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PRESBYTERIAN HOMES, INC.

Financial Statements
and Schedule

December 31, 2005 and 2004

(With Independent Auditor's Report Thereon)

PRESBYTERIAN HOMES, INC.

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RETIREMENT AND SENIOR
CARE SERVICES

1217 Slate Hill Road • Camp Hill, Pennsylvania 17011

Certification of Chief Executive and Chief Financial Officers

We are responsible for the financial statements and supporting information of Presbyterian Homes, Inc., as of December 31, 2005 and 2004, and attest that they are accurate, complete and fairly presented.

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

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

Financial statements alone can never reflect the breadth and depth of our stewardship of this ministry. They do not report on our most significant assets, our employees and volunteers. They also do not reflect our most important stewardship role; our commitment to provide Christian understanding and compassion to those seniors entrusted to our care. We believe that we continue to successfully fulfill the financial and non-financial aspects of our mission, extending a proud tradition of ministry that has served older persons in the name of Christ for the past 78 years.

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

Stephen E. Proctor
Chief Executive Officer
PHI

Jeffrey J. Davis
Chief Financial Officer
PHI

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

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Independent Auditor's Report

The Board of Directors
Presbyterian Homes, Inc.:

We have audited the accompanying statements of financial position of Presbyterian Homes, Inc. (an affiliate of PHI) as of December 31, 2005 and 2004, and the related statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Presbyterian Homes, Inc. as of December 31, 2005 and 2004, and the changes in its net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Beard Miller Company LLP

Beard Miller Company LLP
Lancaster, PA
February 25, 2006

PRESBYTERIAN HOMES, INC.

Statements of Financial Position

December 31, 2005 and 2004

Assets	**2005**	**2004**
Current assets:		
Cash and cash equivalents	$ 1,474,654	1,681,881
Investments	34,547,606	33,292,062
Accounts receivable, net	5,078,191	5,270,223
Assets whose use is limited – required for current liabilities	363,526	433,378
Pledges receivable, current portion	469,398	138,000
Interest receivable	64,619	63,674
Inventory	179,886	179,855
Prepaid expenses and other current assets	625,201	719,642
Total current assets	42,803,081	41,778,715
Assets whose use is limited, net of current portion	6,708,530	6,567,205
Assets whose use is limited, construction funds held by trustee	—	3,503,982
Pledges receivable, net of current portion	827,631	893,632
Property and equipment (net of accumulated depreciation of $65,909,876 and $61,205,718, respectively)	81,948,696	76,906,673
Assets under capital leases (net of accumulated depreciation of $4,483)	79,921	—
Due from affiliates	2,935,176	1,271,424
Funds held in trust by others	7,439,270	7,547,865
Fair value of interest rate swaps	137,939	—
Other assets:		
Beneficial interest in assets of PHI	1,723,591	1,573,527
Deferred financing costs (net of accumulated amortization of $557,258 and $500,226, respectively)	2,926,242	2,270,171
Other receivables	6,442	7,942
Total assets	$ 147,536,519	142,321,136

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Financial Position

December 31, 2005 and 2004

Liabilities and Net Assets	**2005**	**2004**
Current liabilities:		
Accounts payable	$ 4,216,563	3,984,189
Accrued expenses	6,207,666	6,223,590
Notes payable - lines of credit	870,558	—
Accrued interest	247,887	298,483
Current portion:		
Annuities payable	134,763	119,662
Obligations under capital leases	27,019	—
Long-term debt	1,777,866	1,722,675
Total current liabilities	13,482,322	12,348,599
Resident deposits	836,559	518,236
Deferred revenue – entrance fees	28,511,151	27,193,715
Fair value of interest rate swap	—	21,544
Annuities payable, net of current portion	732,494	640,634
Long-term debt, net of current portion		
Obligations under capital leases	53,245	—
Long-term debt	73,011,783	71,806,274
Total liabilities	116,627,554	112,529,002
Net assets:		
Unrestricted	18,637,562	17,914,585
Temporarily restricted	2,918,863	2,776,846
Permanently restricted	9,352,540	9,100,703
Total net assets	30,908,965	29,792,134
Total liabilities and net assets	$ 147,536,519	142,321,136

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Activities and Changes in Net Assets

Year ended December 31, 2005

(with comparative December 31, 2004 totals)

	2005				
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**2004 Total**
Revenues, gains and other support:					
Resident services, including amortization of entrance fees of $4,038,321 and $3,481,727, respectively	$ 78,655,417	—	—	78,655,417	73,993,333
Interest and dividend income	1,755,068	64,792	—	1,819,860	1,477,152
Realized gains on investments	258,764	—	—	258,764	784,612
Gifts and bequests	1,075,611	491,978	163,003	1,730,592	1,629,764
Net assets released from restrictions	562,753	(562,753)	—	—	—
Total revenues, gains and other support	82,307,613	(5,983)	163,003	82,464,633	77,884,861
Expenses:					
Nursing services	25,782,196	—	—	25,782,196	25,056,684
Rehabilitation	3,113,394	—	—	3,113,394	2,567,378
Recreation and special services	2,549,425	—	—	2,549,425	2,396,834
Pharmacy	2,026,085	—	—	2,026,085	1,684,813
Social services	369,857	—	—	369,857	360,648
Physician services	241,703	—	—	241,703	211,338
Food services	8,851,585	—	—	8,851,585	8,431,625
Building operations and maintenance	7,793,317	—	—	7,793,317	6,846,348
Housekeeping	2,218,194	—	—	2,218,194	2,119,507
Laundry and linen	982,733	—	—	982,733	1,003,733
General and administrative	12,331,180	—	—	12,331,180	11,662,204
Employee benefits	5,515,005	—	—	5,515,005	5,150,428
Interest	3,363,661	—	—	3,363,661	2,979,792
Depreciation	5,155,346	—	—	5,155,346	4,994,660
Amortization	134,135	—	—	134,135	493,680
Unrealized gain on fair value of interest rate swap	(159,483)	—	—	(159,483)	(93,838)
Loss on early extinguishment of debt	1,816,514	—	—	1,816,514	—
Total expenses	82,084,847	—	—	82,084,847	75,865,834
Change in net assets before unrealized gain on investments and assets held in trust by others	222,766	(5,983)	163,003	379,786	2,019,027
Unrealized gain on investments and assets held in trust by others	500,211	148,000	88,834	737,045	544,412
Change in net assets	722,977	142,017	251,837	1,116,831	2,563,439
Net assets, beginning of year	17,914,585	2,776,846	9,100,703	29,792,134	27,228,695
Net assets, end of year	$ 18,637,562	2,918,863	9,352,540	30,908,965	29,792,134

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Activities and Changes in Net Assets

Year ended December 31, 2004

	2004			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains and other support:				
Resident services, including amortization of entrance fees of $3,481,727	$ 73,993,333	—	—	73,993,333
Interest and dividend income	1,449,509	27,643	—	1,477,152
Realized gain on investments	784,612	—	—	784,612
Gifts and bequests	1,326,478	23,878	279,408	1,629,764
Net assets released from restrictions	1,103,077	(1,103,077)	—	—
Total revenues, gains and other support	78,657,009	(1,051,556)	279,408	77,884,861
Expenses:				
Nursing services	25,056,684	—	—	25,056,684
Rehabilitation	2,567,378	—	—	2,567,378
Recreation and special services	2,396,834	—	—	2,396,834
Pharmacy	1,684,813	—	—	1,684,813
Social services	360,648	—	—	360,648
Physician services	211,338	—	—	211,338
Food services	8,431,625	—	—	8,431,625
Building operations and maintenance	6,846,348	—	—	6,846,348
Housekeeping	2,119,507	—	—	2,119,507
Laundry and linen	1,003,733	—	—	1,003,733
General and administrative	11,662,204	—	—	11,662,204
Employee benefits	5,150,428	—	—	5,150,428
Interest	2,979,792	—	—	2,979,792
Depreciation	4,994,660	—	—	4,994,660
Amortization	493,680	—	—	493,680
Unrealized gain on fair value of interest rate swap	(93,838)	—	—	(93,838)
Total expenses	75,865,834	—	—	75,865,834
Change in net assets before unrealized gain on investments and assets held in trust by others	2,791,175	(1,051,556)	279,408	2,019,027
Unrealized gain on investments and assets held in trust by others	36,769	212,501	295,142	544,412
Change in net assets	2,827,944	(839,055)	574,550	2,563,439
Net assets, beginning of year	15,086,641	3,615,901	8,526,153	27,228,695
Net assets, end of year	$ 17,914,585	2,776,846	9,100,703	29,792,134

See accompanying notes to financial statements.

PRESBYTERIAN HOMES, INC.

Statements of Cash Flows

Years ended December 31, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Change in net assets	$ 1,116,831	2,563,439
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	5,155,346	4,994,660
Proceeds from entrance fees and deposits	6,995,572	5,267,275
Amortization of entrance fees	(4,038,321)	(3,481,727)
Loss on early extinguishment of debt	1,816,514	—
Unrealized gain on fair value of interest rate swap	(159,483)	(93,838)
Unrealized gains on investments and assets held in trust by others	(737,045)	(544,412)
Realized gains on investments	(258,764)	(784,612)
Contributions restricted for long-term purposes	(163,003)	(279,408)
Change in funds held in trust by others	47,365	(253,534)
Amortization	109,010	456,528
Amortization of bond discount	25,125	37,152
Change in assets and liabilities:		
Accounts receivable	192,032	(931,999)
Pledges recievable	(265,397)	104,989
Other assets	93,465	(199,592)
Other receivables	1,500	13,912
Accounts payable	232,378	700,315
Accrued expenses	(66,521)	1,385,892
Net cash provided by operating activities	10,096,604	8,955,040
Cash flows from investing activities:		
Acquisition of property and equipment	(10,277,290)	(8,513,228)
Purchases of investments	(31,562,471)	(41,988,597)
Proceeds from sale of investments	31,213,902	28,805,757
Change in assets whose use is limited	3,432,509	6,419,594
Net cash used in investing activities	(7,193,350)	(15,276,474)
Cash flows from financing activities:		
Refunds of entrance fees and deposits	(1,321,493)	(1,608,391)
Principal payments on long-term debt	(33,448,655)	(1,673,722)
Proceeds on the issuance of long-term debt	33,600,000	—
Financing costs incurred	(1,497,367)	—
Borrowings (payments) on notes payable	870,558	(229,331)
Borrowings through capital leases	85,505	—
Repayments on capital lease obligations	(5,241)	—
Contributions restricted for long-term purposes	163,003	279,408
Change in annuities payable	106,961	81,098
Due from affiliated entity	(1,663,752)	8,090,094
Net cash (used in) provided by financing activities	(3,110,481)	4,939,156
Net decrease in cash and cash equivalents	(207,227)	(1,382,278)
Cash and cash equivalents, beginning of year	1,681,881	3,064,159
Cash and cash equivalents, end of year	$ 1,474,654	1,681,881

See accompanying notes to financial statements.

(1) General Information

Presbyterian Homes, Inc. (the Corporation) is a not-for-profit corporation, which provides services in the Presbyteries of Carlisle, Donegal, Kiskiminetas, Lackawanna, Lehigh, Northumberland, New Castle and Upper Ohio Valley in the states of Pennsylvania, Delaware, and Ohio. Presbyterian Homes, Inc. owns, operates and manages two stand alone skilled nursing facilities, five continuing care retirement communities, one stand-alone independent living facility and two stand alone assisted living homes. In total, the Corporation includes 450 independent living units, 276 assisted living units, 763 nursing beds. The Corporation is governed by a Board of Directors, all of whom are elected by the Board of Trustees of PHI, the Corporation's parent organization.

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

The Corporation has received a Certificate of Authority from the Pennsylvania Insurance Department as required by the Continuing Care Provider Registration and Disclosure Act of 1984, (the Act).

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

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

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

(b) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity. The interest and dividend income from these restricted assets is used for the charitable purpose.

(continued)

(c) Donor Restrictions

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

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

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

(d) Cash and Cash Equivalents

The Corporation considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents for the purposes of the statements of financial position and cash flows, except for those included in investments or assets whose use is limited. At times during the years ended December 31, 2005 and 2004, cash balances may have exceeded the federally insured limit of $100,000.

(e) Statement of Cash Flows

Interest paid during the years ended December 31, 2005 and 2004 was $3,312,255 and $3,028,894, respectively.

(continued)

(f) Accounts Receivable

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

		2005	2004
Total accounts receivable	$	6,007,942	6,136,323
Less: allowance for doubtful accounts		(929,751)	(866,100)
Net accounts receivable	$	5,078,191	5,270,223

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

(g) Pledges Receivable

During 2003, a pledge was made to the Corporation for $1,500,000. Additional pledges were received in 2005 for $480,609. As of December 31, 2005, the organization has received $452,094 of the gifts and the remaining balance will be paid over the next 8 years. The Corporation recorded these pledges at the net present value less a discounted uncollectible amount of 5%.

		2005	2004
Pledges receivables	$	1,528,515	1,298,000
Less: unamortized discount		(192,630)	(224,526)
Subtotal		1,335,885	1,073,474
Less: allowance for uncollectibles		(38,856)	(41,842)
Net pledges receivables	$	1,297,029	1,031,632

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

Amounts due in:		
Less than one year	$	477,777
One to five years		802,738
More than five years		248,000
	$	1,528,515

(h) Deferred Costs

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

(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
Furniture	5-15 years
Vehicles	5 years

(j) Investments

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

Investment income consisted of the following:

	2005	2004
Interest and dividends	$ 1,819,860	1,477,152
Realized gains on investments	258,764	784,612
Unrealized gains on investments and assets held in trust by others	737,045	544,412
	$ 2,815,669	2,806,176

Investment expenses of $124,528 and $79,263 as of December 31, 2005 and 2004, respectively have been included in general and administrative expenses.

(k) Inventories

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

(l) Funds Held in Trust by Others

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

Assets held in trust by others are valued at the estimated fair value of the underlying investments. The change in the fair value of assets held in trust by others is reported as permanently restricted unrealized gains or losses on investments.

Also included in funds held in trust by others are contributions receivable from charitable remainder trusts that are held by independent trustees. Periodic payments are made to annuitants and the remaining corpus will revert to the Corporation upon the death of the annuitant. These annuities are recorded at the present value of the annuity amount discounted at the contract rate over the estimated remaining life of the annuitant.

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

	2005	2004
Assets held in trust by others	$ 6,642,256	6,469,220
Contributions receivable from remainder trusts	797,014	1,078,645
	$ 7,439,270	7,547,865

(m) Costs of Borrowing

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

(n) Assets Whose Use is Limited

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

(continued)

(o) Deferred Revenue – Entrance Fees

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

The amount of entrance fees refundable to residents at December 31, 2005 and 2004 under contractual refund provisions was approximately $17,860,377 and $15,029,000, respectively.

(p) Statutory Liquid Reserve

The Continuing Care Provider Registration and Disclosure Act requires a working capital reserve equivalent to the greater of the total debt service payments due during the next 12 months on account of any loan or long-term financing, or 10% of the projected annual operating expenses of the Corporation exclusive of depreciation. The reserve is computed on only the proportional share of financing or operating expenses that are applicable to Residence and Care Agreements. The reserve requirement is considered to be fulfilled by the Corporation's unrestricted cash and investments.

(q) Resident Deposits

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

(r) Estimated Obligation to Provide Future Services to Continuing Care Residents

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

(s) Resident Service Revenue and Business Concentration

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

The reimbursement methodology for a variety of health care providers has changed significantly as a result of provisions contained in the Balanced Budget Act of 1997 ("Budget Act"). The Budget Act provides for a prospective payment system ("PPS") for Medicare reimbursement for skilled nursing services (rather than the retrospective cost-based methodology in place prior to July 1, 1998). Skilled nursing facilities are paid a federal per diem rate for covered services, which include routine and ancillary services and capital-related costs. In conjunction with PPS, consolidated billing for Medicare Part A Services is required for skilled nursing facilities. Under consolidated billing for Medicare Part A Services, facilities must bill Medicare for all of the services residents receive, with several exceptions, including all therapy services. The Corporation's skilled nursing facilities began utilizing this new rate methodology in January 1999.

Nursing services provided to Pennsylvania Medicaid beneficiaries are paid at prospectively determined rates per day. These rates vary according to a resident classification system that is based on clinical 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.

Revenues from Medicare and Pennsylvania and Delaware Medicaid (Medicaid) represent approximately 48% and 49% of revenues for 2005 and 2004, respectively. Medicare and Medicaid receivables represent approximately 51% and 55% of accounts receivable at December 31, 2005 and 2004, respectively.

In January 2005, the Commonwealth of Pennsylvania (the State) received approval from the Federal Center for Medicare Services (CMS), to retroactively assess a nursing bed assessment for the State's July 1, 2003 to June 30, 2004 fiscal year. The assessment was $1.50 a day for continuing care retirement community non-Medicare occupied beds, and $15.91 a day for stand alone nursing facility non-Medicare occupied beds. As a part of this, nursing home providers received an additional supplement of $5.17 a day, based on a number of factors, including their Medicaid utilization. The net effect of this assessment and supplement resulted in $867,000 in additional revenues for the Corporation in 2004. This amount was scheduled to be paid by the State during 2005 and was included in accounts receivable as of December 31, 2004. As of December 31, 2005 the Corporation received approximately $787,345 additional revenue for the net effect of this assessment and supplement .

(t) Fundraising Expense

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

(u) Donated Services

Donated services are reflected in the financial statements at the fair value of the service donated. The Corporation pays for most services requiring specific expertise.

(v) 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.

(w) 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.

(x) 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.

(y) Advertising

Advertising costs are expensed in the year incurred. Total advertising expense for the years ended December 31, 2005 and 2004, was $601,643 and $429,466, respectively.

(z) Classification of Expenses

	2005	**2004**
Program activities	$ 68,096,636	64,297,468
General and administrative	12,144,871	11,454,476
Change in fair value of interest rate swap	(159,483)	(93,838)
Loss on early extinguishment of debt	1,816,514	—
Fundraising	186,309	207,728
	$ 82,084,847	75,865,834

(continued)

(aa) Derivatives and Hedging Activities

The Corporation utilizes interest rate swap agreements to hedge variable interest rates; which are accounted for using Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities* as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. For 2004, an adjustment to the liability was recorded causing a gain of $93,838. This adjustment represents the decrease in the fair value (liability) of the swaps. For 2005, an adjustment to the liability was recorded causing a gain of $159,483. This adjustment represents the decrease in the fair value (liability) of the swaps and created an asset on the 2005 Statement of Financial Position.

The Corporation's interest rate swap is carried at fair value asset (liability) as determined by a third party. Changes in fair value are reported in the statement of activities and changes in net assets as a component of the change in net assets.

(ab) Reclassification

Certain amounts in the 2004 financial statements have been reclassified to conform with the 2005 financial presentation. These reclassifications had no effect on the change in net assets.

(ac) Performance Indicator

The Corporation measures the performance of its operations using the statement of activities and changes in net assets, which includes a performance indicator of operations labeled as "changes in net assets before unrealized gain on investments and assets held in trust by others". Changes in unrestricted net assets which are excluded from this measure are: unrealized gains on investments and assets held in trust by others, and other significant adjustments which do not directly indicate operational performance.

(3) Investments

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

	2005		2004	
	Cost	Fair value	Cost	Fair value
Money market funds	$ 1,250,989	1,250,989	15,637,856	15,637,856
Certificates of deposit	–	–	157,791	157,791
Marketable equity securities	22,451,944	25,433,030	10,062,658	12,440,714
Government agencies securities	5,747,806	5,641,123	4,529,928	4,504,376
Corporate debt securities	3,717,067	3,628,223	1,924,643	1,865,890
Other	277,261	271,408	158,697	158,697
Totals	$ 33,445,067	36,224,773	32,471,573	34,765,324
Less permanently restricted investments (note 5)		(1,677,167)		(1,473,262)
Total investments		$ 34,547,606		$ 33,292,062

The Corporation invests in a wide variety of individual fixed income and equity investments including bonds issued by the US Government and it’s agencies, corporate bonds, and common stock. The Corporation has approximately two hundred and seventy seven and two hundred and twenty of such individual holdings as of December 31, 2005 and 2004, respectively.

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

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

(3) Investments (continued)

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

		Less than 12 Months		More than 12 Months		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	$	3,420,571	60,848	1,693,566	51,859	5,114,137	112,707
Corporate bonds		2,203,291	50,254	1,101,341	47,694	3,304,632	97,948
Subtotal debt securities		5,623,862	111,102	2,794,907	99,553	8,418,769	210,655
Common stocks		5,056,353	363,889	363,671	116,474	5,420,024	480,363
Total temporarily impaired securites	$	10,680,215	474,991	3,158,578	216,027	13,838,793	691,018

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

		Less than 12 Months		More than 12 Months		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies	$	2,291,068	29,899	968,486	18,208	3,259,554	48,107
Corporate bonds		757,134	16,104	545,191	14,393	1,302,325	30,497
Subtotal debt securities		3,048,202	46,003	1,513,677	32,601	4,561,879	78,604
Common stocks		1,705,693	174,749	218,820	21,472	1,924,513	196,221
Total temporarily impaired securites	$	4,753,895	220,752	1,732,497	54,073	6,486,392	274,825

(continued)

(4) Related Party Transactions

The Corporation incurs a management fee payable to its parent organization under a management agreement whereby PHI provides the Corporation with various management and administrative services to each of the Corporation's operating facilities. The Corporation also incurs certain operating expenses under the management agreement that are comprised primarily of the salaries and benefits of certain key management personnel provided to the Corporation by the parent organization. Under the terms of the management agreement, the Corporation shall reimburse PHI monthly in arrears by the fifteenth day of the following month in an amount equal to the cost of these management salaries and benefits plus other expenses as described in the agreement. During the years ended December 31, 2005 and 2004, the Corporation incurred management fees and other expenses under the management agreement totaling \$4,538,026 and \$4,444,087, respectively, which is classified as general and administrative expenses in the statement of activities and changes in net assets.

In addition, the Corporation purchases medications from Continuing Care Rx, Inc. As of December 29, 2004 PHI sold its majority interest in Continuing Care Rx Holdings, Inc. and remains a minority shareholder. Total purchases from Continuing Care Rx, Inc. for 2005 and 2004 were approximately \$1,794,973 and \$1,486,488, respectively, of which \$329,569 and \$275,480 is included in accounts payable as of December 31, 2005 and 2004, respectively.

During 2001 the Corporation received \$4,000,000 par with a \$5,000,000 liquidation value cumulative preferred stock in Continuing Care Rx, Inc. from PHI. The preferred stock has a stated dividend rate of 7% annually payable in arrears. The stock was recorded at an estimated market value of \$4,000,000 and correspondingly reduced the amount of the intercompany loan due from PHI. In 2004 this stock was converted to a note receivable, and subsequently repaid in part during 2004. The remainder of the balance was paid in full upon the sale of Continuing Care Rx, Inc. on December 29, 2004. Dividends and interest received from this investment in 2004 totaled \$291,576.

The Corporation is a guarantor of certain debts of Presbyterian Senior Living Services, Inc. (Glen Meadows), an affiliate organization. In the event of a deficiency judgment from the sale of real property pledged as security for the purchase of a facility in Glen Arm, Maryland, Presbyterian Homes, Inc. has guaranteed payment up to \$6,000,000. The Corporation has also guaranteed a line of credit with a maximum available amount of \$1,250,000 for Presbyterian Senior Living Services, Inc., which is subject to renewal in May 2006.

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. During 2005 and 2004, the Corporation purchased services from Alliance Rehab for \$3,100,972 and \$956,986, respectively, of which \$554,339 and \$535,362 is included in accounts payable as of December 31, 2005 and 2004, respectively.

Amounts due from affiliate entities, principally PHI, as of December 31, 2005 and 2004 are \$2,935,176 and \$1,271,424, respectively.

 (continued)

(4) Related Party Transactions

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

(5) Assets Whose Use is Limited

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

	2005	2004
Permanently restricted investments	$ 1,677,167	1,473,262
Debt service reserve fund	5,031,363	5,093,943
Bond fund	363,526	433,378
	7,072,056	7,000,583
Less current portion	(363,526)	(433,378)
	$ 6,708,530	6,567,205

As described in note 7, in January 2003 the Corporation issued Cumberland County Municipal Authority Revenue Bonds, Series 2003 A and B, part of the proceeds of which provided for the establishment of a construction fund to fund capital expenditures. The construction funds, which are also classified as assets whose use is limited, are held by a trustee and distributed when specific requirements of the bond indentures have been met.

The Corporation's debt service reserve, bond and construction funds are required by certain covenants included in its bond indentures. Amounts included in assets whose use is limited have been invested in government agency securities and fixed rate investment contracts where the cost equals fair value.

(continued)

(6) Property and Equipment

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

	2005		2004	
	Cost	Accumulated depreciation	Cost	Accumulated depreciation
Land	$ 4,074,242		4,074,242	–
Land improvements	7,392,267	3,898,130	7,068,414	3,601,519
Buildings and improvements	118,777,298	49,943,490	104,296,191	45,781,993
Departmental equip-ment, furniture and fixtures	12,638,885	9,710,074	11,768,498	9,586,945
Furniture	1,721,334	1,420,724	1,711,675	1,326,723
Vehicles	1,216,928	937,458	1,163,035	908,538
Construction-in-progress	2,037,618		8,030,336	–
	$ 147,858,572	65,909,876	138,112,391	61,205,718
Net book value		$ 81,948,696		$ 76,906,673

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

As of December 31, 2005 and 2004, commitments for future construction totaled approximately $1,400,000 and $4,000,000, respectively.

(7) Long-term Debt

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

		2005	2004
Cumberland County Municipal Authority Bonds Series 1993A principal due in 2018, variable interest rate, 3.55% and 2% at December 31, 2005 and 2004, respectively, secured by irrevocable letter of credit with an annual fee of 0.95%, which expires on December 15, 2010.	$	6,000,000	6,000,000
Cumberland County Municipal Authority Revenue Bonds Series 1996, principal due in varying annual amounts from 2013 to 2026, interest rate set at 6.0%, net of unamortized discount, collateralized by property and equipment and gross revenues of the Corporation		–	31,585,000
Cumberland County Municipal Authority Revenue Bonds Series 2003A, tax exempt bonds, principal due in varying annual amounts from 2005 to 2026, interest rates ranging from 2.15% to 5%, insured by municipal bond insurance and property and equipment and gross revenues of the Corporation		17,175,000	18,265,000
Cumberland County Municipal Authority Revenue Bonds Series 2003B, tax exempt variable rate bonds, principal maturities in varying amounts from 2004 to 2032, interest adjusted weekly, 3.5% and 1.24% at December 31, 2004 and 2003, respectively, collateralized by letter of credit with an annual fee of 0.95 % which expires on December 15, 2010		8,765,000	8,855,000
Kent County Delaware Economic Development Revenue Bond Series 2003, principal and interest payable monthly on a 15-year amortization period, final principal payment due October 31, 2018, variable interest of 3.65% and 1.94% at December 31, 2005 and 2004 respectively, collateralized by property and equipment and gross revenues of the Corporation		8,898,628	9,437,794

(continued)

(7) Long-term Debt (Continued)

		2005	2004
Cumberland County Municiple Authority Revenue Bonds Series 2005A, tax exempt debenture bonds, principal due in varying annual amounts from 2013 to 2020, interest rates ranging from 4% to 5%, insured by municipal bond insurance		16,800,000	–
Cumberland County Municiple Authority Revenue Bonds Series 2005B, taxable variable rate debenture bonds, principal maturities in varying amounts from 2013 to 2026, interest adjusted weekly after first year, 4.25% at December 31, 2005, insured by municipal bond insurance		16,800,000	–
Note payable to Synod of the Trinity of the Presbyterian Church, U.S.A., no scheduled repayment of principal, variable interest rate based on the prime rate, 6.25% and 4.25% at December 31, 2005 and 2004, respectively, unsecured until October 2005.		200,000	200,000
Note payable to Case Credit Corporation, principal payable in equal installments of principal only, until October 2005. Note is non-interest bearing, and is secured by a skid loader.		–	3,509
		74,638,628	74,346,303
Less current portion		(1,777,866)	(1,722,675)
Plus unamortizied premium		493,076	–
Less unamortized discount		(342,055)	(817,354)
	$	73,011,783	71,806,274

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

(continued)

(7) Long-term Debt (Continued)

Under the terms of the Corporation's 2003 and 2005 Cumberland County Municipal Authority Revenue bond indenture, the Corporation is required to maintain certain deposits with a trustee. These deposits are included in assets whose use is limited. The indenture also places limits on the incurrence of additional borrowings and requires the Corporation to satisfy certain measures of financial performance as long as the bonds are outstanding. These covenants have been met as of December 31, 2005.

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

Years ended December 31,		Aggregate maturities
2006	$	1,777,866
2007		1,835,015
2008		1,906,080
2009		1,995,484
2010		2,079,735
Thereafter		65,044,448
	$	74,638,628

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

Notational Amount	Interest Rate	Termination Date
$10,000,000	3.39%	November 28, 2008

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

(8) Notes Payable

The Corporation has a line of credit with a financial institution, which provides for borrowings of up to $4,000,000 at an interest rate based on the prime rate of the financial institution, which was 5.75% and 4.125% as of December 31, 2005 and 2004, respectively. The line of credit is collateralized by accounts receivable on a parity basis with the Corporation's bonded debt. As of December 31, 2005 and 2004, the Corporation had amounts totaling $870,558 and $0, respectively, outstanding under this agreement. The line expires on June 29, 2007.

(9) Leases

The Corporation is obligated under various capital leases for equipment that expire at various dates during the next three years. At December 31, 2005, the gross amount of the equipment and related accumulated amortization recorded under capital leases was as follows:

	2005
Medical and office equipment	$ 84,404
Accumulated amortiztion	(4,483)
	$ 79,921

A schedule of future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2005 follows:

2006	$ 30,615
2007	30,615
2008	25,373
	86,603
Amounts representing interest	(6,339)
	$ 80,264

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

2006	$ 231,386
2007	125,107
2008	44,805
2009	13,820
	$ 415,118

Rental expense under operating leases was $493,004 and $500,362 for the years ended December 31, 2005 and 2004, respectively.

(10) Annuities

The Corporation has a gift annuity program. In return for their gifts, donors are paid a fixed annuity amount during the lifetime of the donor and/or the donor's beneficiary, which creates a liability of the Corporation. Total annuities payable were $867,257 and $760,296 at December 31, 2005 and 2004, respectively. The Corporation uses published mortality-rate tables adopted by the United States Internal Revenue Service and an assumed discount rate of approximately 4% to 6% percent to determine the present value of the actuarially determined liability. The Corporation has assets included in investments of $976,580 and $859,109 as of December 31, 2005 and 2004, respectively to satisfy annuities.

(11) Workers' Compensation Insurance

The Corporation has instituted a self-insured Workers' Compensation program as allowed by the Commonwealth of Pennsylvania and State of Delaware Bureaus of Workers' Compensation. This program provides for self payment of work related injuries and illnesses as opposed to utilizing an insurance carrier. The Corporation has contracted with major insurance carriers for excess insurance coverage, loss control services and administration. The Corporation maintains a letter of credit for $2 million in connection with this self-insurance program. At December 31, 2005 and 2004, the Corporation has recorded an accrued expense of approximately $2.8 million and $1.9 million, respectively for workers' compensation claims which includes known case reserves and an estimate of the Corporation's liability for incurred but not reported claims.

(12) Temporarily Restricted Net Assets

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

	2005	2004
Charity care and/or equipment, including pledges receivable	$ 2,121,849	1,698,201
Contributions receivable from remainder trust	797,014	1,078,645
	$ 2,918,863	2,776,846

Net assets of $562,753 and $1,103,077 were released from restriction during 2005 and 2004 respectively in satisfaction of the above restrictions.

(continued)

(13) Permanently Restricted Net Assets

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

		2005	2004
Charity care and/or equipment	$	2,710,284	2,631,483
Benefit in perpetual trusts; charity care		6,642,256	6,469,220
	$	9,352,540	9,100,703

(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 $6.9 and $6.1 million for the years ended December 31, 2005 and 2004, respectively, of which the amount of charges foregone for services and supplies was approximately $1 million and $990,000, respectively.

(15) Retirement Plan

The Corporation has a defined-contribution retirement plan covering all employees that have completed one year of service and have reached the age of 21. Vesting occurs after five years of service. Contributions to the plan are at the discretion of the Board of Trustees of PHI. For the year ended December 31, 2005 and 2004, retirement plan expense totaled approximately $653,000 and $664,000, respectively. Starting in 2006, the Corporation will be allowing employee the ability to direct how their contributions are invested. Also in 2006, the vesting period will change from 5 years to 3 years.

(16) Commitments and Contingencies

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

(continued)

(17) Financial Instruments

(a) Fair Values of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents: The carrying amount approximates fair value because of the short term nature of those investments.

Investments: The fair values of U.S. Government securities, notes, commercial bonds and equity securities are estimated based on quoted market prices for those or similar investments. Management has determined the fair value of other equity securities based on the stock prices and implied yields of similar publicly traded securities as of December 31, 2005.

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

The Corporation has a number of other financial instruments, none of which are held for investment purposes. The Corporation estimates that the fair value of all financial instruments at December 31, 2005 and 2004 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying statements of financial position.

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

Financial instruments with off-balance-sheet risk to the Corporation, consist of certain financial guarantees of its affiliates and letters of credit obtained from various financial institutions. The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual amount of those obligations as disclosed in note 4.

Independent Auditor's Report on Supplementary Information

To the Board of Directors
Presbyterian Homes, Inc.:

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The following supplementary information accompanying the financial statements is presented for purposes of additional analysis and is not required part of the basic financials statements. The supplementary information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and, accordingly, we express no opinion on such information.

Beard Miller Company LLP

Beard Miller Company LLP
Lancaster, PA
February 25, 2006

Schedule 1

PRESBYTERIAN HOMES, INC.

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

As of December 31, 2005

2006 Budgeted Operating Expenses	$ 83,480,114	
Less: depreciation expense	(5,236,900)	
Expenses subject to minimum liquid assets requirement	78,243,214	
Percentage of residents subject to residence and care arrangements at December 31, 2005	23%	
	17,995,939	
Statutory requirement	10%	
Statutory minimum liquid reserve requirement	$ 1,799,594	(a)
Next 12 months debt service payments:		
Principal payments	$ 1,777,866	
Interest payments	2,971,746	
Total debt service for next 12 months	4,749,612	
Percentage of residents subject to residence and care arrangements at December 31, 2005	23%	
Statutory minimum liquid reserve requirement	$ 1,092,411	(b)
Assets satisfying statutory minimum liquid reserve requirement		
Unrestricted cash and investments	$ 35,051,077	
Greater of (a) or (b)	1,799,594	
Assets in excess of statutory minimum liquid reserve requirement	$ 33,251,483	