposits	13,272,506	18,257,110
Amortization of entrance fees	(9,235,083)	(9,106,172)
Loss on early extinguishment of debt	91,013	—
Change in fair value of interest rate swaps	122,619	7,700
Change in value of annuities	—	(53,296)
Unrealized gains on investments and change in fair value of assets held in trust by others	(1,254,709)	(1,423,982)
Realized gains on investments	(2,520,527)	(3,599,241)
Realized gain on sale of property and equipment	(4,836,237)	(671,578)
Equity received from tax credit limited partner	(2,305,815)	(3,637,330)
Contributions restricted for long-term purposes	(499,861)	(1,787,947)
Amortization of deferred costs	290,255	303,360
Amortization of bond discount (premium)	3,313	(108,491)
Loss on impairment of assets	987,144	924,050
Changes in assets and liabilities:		
Decrease (increase) in accounts receivable	157,223	(3,785,704)
(Increase) decrease in pledges receivable	(123,907)	111,307
(Increase) decrease in other assets	(2,921)	286,304
(Decrease) increase in accounts payable	(4,026,359)	2,032,587
Increase in accrued expenses	334,805	241,533
Net cash provided by operating activities	15,587,234	23,262,761
Cash flows from investing activities:		
Acquisition of property and equipment, net of disposals	(19,705,587)	(25,390,590)
Net proceeds from sale of property and equipment	7,733,323	925,307
Purchases of investments	(55,908,587)	(138,953,710)
Proceeds from sale of investments	54,652,393	141,082,933
Net cash used in investing activities	(13,228,458)	(22,336,060)

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

Years ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(4,752,416)	(7,913,658)
Principal payments on and redemptions of long-term debt	(11,328,053)	(5,349,418)
Proceeds from issuance of long-term debt	8,000,000	1,790,871
Financing costs (incurred) disposed	(104,634)	28,749
Net borrowings of notes payable	2,570,291	3,993,853
Borrowings through capital leases	30,541	388,452
Repayments on capital leases	(167,377)	(145,448)
Equity received from tax credit limited partner	2,305,815	3,637,330
Contributions restricted for long-term purposes	499,861	1,787,947
Increase (decrease) in annuities payable	29,828	(30,710)
Net cash used in financing activities	<u>(2,916,144)</u>	<u>(1,812,032)</u>
Net decrease in cash and cash equivalents	(557,368)	(885,331)
Cash and cash equivalents, beginning of year	<u>4,445,308</u>	<u>5,330,639</u>
Cash and cash equivalents, end of year	<u>\$ 3,887,940</u>	<u>4,445,308</u>

See accompanying notes to consolidated financial statements.

PHI

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(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), Schartner House Apartments (SHA), 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., the parent corporation of Continuing Care Rx, a pharmaceutical company.

In May 2006, the Corporation redeemed its membership interest in Alliance Rehab HVA, LLC. Prior to that date, the Corporation owned 10 percent in the limited liability corporation. (Note 5).

In 2006, the Corporation formed a new corporation, Schartner House Associates, L.P., whose general partner Schartner House, Inc. is a wholly owned taxable affiliate of PHI for the purpose of building and operating a fifty unit affordable senior apartment building. Schartner House Apartments was placed into service in August of 2007. More information is included in Note 6.

As of October 1, 2006 the board of directors, of the Quincy United Methodist Home, doing business as Quincy Retirement Community (QRC) amended the bylaws of that corporation to become a controlled affiliated of PHI. PHI's financial statements for 2006 include the results of QRC as if it had been part of PHI for the full year starting in January 1, 2006.

In 2007, the Corporation was awarded tax credits for an affordable senior living project in Parkesburg and formed Westminster Place at Parkesburg, Inc. The Corporation purchased land for \$544,000.

In 2007, the Corporation also formed two new corporations. PHI Life, Inc. is a PACE program (Program of All-inclusive Care for the Elderly). In 2007, it was awarded contracts for three counties. The program will be operational in the third quarter of 2008. The corporation also formed PHI Services, Inc., a wholly owned taxable corporation to perform services to the community. The first company under this corporation is Mission Driven Products.

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, 2007 and 2006

(1) General Information (continued)

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

	Total	Pres Homes	PHSC	PSLSI	PHPH	QRC	SHA	PAI	GHI
Nursing beds	1,252	651	60	31	376	134	—	—	—
Assisted									
living units	466	276	33	29	96	32	—	—	—
Independent									
living units	1,107	456	162	207	98	184	—	—	—
HUD									
housing units	215	—	—	—	—	—	50	165	62
Total	<u>3,040</u>	<u>1,383</u>	<u>255</u>	<u>267</u>	<u>570</u>	<u>350</u>	<u>50</u>	<u>165</u>	<u>62</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) Tax Status

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

(c) 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.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(d) Reclassification

Certain amounts in the 2006 financial statements have been reclassified to conform with the 2007 financial presentation. These reclassifications had no effect on the change in net assets.

(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 purposes of the statements of cash flows. At times during the years ended December 31, 2007 and 2006, cash balances may have exceeded the federally insured limit of \$100,000.

(f) Investments

Investments in 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. Alternative investments – limited partnerships are not readily marketable and are presented at estimated fair value as determined by the investment managers. Management reviews, evaluates and monitors the values provided and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments – limited partnerships. A decline in market value of any investment below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to realized loss and a new cost basis for the investment is established. For the years ended December 31, 2007 and 2006, no amounts were charged to realized loss for this purpose as management believes the decline in value is temporary due to general economic conditions and not a permanent decline in value.

Investment income consisted of the following:

	<u>2007</u>	<u>2006</u>
Interest and dividends	\$ 3,695,110	4,081,293
Realized gains on investments	2,520,527	3,599,241
Unrealized gains on investments and change in fair value of assets held in trust by others	<u>1,254,709</u>	<u>1,423,982</u>
	<u>\$ 7,470,346</u>	<u>9,104,516</u>

Investment expenses of \$300,496 and \$280,382 as of December 31, 2007 and 2006, respectively have been included in general and administrative expenses.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(g) Accounts Receivable

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

	<u>2007</u>	<u>2006</u>
Total accounts receivable	\$ 14,792,181	14,713,626
Less: allowance for doubtful accounts	<u>(1,901,619)</u>	<u>(1,500,004)</u>
Net accounts receivable	<u>\$ 12,890,562</u>	<u>13,213,622</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.

(h) 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.

(i) Pledges Receivable

During 2003, a pledge was made to Presbyterian Homes, Inc. for \$1,500,000. Additional pledges for Presbyterian Homes, Inc., Presbyterian Housing and Services Corporation, Quincy Retirement Community and Presbyterian Homes in the Presbytery of Huntingdon were received during 2007 and 2006 for \$538,033, and \$643,964. As of December 31, 2007, the organizations have received \$1,725,313 of the gifts and the remaining balance will be paid over the next five years. The Corporation recorded these pledges at the net present value less a discounted uncollectible amount of 10%.

	<u>2007</u>	<u>2006</u>
Pledges receivables	\$ 1,530,668	1,516,302
Less: unamortized discount	<u>(85,953)</u>	<u>(162,526)</u>
Subtotal	1,444,715	1,353,776
Less: allowance for uncollectibles	<u>(98,787)</u>	<u>(131,755)</u>
Net pledges receivables	<u>\$ 1,345,928</u>	<u>1,222,021</u>

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

Amounts due in:

Less than one year	\$ 652,694
One to five years	<u>877,974</u>
	<u>\$ 1,530,668</u>

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(j) 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.

(k) 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	3-35 years
Buildings and improvements	5-75 years
Departmental equipment, furniture and fixtures	1-40 years
Furniture	5-25 years
Vehicles	4-5 years

(l) Costs of Borrowing

Interest cost incurred on borrowed funds less interest income on these funds during the period of construction of capital assets is capitalized as a component of construction-in-progress. Interest of \$0 and \$24,740 was capitalized in 2007 and 2006, respectively.

(m) 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.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(m) Assets Held in Trust by Others (continued)

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

	<u>2007</u>	<u>2006</u>
Assets held in trust by others	\$ 13,386,185	12,704,757
Gift annuities	139,044	—
Contributions receivable from remainder trusts	<u>2,211,799</u>	<u>2,083,935</u>
	<u>\$ 15,737,028</u>	<u>14,788,692</u>

(n) 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 \$34,281 and \$156,900, representing the fair value asset of the swaps as of December 31, 2007 and 2006, respectively. For 2007 and 2006, adjustments were recorded causing a loss of \$122,619 and \$7,700, respectively. These adjustments represent the decrease 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.

(o) 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. Amortization expense is expected to be approximately \$253,914 in 2008 and \$226,123 in 2009, 2010, 2011 and 2012.

(p) 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.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(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, 2007 and 2006, management's estimation resulted in no obligation in excess of recorded amounts to provide future services to continuing care residents.

(r) *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.

(s) *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 that is refundable is based upon reoccupancy or six months, whichever is sooner. 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 guaranteed entrance fees refundable to residents at December 31, 2007 and 2006 under contractual refund provisions was approximately \$51,599,000 and \$52,477,000, respectively.

(t) *Temporarily and Permanently Restricted Net Assets*

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. 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.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(u) Donor Restrictions

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

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

Contributions, including unconditional promises to give, are recognized as revenues when the promise to give is first made. Conditional promises to give are not recognized until they become unconditional, that is when the conditions 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.

(v) 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.

Medicare reimbursement provided a prospective payment system ("PPS") for skilled nursing services. Skilled nursing facilities are paid a federal per diem rate for covered services, which include routine and ancillary services and capital-related costs. In conjunction with PPS, consolidated billing for Medicare Part A Services is required for skilled nursing facilities. Under consolidated billing for Medicare Part A Services, facilities must bill Medicare for all of the services residents receive with several exceptions, including all therapy services.

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.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

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

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 43% and 46% of consolidated revenues for December 31, 2007 and 2006, respectively. Medicare and Medicaid receivables represent approximately 63% of consolidated accounts receivable at both December 31, 2007 and 2006.

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

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

For the periods July 1, 2006 to June 30, 2007 \$1.97 a day for continuing care retirement community non-Medicare occupied beds, and \$20.35 a day for stand alone nursing facility non-Medicare occupied beds. As a part of this, nursing home providers received an additional supplement of \$10.66 a day, based on a number of factors, including their Medicaid utilization.

The supplemental and assessment amounts per day have not yet been finalized for the period 7/1-12/31/07. The State has published proposed amounts but no amount has been included on the Corporation's financial statements for this period.

For the years ended December 31, 2007 and 2006 the Corporation received approximately \$891,566 and \$347,182 in additional revenue, respectively for the net effect of this assessment and supplement.

(w) Charity Care

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

(x) Advertising

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2007 and 2006, was \$678,888 and \$711,593, respectively.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(y) Classification of Expenses

	<u>2007</u>	<u>2006</u>
Program activities	\$ 135,760,673	127,819,425
General and administrative	22,630,889	19,345,975
Change in fair value of interest rate swaps	122,619	7,700
Loss on extinguishment of debt	91,013	—
Fundraising	1,225,408	1,025,102
	<u>\$ 159,830,602</u>	<u>148,198,202</u>

(z) Fundraising Expenses

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

(aa) 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 “change in unrestricted net assets before unrealized (loss) gains on investments, discontinued operations, loss on impairment of assets, and equity received from tax credit limited partner.” Changes in unrestricted net assets which are excluded from this measure are: unrealized (loss) gains on investments, discontinued operations, loss on impairment of assets, equity received from tax credit limited partner and other significant adjustments which do not directly indicate operational performance.

(ab) Statements of Cash Flows

Interest paid during the years ended December 31, 2007 and 2006 was \$8,049,942 and \$8,033,679, respectively. Interest of \$0 and \$24,740 was capitalized in 2007 and 2006, respectively. Purchases of assets under capital lease arrangements during the year ended December 31, 2007 and 2006 were \$30,541 and \$312,454, respectively.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(3) Investments

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

		2007		2006	
		Market	Cost	Market	Cost
Certificates of deposit	\$	79,772	80,000	1,042,093	1,041,495
Money market funds		4,956,600	4,956,600	4,236,623	4,236,623
Marketable equity securities		2,145,821	2,145,821	3,782,131	3,585,620
Mutual funds - equity		45,508,902	42,291,579	41,839,411	38,145,507
Mutual funds - fixed income		20,720,054	20,345,478	16,348,679	16,227,579
U.S. Government securities		—	—	3,200,423	3,234,245
Corporate bonds and notes		7,068,991	7,068,991	7,331,927	6,710,635
Alternate investments		5,855,296	5,017,975	4,465,892	3,724,365
Other		140,973	140,973	146,136	146,136
Totals	\$	86,476,409	82,047,417	82,393,315	77,052,205
Less assets whose use is limited (note 4)		(19,517,447)		(15,347,650)	
Total investments	\$	66,958,962		67,045,665	

During 2006 and 2007, the Corporation has been moving its investments from individual fixed income and equity investments including bonds issued by the US Government and it's agencies, corporate bonds, and common stock to a diversified portfolio of mutual funds and alternative investments. The Corporation has seventeen mutual funds, three investments in limited partnerships, one certificate of deposit and one equity investment, as of December 31, 2007. As of December 31, 2006, the Corporation had approximately two hundred thirty five investments which consisted of individual fixed income and equity investments including bonds issued by the US Government and it's agencies, corporate bonds, mutual funds, common stocks, certificates of deposit and alternative investments.

As of December 31, 2007 and 2006, six and fifty individual holdings had a market value that had been below cost for less than a year, respectively. For 2007, these were all mutual funds and in total, their market value was less than three and a half percent below cost. For 2006, these were mostly equities and mutual funds and fixed income investments and in total, their market value was also less than two percent below cost.

Only one individual holding had a market value that had been below cost for more than a year as of December 31, 2007. This was a certificate of deposit and in total the market value was less than one half percent below cost. There were thirty one individual holdings that had a market value that had been below cost for more than a year as of December 31, 2006. These were both equity and fixed income funds, and in total, their market value was less than five percent below cost.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(3) Investments (continued)

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

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual Funds	\$ 10,425,604	(333,105)	—	—	10,425,604	(333,105)
Subtotal securities	10,425,604	(333,105)	—	—	10,425,604	(333,105)
Certificates of Deposit	—	—	79,772	(228)	79,772	(228)
Total temporarily impaired securities	\$ 10,425,604	(333,105)	79,772	(228)	10,505,376	(333,333)

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

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	\$ 1,170,470	(5,185)	1,779,258	(44,892)	2,949,728	(50,077)
Corporate bonds	148,173	(2,489)	—	—	148,173	(2,489)
Subtotal debt securities	1,318,643	(7,674)	1,779,258	(44,892)	3,097,901	(52,566)
Mutual Funds	6,596,730	(110,622)	—	—	6,596,730	(110,622)
Common stocks	109,953	(19,018)	89,587	(53,737)	199,540	(72,755)
Subtotal securities	6,706,683	(129,640)	89,587	(53,737)	6,796,270	(183,377)
Certificates of Deposit	139,690	(310)	217,172	(2,993)	356,862	(3,303)
Total temporarily impaired securities	\$ 8,165,016	(137,624)	2,086,017	(101,622)	10,251,033	(239,246)

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Notes to Consolidated Financial Statements
December 31, 2007 and 2006

(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>2007</u>	<u>2006</u>
Permanently restricted investments	\$ 5,590,546	4,122,715
Debt service reserve funds	7,390,387	7,597,624
Held by trustee - for future projects	2,874,501	—
Operating reserve fund	1,531,994	1,438,394
Bond funds	606,645	1,016,644
Assets designated for renovation and charity care	707,700	633,127
Other reserves required by financing arrangements	815,674	539,146
	<u>19,517,447</u>	<u>15,347,650</u>
Less current portion	<u>(1,314,345)</u>	<u>(1,649,771)</u>
	<u>\$ 18,203,102</u>	<u>13,697,879</u>

(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 46% and accounted for under the equity method is included in investments in marketable equity securities and totaled \$635,217 and \$430,097 as of December 31, 2007 and 2006, respectively. During 2007 and 2006, respectively, PHI paid Prelude approximately \$1,936,000 and \$1,660,000 for information services provided by Prelude, of which \$327,478 and \$158,948 was included in accounts payable as of December 31, 2007 and 2006, respectively.

Following is summarized financial information of Prelude as of December 31, 2007:

	<u>2007</u>
Assets	\$ 3,357,158
Liabilities	1,949,464
Equity	1,407,694
Sales	7,110,220
Net Income	251,838

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(5) Related Party Transactions (continued)

In addition, the Corporation's affiliates purchase medications from Continuing Care Rx, Inc. As of December 29, 2004 the Corporation sold its majority interest in Continuing Care Rx, Inc. and remains a minority shareholder in CCRx Holdings, Inc, the parent corporation of Continuing Care Rx, Inc. Total purchases by affiliates from Continuing Care Rx, Inc. for 2007 and 2006 were approximately \$3,394,457 and \$2,871,958, respectively, of which \$642,000 and \$589,591 was included in accounts payable as of December 31, 2007 and 2006, 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. In May 2006, PHI redeemed its membership interest in Alliance Rehab HVA, L.L.C. During 2006, the Corporation purchased services from Alliance Rehab for \$2,968,043, of which \$733,459 was included in accounts payable as of December 31, 2006.

(6) Property and Equipment

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

	2007	2006
Land	\$ 30,897,267	27,056,847
Land improvements	20,095,946	19,503,231
Buildings and improvements	275,850,608	264,487,449
Departmental equipment, furniture and fixtures	41,683,549	40,924,049
Furniture	3,851,496	4,341,960
Vehicles	2,860,970	2,713,397
Construction-in-progress	6,296,005	12,444,565
	381,535,841	371,471,498
Accumulated depreciation	(168,933,167)	(162,238,195)
	\$ 212,602,674	209,233,303

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

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

As of December 31, 2007 and 2006, commitments for future construction totaled approximately \$1,179,550 and \$6,910,300, respectively. Additionally, the Corporation executed a software license and support maintenance agreement with a new payroll service provider on December 20, 2007. The agreement includes future commitments of approximately \$800,000.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(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 were 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 30 years. Schartner House Inc. was organized by the Corporation to be a general partner for this project. The partnership, Schartner House Associates, L.P. (the Partnership) has a general partner, Schartner House Inc, a special limited partner, MMA Special Limited Partner, Inc. and an investor limited partner, MMA Financial Institutional Tax Credits XXI. The amount of equity provided by MMA during 2007 and 2006 is included in unrestricted net assets as a minority interest (labeled as tax credit equity) of \$5,702,876 and \$3,628,892, respectively.

During 2007, it was determined that a planned construction project at Saint Andrew's Village was not moving forward and \$987,144 of assets were considered impaired.

During 2006, it was determined that a planned renovation and construction project was not moving forward at QRC and \$924,050 of assets were considered impaired.

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

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

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

During 2006, the Board of Directors voted to close the Corporation's stand-alone personal care unit, Moshannon Heights. As a part of the closure, Windy Hill Retirement Village constructed a new wing to which the current residents of Moshannon Heights were transferred. Construction at Windy Hill was completed in April of 2006. The construction was completed with the proceeds of the 2006 College Township Revenue Bonds. In 2007, the Corporation sold the Moshannon Heights building for approximately \$200,000.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(6) Property and Equipment (continued)

For the years ended December 31, 2007 and 2006, Moshannon Heights' loss consisted of:

	2007	2006
Depreciation	\$ (7,818)	(37,528)
Interest	—	(3,026)
Amortization	—	(97)
Other expenditures, net of loss of \$17,525 and \$84,927, respectively	3,222	(262,711)
Total loss on discontinued operations	<u>\$ (4,596)</u>	<u>(303,362)</u>

During 2007, the Corporation disposed of its MSO building for approximately \$1.3 million. The proceeds from the sale were used to purchase land for Chimney Rocks. This land will be used for future expansion.

Additionally included in discontinued operations for 2006 is \$29,512 of remaining costs related to Presbyterian Health Center which was sold in 2003.

(7) Long-term Debt

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

	2007	2006
Cumberland County Municipal Authority Bonds Series 1993A, principal due in 2018, variable interest rate, 3.40% and 3.94% at December 31, 2007 and 2006, respectively, secured by irrevocable letter of credit	\$ 6,000,000	6,000,000
Cumberland County Municipal Authority Revenue Bonds Series 2003A, tax exempt bonds, principal due in varying annual amounts from 2005 to 2026, interest rates ranging from 2.15% to 5%, insured by municipal bond insurance and property and equipment and gross revenues of Presbyterian Homes, Inc.	14,920,000	16,060,000
Cumberland County Municipal Authority Revenue Bonds Series 2003B, tax exempt variable rate bonds, principal maturities in varying amounts from 2004 to 2032, interest adjusted weekly, 3.39% and 3.92% at December 31, 2007 and 2006, respectively, collateralized by letter of credit	8,540,000	8,660,000
Kent County Delaware Economic Development Revenue Bond Series 2003, principal and interest payable monthly on a 15-year amortization period, final principal payment due October 31, 2018, variable interest of 4.48% and 4.40% at December 31, 2007 and 2006, respectively, collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.	7,765,747	8,340,762

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(7) Long-term Debt

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

	<u>2007</u>	<u>2006</u>
Cumberland County Municipal Authority 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 and collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.	16,800,000	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% and 3.65 % at December 31, 2007 and 2006, respectively, insured by municipal bond insurance and collateralized by property and equipment and gross revenues of Presbyterian Homes, Inc.	16,800,000	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%, collateralized by property and equipment and gross revenues of Presbyterian Housing and Services Corporation	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, 3.39% and 3.92% at December 31, 2007 and 2006, respectively, collateralized by a letter of credit	23,350,000	24,505,000
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% beginning in 2003 due to FHA subsidy	601,009	690,850
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%	924,871	993,208
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 3.55% and 3.93% at December 31, 2007 and 2006, respectively, collateralized by letter of credit	3,340,000	3,340,000

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(7) Long-term Debt (continued)

	<u>2007</u>	<u>2006</u>
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 5.11% and 5.35% at December 31, 2007 and 2006, respectively, collateralized by letter of credit	15,060,000	15,410,000
Term Loan with S&T Bank, bearing interest at a variable rate of 7.25% and 8.25% at December 31, 2007 and 2006, respectively, principal and interest payments due monthly, final principal payment due May 2009, collateralized by property and equipment of corporate office of PHI	357,418	585,918
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% at December 31, 2007 and 2006. The note is collateralized by certain receivables and property at Westminster Woods	2,993,917	3,145,574
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 3.47% and 3.96% at December 31, 2007 and 2006, respectively. These bonds are collateralized by all or portions of the following facilities: Westminster Woods, Woodland Retirement Center, and Hollidaysburg Home.	7,445,000	8,010,000
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 5.295% at December 31, 2007 and 2006, respectively. The note is collateralized by a second lien position on the Westminster Woods facility.	824,473	859,663
Series 2005 College Township Revenue Bonds, payable in equal installments of \$25,248 per month to include principal and interest beginning October 2006 through September 2026. The bonds bear a floating rate of 5.01% as of December 31, 2007 and 2006. The bonds are collateralized by the Windy Hill campus.	3,657,787	3,771,689
Management Services Office ("MSO") mortgage. Payable in equal monthly installments of principal and interest sufficient to amortize the principal balance to June 2023. The note bears interest at a variable rate, which was 5.44% at December 31, 2006. The note is collateralized by the MSO facility.	-	858,275

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(7) Long-term Debt (continued)

	<u>2007</u>	<u>2006</u>
Mortgage note payable, Community Program Loan Trust, payable in monthly installments of \$28,126, due August 2014. The note bears an interest rate of 5%, and is collateralized by all property, plant and equipment except the ILU assets of QRC.	-	1,393,746
Mortgage note payable, Waynesboro Borough Authority, payable in monthly installments of \$18,255, due January 2025. The note bears an interest rate of 5.36%, as of December 31, 2006, and is collateralized by all ILU assets and a second lien on all other property, plant and equipment of QRC.	-	2,733,897
Mortgage note payable, M&T Bank, payable on demand. If no demand is made, payable in monthly installments of \$9,090 and due July 2028. The note bears an interest rate of 7.50%. The note is collateralized by a second lien position on the ILU assets, and all other property, plant and equipment of QRC.	-	1,182,446
Note payable, M&T Bank, is payable on demand. Unless called, payable in monthly installments of principal of \$1,200 plus accrued interest and due February 2039. The note bears a variable interest rate of prime plus one percent, 9.25% at December 31, 2006. The note is collateralized by all personal property, fixtures and receivables of QRC.	-	463,800
Mortgage note payable, Waynesboro Borough Authority, principal and interest payable monthly on a 20-year amortization period, due October 2027. The note bears an interest rate of 4.51% at December 31, 2007. The note is collateralized by all ILU assets and a second lien on all other property, plant and equipment of QRC.	7,933,209	-
Note payable, John Deere Credit, payable in monthly installments of \$374. The note bears an interest rate of 3.80%. The note is collateralized by equipment	7,301	22,010
Presbytery of Huntingdon revolving loan with no interest payable in annual installments of \$5,000	15,000	20,000

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(7) Long-term Debt (continued)

	<u>2007</u>	<u>2006</u>
Other notes and mortgages, primarily paying interest only as of December 31, 2007 and 2006; interest rates ranging from 0% to 1% as of December 31, 2007 and 2006.	117,250	117,250
	153,170,473	156,481,579
Less: Current portion	(5,051,324)	(6,616,667)
Unamortized discount	(393,024)	(414,565)
Plus: Unamortized premium	344,816	363,044
	<u>\$ 148,070,941</u>	<u>149,813,391</u>

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

On August 16, 2007, QRC consolidated its outstanding mortgages into one mortgage revenue note totaling \$8,000,000. The funds were used to refund all of the outstanding mortgage notes and provide approximately \$2.8 million for capital improvements and to pay for issuance costs. The \$2.8 million is being held in a project fund at M&T bank.

Under the terms of Presbyterian Homes, Inc.'s, PHSC's, PHPH's, QRC'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, 2007 for all the corporations. In 2006, these covenants had been met for all the corporations, with the exception of PSLSI and QRC, which obtained waivers from the bank.

The Corporation had outstanding letters of credit of \$42,072,000 and \$44,959,000 at December 31, 2007 and 2006, respectively as required by certain bonds for PHSC and PSLSI.

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Notes to Consolidated Financial Statements
December 31, 2007 and 2006

(7) Long-term Debt (continued)

Current Maturities of Long-term Debt

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

<u>Years ended December 31,</u>	<u>Aggregate maturities</u>
2008	\$ 5,051,324
2009	5,246,158
2010	5,362,081
2010	5,599,084
2011	5,892,107
Thereafter	<u>126,019,719</u>
	<u>\$ 153,170,473</u>

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.

In October 2003, Presbyterian Housing and Services Corporation extended its a swap agreement with a new financial intermediary, which fixed the interest rate to be paid by PHSC on a portion of the PHSC's 2002 bonds as follows:

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

Pursuant to this agreement the intermediary assumed 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, PHSC. The swap agreement was reported at fair value until terminated on May 1, 2006.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(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, 2007 and 2006, under the line of credit agreements, the Corporation had available a maximum of \$14,900,000 and \$11,400,000 from the financial institutions. As of December 31, 2007 and 2006, the Corporation had amounts totaling \$9,873,581 and \$7,303,290 outstanding under these agreements at interest rates ranging from 5.75% to 8.25%.

(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>2007</u>	<u>2006</u>
Medical and office equipment	\$ 483,529	511,038
Accumulated amortization	<u>(238,140)</u>	<u>(134,662)</u>
	<u>\$ 245,389</u>	<u>376,376</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, 2007 follows:

2008	\$ 169,023
2009	73,940
2010	<u>13,625</u>
	256,588
Amounts representing interest	<u>(14,270)</u>
	<u>\$ 242,318</u>

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(9) Leases (continued)

The Corporation leases several offices, certain equipment and automobiles under operating leases, which expire at various dates through 2012. The future minimum lease payments under these operating leases are as follows:

2008	\$ 227,802
2009	128,609
2010	31,533
2011	4,387
2012	300
	<hr/>
	\$ 392,631

Rental expense under operating leases was \$308,861 and \$425,562 for the years ended December 31, 2007 and 2006, respectively.

(10) Annuities

The Corporation has a gift annuity program. In return for their gifts, donors are paid a fixed annuity amount during the lifetime of the donor and/or the donor's beneficiary. Total annuities payable were \$1,200,338 and \$1,170,510 at December 31, 2007 and 2006, 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 \$1,711,732 and \$1,617,686 as of December 31, 2007 and 2006, respectively to satisfy annuities.

(11) Workers' Compensation Insurance

The Corporation has a self-insured Workers' Compensation program as allowed by the Commonwealth of Pennsylvania and the State of Delaware Bureau of Workers' Compensation. This program provides for self payment of work related injuries and illnesses as opposed to utilizing an insurance carrier. The Corporation has contracted with major insurance carriers for excess insurance coverage, loss control services and administration. In 2006, the Corporation maintained a restricted investment account in the amount of \$2,414,724 as collateral for this self-insurance program. In 2007, the Corporation maintained a letter of credit for \$5.5 million in connection with this self-insurance program. At December 31, 2007 and 2006, the Corporation has recorded an accrued expense of approximately \$5 million and \$4.23 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.

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Notes to Consolidated Financial Statements

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(12) Temporarily Restricted Net Assets

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

	<u>2007</u>	<u>2006</u>
Purchase of buildings and equipment	\$ —	4,091
Educational	83,041	67,073
Trust assets held for the benefit of The Easton Home	1,297,564	1,167,758
Charity care and/or equipment, including pledges receivable	1,589,339	1,477,003
Assets held in charitable trust for charity care	738,384	780,679
Various resident activities	149,097	112,963
	<u>\$ 3,857,425</u>	<u>3,609,567</u>

Net assets of \$770,505 and \$951,429 were released from restriction during 2007 and 2006 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>2007</u>	<u>2006</u>
Charity care/equipment	\$ 4,879,059	4,375,354
Trust assets held for the benefit of The Easton Home	965,013	830,086
Contribution receivable from remainder trust	1,338,487	1,303,256
Educational	9,597	9,597
Gift annuities	99,155	—
Perpetual trusts, income restricted for charity care	13,386,185	12,704,757
	<u>\$ 20,677,496</u>	<u>19,223,050</u>

(14) Charity Care

The Corporation provides care to residents who meet certain criteria under its charity care policy at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. In addition, the Corporation considers contractual allowances charity care. The total amount of charity care provided under these policies was approximately \$12.8 and \$11.6 million for the years ended December 31, 2007 and 2006, respectively, of which the amount of charges foregone for services and supplies was approximately \$2,176,000 and \$2,070,000, respectively.

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Notes to Consolidated Financial Statements

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(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 three years of service. Contributions to the plan are at the discretion of the Board of Trustees of PHI and employees have the ability to direct how their contributions are invested. For the years ended December 31, 2007 and 2006, retirement plan expense totaled approximately \$1,552,000 and \$1,134,000, respectively.

QRC has a defined benefit pension plan covering substantially all employees. This plans was curtailed and the benefits were frozen effective December 31, 2004. The benefits are based on years of service and the employee's average compensation during the last 10 years of employment. The Corporation's funding policy is to contribute annually the minimum amount required under statutory funding limitations. Contributions are intended to provide for benefits attributed to service through December 31, 2004. In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158). Effective for the fiscal year ended December 31, 2007, the Corporation adopted the provisions of this standard and recognized the funded status of the plan that it sponsors.

The following table sets forth the plan's funded status and amounts recognized in the Corporation's financial statements as of and for the years ended December 31:

	<u>2007</u>	<u>2006</u>
Projected benefit obligation for service rendered to date	\$ (2,732,684)	(2,588,542)
Plan assets at fair value	<u>2,371,926</u>	<u>2,285,866</u>
Accrued pension liability, net	<u><u>\$ (360,758)</u></u>	<u><u>(302,676)</u></u>
Change in Benefit Obligation:		
Project benefit obligation - beginning of year	\$ (2,588,542)	(2,914,615)
Interest cost	(158,130)	(159,230)
Distributions	71,384	368,669
Change due to assumptions as of end of year	122,702	126,003
Experience loss as of beginning of year	(180,098)	(9,369)
Projected benefit obligation - end of year	<u><u>\$ (2,732,684)</u></u>	<u><u>(2,588,542)</u></u>
Change in Plan Assets:		
Fair value of plan assets - beginning of year	\$ 2,285,866	2,275,816
Actual return on plan assets	182,824	249,414
Contributions	—	181,000
Benefits Paid	(96,764)	(420,364)
Fair value of plan assets - end of year	<u><u>\$ 2,371,926</u></u>	<u><u>2,285,866</u></u>

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(12) Retirement Plan (continued)

The accumulated benefit obligation amounted to \$2,732,684 and \$2,588,542 as of December 31, 2007 and 2006, respectively.

Items not recognized as a component of net period pension cost amounted to \$345,148 at December 31, 2007.

Net periodic pension expense included in following components for the years ended December 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Service cost	\$ 25,380	51,695
Interest cost	158,130	159,230
Expected return on plan assets	(183,998)	(186,993)
Amortization of unrecognized net loss	<u>17,802</u>	<u>21,857</u>
Net Periodic Pension Expense	<u>\$ 17,314</u>	<u>45,789</u>

The plan's funded status as of any measurement date is based on prevailing market conditions as to discount rate and plan assets and, accordingly, is subject to volatility.

The following weighted average rates were used in determining the actuarial present value of the projected benefit obligations and the related net periodic pension cost as of December 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Discount rate	6.0%	5.8%
Expected rate of return on plan asset	8.0%	8.0%
Rate of compensation increase	3.0%	3.0%

The expected long-term rate of return on plan assets reflects the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. The selected rate considers the historical and expected future investment trends of the present and expected assets in the plan.

The expected return on plan assets was determined based on capital market assumptions developed by the Home's independent investment advisors along with other factors such as asset allocation target, investment manager performance, and overall pension performance. The capital market assumptions were projected over a five, ten and 30-years time horizon. Specifically, investment returns for the pension fund were projected over a 10-years period using varying equity allocations.

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(12) Retirement Plan (continued)

The pension plan assets were invested and allocated in the following manner as of December 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Equity securities	47.8%	46.4%
Debt securities	43.6%	45.8%
Other	8.6%	7.8%

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid during the years ending December 31:

2008	41,208
2009	50,177
2010	60,916
2011	74,657
2012	83,302
2013-2017	606,579

QRC is not required and therefore, does not expect to contribute to the pension plan during the year ending December 31, 2007.

In 2007, QRC began participating in the retirement plan through the Corporation.

(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.

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Notes to Consolidated Financial Statements

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(17) Financial Instruments (continued)

Investments: The fair values of U.S. Government securities, notes, corporate bonds and equity securities and mutual funds are estimated based on quoted market prices for those or similar investments. Alternative investments – limited partnerships are valued as described in Note 2(f).

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

The Corporation has a number of other financial instruments, none of which are held for investment purposes. The Corporation estimates that the fair value of all financial instruments at December 31, 2007 and 2006 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying 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.

(18) Subsequent Events

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

(19) Other Matters

In the second quarter of 2008, Presbyterian Homes, Inc., Presbyterian Housing and Services Corporation, Presbyterian Homes in the Presbytery of Huntingdon PHI Investment Management Services and Quincy Retirement Community will be forming an obligated group. All debt from these facilities will be combined into one bond indenture.