

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Financial Statements

December 31, 2007 and 2006

(With Independent Auditor's Report Thereon)

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

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Certification of Chief Executive and Chief Financial Officers

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

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

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

Financial statements alone can never reflect the breadth and depth of our stewardship of this ministry. They do not report on our most significant assets, our employees and volunteers. They also do not reflect our most important stewardship role; our commitment to provide Christian understanding and compassion to those seniors entrusted to our care. We believe that we continue to successfully fulfill the financial and non-financial aspects of our mission, extending a proud tradition of ministry that has served older persons in the name of Christ for the past 80 years.

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



Stephen E. Proctor
Chief Executive Officer
PHI



Jeffrey J. Davis
Chief Financial Officer
PHI

Independent Auditor's Report

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

We have audited the accompanying consolidated statements of financial position of Presbyterian Senior Living Services, Inc. (an affiliate of PHI) as of December 31, 2007 and 2006, and the related consolidated statements of activities and changes in net assets (liabilities), and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Presbyterian Senior Living Services, Inc. as of December 31, 2007 and 2006, and the changes in their net assets (liabilities), 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

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Financial Position

December 31, 2007 and 2006

Assets	<u>2007</u>	<u>2006</u>
Current assets:		
Cash and cash equivalents	\$ 388,446	36,767
Investments	241,482	227,993
Accounts receivable, net	699,297	359,631
Current portion, assets whose use is limited	707,700	633,127
Interest receivable	9,700	—
Prepaid expenses and other current assets	149,523	151,067
Total current assets	<u>2,196,148</u>	<u>1,408,585</u>
Assets whose use is limited, net of current portion	1,731,157	1,621,614
Property and equipment (net of accumulated depreciation of \$17,423,371 and \$15,917,628, respectively)	32,927,143	32,835,696
Assets under capital leases (net of accumulated depreciation of \$8,024 and \$4,012, respectively)	4,012	8,024
Other assets:		
Deferred financing costs (net of accumulated amortization of \$134,801 and \$118,573, respectively)	<u>329,869</u>	<u>346,098</u>
Total assets	<u>\$ 37,188,329</u>	<u>36,220,017</u>

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

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

Year ended December 31, 2007

(with comparative December 31, 2006 totals)

	2007			Total	2006 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted		
Revenues, gains and other support:					
Resident services, including amortization of entrance fees of \$1,321,464 and \$1,360,717, respectively	\$ 11,504,102	—	—	11,504,102	10,816,586
Interest and dividend income	73,853	20,234	—	94,087	87,454
Realized gains (losses) on investments	52,375	—	—	52,375	(34,692)
Contributions	—	22,733	—	22,733	65,444
Net assets released from restrictions	46,942	(46,942)	—	—	—
Total revenues, gains and other support	11,677,272	(3,975)	—	11,673,297	10,934,792
Expenses:					
Nursing services	2,200,087	—	—	2,200,087	2,196,783
Rehabilitation	241,126	—	—	241,126	129,459
Recreation and special services	376,776	—	—	376,776	293,902
Pharmacy	95,679	—	—	95,679	122,444
Social services	52,248	—	—	52,248	7,973
Physician services	43,799	—	—	43,799	32,684
Food services	1,588,625	—	—	1,588,625	1,636,061
Building operations and maintenance	1,897,691	—	—	1,897,691	1,868,592
Housekeeping	383,139	—	—	383,139	345,949
Laundry and linen	43,949	—	—	43,949	42,937
General and administrative	1,957,730	—	—	1,957,730	1,733,310
Employee benefits	488,049	—	—	488,049	443,183
Interest	1,223,502	—	—	1,223,502	1,280,104
Depreciation	1,509,755	—	—	1,509,755	1,410,866
Amortization	16,229	—	—	16,229	16,229
Total expenses	12,118,384	—	—	12,118,384	11,560,476
Change in net assets (liabilities) before unrealized gains on investments	(441,112)	(3,975)	—	(445,087)	(625,684)
Unrealized gains on investments	13,947	—	—	13,947	180,947
Change in net assets (liabilities)	(427,165)	(3,975)	—	(431,140)	(444,737)
Net assets (liabilities), beginning of year	(9,974,065)	115,744	335,850	(9,522,471)	(9,077,734)
Net assets (liabilities), end of year	\$ (10,401,230)	111,769	335,850	(9,953,611)	(9,522,471)

See accompanying notes to consolidated financial statements

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

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

Year ended December 31, 2006

	2006			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Revenues, gains and other support:				
Resident services, including amortization of entrance fees of \$1,360,717	\$ 10,816,586	—	—	10,816,586
Interest and dividend income	72,821	14,633	—	87,454
Realized losses on investments	(34,692)	—	—	(34,692)
Contributions	23,810	41,634	—	65,444
Net assets released from restrictions	28,132	(28,132)	—	—
Total revenues, gains and other support	10,906,657	28,135	—	10,934,792
Expenses:				
Nursing services	2,196,783	—	—	2,196,783
Rehabilitation	129,459	—	—	129,459
Recreation and special services	293,902	—	—	293,902
Pharmacy	122,444	—	—	122,444
Social services	7,973	—	—	7,973
Physician services	32,684	—	—	32,684
Food services	1,636,061	—	—	1,636,061
Building operations and maintenance	1,868,592	—	—	1,868,592
Housekeeping	345,949	—	—	345,949
Laundry and linen	42,937	—	—	42,937
General and administrative	1,733,310	—	—	1,733,310
Employee benefits	443,183	—	—	443,183
Interest	1,280,104	—	—	1,280,104
Depreciation	1,410,866	—	—	1,410,866
Amortization	16,229	—	—	16,229
Total expenses	11,560,476	—	—	11,560,476
Change in net assets (liabilities) before unrealized gains on investments	(653,819)	28,135	—	(625,684)
Unrealized gains on investments	180,947	—	—	180,947
Change in net assets (liabilities)	(472,872)	28,135	—	(444,737)
Net assets (liabilities), beginning of year	(9,501,193)	87,609	335,850	(9,077,734)
Net assets (liabilities), end of year	\$ (9,974,065)	115,744	335,850	(9,522,471)

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2007 and 2006

	2007	2006
Cash flows from operating activities:		
Change in net liabilities	\$ (431,140)	(444,737)
Adjustments to reconcile change in net liabilities to net cash provided by operating activities:		
Depreciation	1,509,755	1,410,866
Proceeds from entrance fees and deposits	2,667,268	4,717,963
Amortization of entrance fees	(1,321,464)	(1,360,717)
Unrealized gains on investments	(13,947)	(180,947)
Realized (gains) losses on investments	(52,375)	34,692
Amortization	16,229	16,229
Change in assets and liabilities:		
Accounts receivable	(339,666)	175,211
Prepaid expenses and other current assets	(8,156)	16,667
Accounts payable	(21,084)	60,953
Other current liabilities	110,971	21,914
Net cash provided by operating activities	2,116,391	4,468,094
Cash flows from investing activities:		
Acquisition of property and equipment	(1,597,190)	(1,517,679)
Purchases of investments	(1,947,745)	(3,167,946)
Proceeds from sale of investments	1,816,462	2,940,628
Net cash used in investing activities	(1,728,473)	(1,744,997)
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(2,337,984)	(4,371,670)
Principal payments and redemptions of bonds	(350,000)	(330,000)
Payments on note payable	—	(676,000)
Borrowings through capital lease obligations	—	12,036
Repayments on capital lease obligations	(4,008)	(3,795)
Change in annuities payable	(4,470)	(4,644)
Change in due to affiliates	2,660,223	2,456,108
Net cash used in financing activities	(36,239)	(2,917,965)
Net increase (decrease) in cash and cash equivalents	351,679	(194,868)
Cash and cash equivalents, beginning of year	36,767	231,635
Cash and cash equivalents, end of year	\$ 388,446	36,767

See accompanying notes to consolidated financial statements.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(1) General Information

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

The Community contains 114 independent living cottages, 93 independent living apartments, 29 assisted living units and a 31-bed skilled nursing facility. The facility covers approximately 60 acres of the 483-acre site owned by the Corporation.

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

(2) Summary of Significant Accounting Policies

(a) Basis of Consolidation

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

(b) Basis of Accounting

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

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(b) Basis of Accounting (continued)

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

(c) Tax Status

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

(d) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(e) Cash and Cash Equivalents

The Corporation considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents, for the purposes of the statements of financial position and cash flows, except for those included in investments or assets whose use is limited. At times during the years ended December 31, 2007 and 2006, cash balances may have exceeded the federally insured limit of \$100,000.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(f) Investments

Investments in marketable equity securities and mutual funds with readily determinable fair values and all investments in debt securities are measured at fair value as determined by a national exchange in the statements of financial position. A decline in market value of any investment below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to realized loss and a new cost basis for the investment is established. For the years ended December 31, 2007 and 2006, no amounts were charged to realized loss as management believes the decline in value is temporary due to general economic conditions and not a permanent decline in value.

Investment income consisted of the following:

	<u>2007</u>	<u>2006</u>
Interest and dividends	\$ 94,089	87,454
Realized gains (losses) on investments	52,375	(34,692)
Unrealized gains on investments	13,947	180,947
	<u>\$ 160,411</u>	<u>233,709</u>

Investment expenses of \$10,430 and \$6,468 as of December 31, 2007 and 2006, respectively have been included in general and administrative expenses.

(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	\$ 735,676	377,232
Less: allowance for doubtful accounts	(36,379)	(17,601)
Net accounts receivable	<u>\$ 699,297</u>	<u>359,631</u>

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

(h) Assets Whose Use is Limited

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

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(i) Property and Equipment

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

Depreciable lives are determined as follows:

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

(j) Deferred Financing Costs

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

(k) Resident Deposits

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

(l) Deferred Revenue – Entrance Fees

Residents entering the Community execute a Residence and Care Agreement, which requires payment of an entrance fee, based on the unit to be occupied. Ten percent of the entrance fee, as approved by the Maryland Department of Aging, is due upon execution of the agreement and the remainder is due upon occupancy. Entrance fees are refundable in full upon termination of the agreement and subsequent reoccupancy of the unit. These entrance fees are amortized into revenue using the straight-line method over the remaining useful life of the facility. In November 2003, the Maryland Department of Aging approved for single residents both 25% nonrefundable and 50% nonrefundable entrance fee contracts. In January 2004, the Maryland Department of Aging approved both 25% nonrefundable and 50% nonrefundable entrance fee contracts to married couples. The Community adopted these contracts for both single and married residents in 2004 in addition to continued use of the 100% refundable contract.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(l) *Deferred Revenue – Entrance Fees (continued)*

The amount of entrance fees guaranteed to be refundable to residents at December 31, 2007 and 2006 under contractual refund provisions was approximately \$28,462,000 and \$29,334,000, respectively.

(m) *Temporarily and Permanently Restricted Net Assets*

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. The Corporation's temporarily restricted net assets consist principally of funds directed for special projects and resident welfare. Net assets released from restriction consist of expenses incurred satisfying those restricted purposes. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity. Income from the permanently restricted net assets is primarily to be used for resident welfare.

(n) *Donor Restrictions*

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

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.

(o) *Resident Services Revenue and Business Concentration*

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

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

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

Medicare reimbursement provided for a prospective payment system (“PPS”) for skilled nursing services. Skilled nursing facilities are paid a federal per diem rate for covered services, which include routine and ancillary services and most 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, including all therapy services.

Nursing services provided to 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 of changes in Medicaid reimbursement in this state.

Revenues from Medicare and Medicaid represent approximately 10% and 12% of consolidated revenues for 2007 and 2006, respectively. Medicare and Medicaid receivables represent approximately 32% and 41% of consolidated accounts receivable at December 31, 2007 and 2006, respectively.

(p) Classification of Expenses

	<u>2007</u>	<u>2006</u>
Program activities	\$ 10,160,654	9,827,166
General and administrative	1,914,323	1,699,117
Fundraising	43,407	34,193
	<u>\$ 12,118,384</u>	<u>11,560,476</u>

(q) Advertising

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2007 and 2006, was \$67,587 and \$62,619, respectively.

(r) Performance Indicator

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

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(s) Consolidated Statements of Cash Flows

Interest paid during the years ended December 31, 2007 and 2006 was \$1,230,707 and \$1,266,331, respectively.

(3) Investments

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

	2007		2006	
	Fair Value	Cost	Fair Value	Cost
Money market funds	\$ 217,542	217,542	854,850	854,850
Mutual funds - equities	1,673,318	1,548,821	1,107,060	1,000,271
Mutual funds - fixed income	789,479	773,967	520,824	515,057
Totals	\$ 2,680,339	2,540,330	2,482,734	2,370,178
Less assets whose use is limited (note 5)	\$ (2,438,857)		(2,254,741)	
Total investments	\$ 241,482		227,993	

During 2006, the Corporation moved its investments from individual fixed income investments including bonds issued by the US Government and its agencies, and corporate bonds to a diversified portfolio of mutual funds. The Corporation had seventeen mutual funds as of December 31, 2007 and 2006. As of December 31, 2007, five mutual funds had a market value below cost. As of December 31, 2006, only two mutual funds had a market value below cost.

Five individual holdings had market values that have been below cost for less than a year as of December 31, 2007. In total, their market value is less than four percent below cost for 2007. One individual holding had a market value that has been below cost for less than a year as of December 31, 2006. In total, the market value of the loss is less than one percent below cost for 2006.

There are no individual holdings that have a market value that has been below cost for more than a year as of both December 31, 2007 and 2006.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

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:

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

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

	<u>Less than 12 Months</u>		<u>More than 12 Months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
Mututal funds	\$ 8,102	(112)	—	—	8,102	(112)
Total temporarily impaired securities	\$ <u>8,102</u>	<u>(112)</u>	<u>—</u>	<u>—</u>	<u>8,102</u>	<u>(112)</u>

(4) Related Party Transactions

The Corporation incurs a management fee payable to PHI under a Development, Marketing, and Management Agreement (Management Agreement). Under the Management Agreement, PHI provides a full-time licensed administrator who is responsible for the facility's operation, under the direction of PHI. For the years ended December 31, 2007 and 2006, the Corporation incurred fees under the agreement of \$723,442 and \$672,486, respectively, which are classified as general and administrative expenses on the consolidated statements of activities and changes in net assets (liabilities).

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

At December 31, 2007 and 2006 the amounts payable to PHI were \$9,754,198 and \$7,093,975, respectively. Under the Management Agreement, this is included in due to or from affiliated entity.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(4) Related Party Transactions (continued)

Prelude Systems, Inc. (Prelude), is a joint venture between PHI and Diakon Lutheran Social Ministries. Prelude is a technical services organization with a wide range of programs designed to support the information systems needs of both PHI and Diakon as well as other healthcare and community service organizations. During 2007 and 2006, respectively, the Corporation paid Prelude approximately \$87,916 and \$79,195 for information services provided by Prelude.

During 2007 and 2006, the Corporation purchased pharmaceuticals of \$93,372 and \$127,063, respectively from Continuing Care Rx, Inc., of which \$19,890 and \$19,594 is included in accounts payable as of December 31, 2007 and 2006, respectively. PHI is a minority shareholder of CCRx Holdings, Inc., the parent corporation of Continuing Care Rx, Inc.

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 \$103,410, of which \$32,586 is included in accounts payable as of December 31, 2006.

(5) Assets Whose Use is Limited

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

	<u>2007</u>	<u>2006</u>
Operating reserve fund	\$ 1,531,994	1,438,394
Designated for renovation and charity care	707,700	633,127
Other reserves required by financing arrangement	199,163	183,220
	<u>2,438,857</u>	<u>2,254,741</u>
Less: current portion assets whose use is limited	<u>(707,700)</u>	<u>(633,127)</u>
Assets whose use is limited, net of net of current portion	<u>\$ 1,731,157</u>	<u>1,621,614</u>

The Corporation's Board of Directors has designated certain funds toward the purpose of acquiring or renovating property and equipment and for providing charity care. These funds are primarily held in mutual funds and money market funds where the cost approximates fair value.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(5) Assets Whose Use is Limited (continued)

The Corporation is required by the Maryland Department of Aging to maintain and fund an operating reserve based on the Corporation's operating expenses for the most recent fiscal year, excluding depreciation and amortization. The Department of Aging requires the Corporation to build the level of this operating reserve over a period not to exceed ten years beginning in 1997. Annual contributions to the operating reserve equaling at least 10% of the calculated reserve amount are required. For the year ended December 31, 2007 the fund balance was \$1,531,994, representing cumulative contributions and earnings in satisfaction of the minimum operating reserve amount. Additional contributions of \$56,866 are anticipated to be made during 2008 based on the following computation:

	<u>2007</u>
Total operating expenses:	\$ 12,118,384
Less: Depreciation	(1,509,755)
Amortization	<u>(16,229)</u>
Total expenses subject to operating reserve computation	(A) 10,592,400
Operating reserve requirement – 15% of (A)	(B) 1,588,860
Minimum operating reserve as of year 11 – 100% of (B)	1,588,860
Operating reserve fund, December 31, 2007	<u>(1,531,994)</u>
Contributions required for year ended December 31, 2008	\$ <u><u>56,866</u></u>

(6) Commitments and Contingencies

The Corporation is involved in legal proceedings arising from its activities in the health care industry. Although it is not possible to presently determine the outcome of these matters, management believes the aggregate liability, if any, resulting from such proceedings will not have a material adverse effect on the Corporation's assets, liabilities, net assets, operations or cash flows.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(7) Property and Equipment

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

	2007		2006	
	Cost	Accumulated depreciation	Cost	Accumulated depreciation
Land	\$ 14,800,000	—	14,800,000	—
Land improvements	2,085,423	1,184,857	2,027,098	1,099,382
Buildings and improvements	30,922,959	14,443,629	28,795,401	13,131,876
Departmental equipment, furniture and fixtures	2,108,916	1,608,347	1,899,412	1,516,754
Vehicles	233,298	186,538	233,298	169,616
Construction-in-progress	199,918	—	998,115	—
	\$ 50,350,514	17,423,371	48,753,324	15,917,628
Net book value		\$ 32,927,143		\$ 32,835,696

Land consists of 483 acres, of which 60 acres are utilized for the facility. The remaining land is leased to independent parties and may be available for future expansion. As of December 31, 2006, there were no significant commitments for future construction. As of December 31, 2007, commitments for future construction totaled \$33,000.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

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(8) Bonds payable

Bonds payable as of December 31 consisted of the following:

	2007	2006
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
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	<u>15,060,000</u>	<u>15,410,000</u>
	18,400,000	18,750,000
Less: current portion bonds payable	<u>(375,000)</u>	<u>(350,000)</u>
	<u>\$ 18,025,000</u>	<u>18,400,000</u>

Under the terms of the Corporation's 1999 Maryland Health and Higher Educational Facility Authority Revenue bond indenture, the Corporation is required to maintain certain deposits with a trustee. These deposits are included in assets whose use is limited. The indenture also places limits on the incurrence of additional borrowings and requires the Corporation to satisfy certain measures of financial performance as long as the bonds are outstanding. These covenants were met as of December 31, 2007. These covenants were not met as of December 31, 2006. The bank granted the Corporation a waiver for 2006.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(8) Bonds payable (continued)

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

<u>Years ended December 31,</u>	
2008	\$ 375,000
2009	405,000
2010	435,000
2011	465,000
2012	500,000
Thereafter	<u>16,220,000</u>
	\$ <u>18,400,000</u>

The Corporation had an outstanding letter of credit of \$18,400,000 and \$19,027,000 at December 31, 2007 and 2006, respectively as required by the bonds. This letter of credit requires the Corporation to pay an annual fee approximating 1.15% of the principal balance of bonds outstanding. This letter of credit expires August 2008 and is collateralized by property and equipment and gross revenues of the Corporation.

(9) Note Payable

The Corporation has available a line of credit with a financial institution. Borrowings under this line of credit arrangement vary with the prime rate of 8.25% at December 31, 2007 and 2006. Under the line of credit agreement, the Corporation had available maximum borrowings of \$1,250,000. As of December 31, 2007 and 2006, the Corporation had no outstanding borrowings under the line of credit agreement. The line of credit expires on June 30, 2009.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

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(10) Leases

The Corporation is obligated under a capital lease for a computer that expires in 2008. At December 31, 2007 and 2006, the gross amount of the equipment and related accumulated amortization recorded under capital leases was as follows:

	2007	2006
Computer	\$ 12,036	12,036
Accumulated amortization	(8,024)	(4,012)
	\$ 4,012	8,024

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	\$ <u>4,361</u>
	4,361
Amounts representing interest	(127)
Present value of minimum lease payments	\$ 4,234

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

2008	\$ 32,356
2009	19,249
2010	6,612
2011	2,197
	\$ 60,414

Rental expense under operating leases was \$37,935 and \$36,072 for the years ended December 31, 2007 and 2006, respectively.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(11) Annuities

The Corporation has a gift annuity program. In return for their gifts, donors are paid a fixed annuity amount during the lifetime of the donor and/or the donor's beneficiary, which creates a liability of the Corporation. Total annuities payable were \$76,091 and \$80,561 at December 31, 2007 and 2006, respectively. The Corporation uses published mortality-rate tables adopted by the United States Internal Revenue Service and an assumed discount rate of approximately four percent to determine the present value of the actuarially determined liability. The Corporation has assets included in investments of \$241,482 and \$227,993 as of December 31, 2007 and 2006, respectively to satisfy annuities.

(12) 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 were approximately \$202,147 and \$287,259 for the years ended December 31, 2007 and 2006, respectively, of which the amount of charges foregone for services and supplies were approximately \$19,330 and \$13,620 for 2007 and 2006, respectively.

(13) Retirement Plan

The Corporation participates in the defined-contribution retirement plan of PHI. This plan covers all employees that have completed one year of service and have reached the age of 21. Vesting occurs after three years of service. Contributions to the plan are at the discretion of the Board of Trustees of 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 \$62,100 and \$63,200, respectively.

(14) 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 mutual funds, government agency securities and corporate debt securities are estimated based on quoted market prices for those or similar investments.

PRESBYTERIAN SENIOR LIVING SERVICES, INC.

Notes to Consolidated Financial Statements

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(14) Fair Values of Financial Instruments (continued)

Long-term debt: The carrying amount included in long-term debt in the statement of financial position for bonds payable approximates the fair 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 statements of financial position.