

SEVEN HILLS FOUNDATION AND AFFILIATES
COMBINED FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2010
AND
INDEPENDENT AUDITOR'S REPORT

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2010

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Seven Hills Foundation and Affiliates

We have audited the accompanying combined statement of financial position of Seven Hills Foundation and Affiliates (the "Foundation") as of June 30, 2010, and the related combined statements of activities, functional expenses and cash flows for the year then ended. These combined financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these combined financial statements based on our audit. The prior years' summarized comparative information has been derived from the 2009 combined financial statements and, in our report, dated November 16, 2009, we expressed an unqualified opinion on those statements.

We conducted our audit 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 combined financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Seven Hills Foundation and Affiliates as of June 30, 2010 and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Bollus Lynch, LLP

Worcester, Massachusetts
November 12, 2010

SEVEN HILLS FOUNDATION AND AFFILIATES
 COMBINED STATEMENT OF FINANCIAL POSITION
 JUNE 30, 2010
 (With Summarized Financial Information for 2009)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2010	2009
Assets					
Current assets					
Cash	\$ 11,629,839	\$ 468,963	\$ 216,713	\$ 12,315,515	\$ 9,863,632
Deposits with trustees	2,741,203	-	-	2,741,203	2,775,304
Accounts receivable, less allowance for doubtful accounts of \$667,771	13,485,586	-	-	13,485,586	12,827,296
Pledges receivable	86,296	-	-	86,296	207,795
Prepaid expenses and other assets	453,241	-	-	453,241	287,876
Notes receivable	472,187	-	-	472,187	202,747
Total current assets	28,868,352	468,963	216,713	29,554,028	26,164,650
Investments	11,575,129	-	-	11,575,129	9,748,819
Investment in unconsolidated affiliates	1,098,948	-	-	1,098,948	1,235,432
Deposits with trustees, net	3,168,700	-	-	3,168,700	4,969,206
Loan acquisition costs, net	2,884,441	-	-	2,884,441	3,010,531
Deposits and other assets	279,936	-	-	279,936	280,336
Property, plant, and equipment, net	80,025,850	-	-	80,025,850	78,057,969
Cash value of life insurance	1,203,564	-	-	1,203,564	604,208
	<u>\$ 129,104,920</u>	<u>\$ 468,963</u>	<u>\$ 216,713</u>	<u>\$ 129,790,596</u>	<u>\$ 124,071,151</u>
Liabilities and Net Assets					
Current liabilities					
Notes payable, bank	\$ 2,430,445	\$ -	\$ -	\$ 2,430,445	\$ 1,280,627
Current maturities of long-term debt	1,819,027	-	-	1,819,027	1,733,459
Accounts payable	3,177,581	-	-	3,177,581	5,918,930
Accrued and other liabilities	6,430,575	-	-	6,430,575	6,387,313
Total current liabilities	13,857,628	-	-	13,857,628	15,320,329
Advances from the State of Rhode Island	1,115,304	-	-	1,115,304	1,115,304
Long-term debt, less current maturities	69,903,622	-	-	69,903,622	70,516,305
Hedging instrument liability	1,019,540	-	-	1,019,540	461,650
Deferred compensation liability	2,728,787	-	-	2,728,787	2,020,463
	<u>88,624,881</u>	<u>-</u>	<u>-</u>	<u>88,624,881</u>	<u>89,434,051</u>
Net assets					
Unrestricted					
Undesignated	29,937,646	-	-	29,937,646	24,889,327
Designated for endowment	10,542,393	-	-	10,542,393	9,056,482
Temporarily restricted	-	468,963	-	468,963	474,578
Permanently restricted	-	-	216,713	216,713	216,713
	<u>40,480,039</u>	<u>468,963</u>	<u>216,713</u>	<u>41,165,715</u>	<u>34,637,100</u>
	<u>\$ 129,104,920</u>	<u>\$ 468,963</u>	<u>\$ 216,713</u>	<u>\$ 129,790,596</u>	<u>\$ 124,071,151</u>

See accompanying notes to combined financial statements.

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED STATEMENT OF ACTIVITIES

YEAR ENDED JUNE 30, 2010

(With Summarized Financial Information for 2009)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2010	2009
Operating support and revenue:					
Government contracts and fees	\$ 129,567,678	\$ -	\$ -	\$ 129,567,678	\$ 120,959,052
Government donated staff and transportation	87,876	-	-	87,876	87,876
H.U.D. rental subsidy	630,471	-	-	630,471	667,168
Private contracts and fees	3,764,588	-	-	3,764,588	3,712,624
Trainee production	264,660	-	-	264,660	198,970
Rent, vending, service fees	4,164,249	-	-	4,164,249	3,512,304
Interest income	176,386	143	-	176,529	267,775
Investment income	237,966	-	-	237,966	588,831
Net investment gains (losses)	1,275,196	-	-	1,275,196	(2,564,200)
Beano income	1,692,342	-	-	1,692,342	1,759,389
Capital campaign	80,023	-	-	80,023	320,486
Contributions	500,113	3,807	-	503,920	5,101,156
Grants	157,124	-	-	157,124	106,662
Cafeteria	307,158	-	-	307,158	223,975
Gain (loss) on sale of property, plant and equipment	(39,686)	-	-	(39,686)	176,349
Other	853,977	-	-	853,977	825,655
Net assets release from restrictions:					
Satisfaction of purpose restrictions	9,565	(9,565)	-	-	-
Total support and revenue	<u>143,729,686</u>	<u>(5,615)</u>	<u>-</u>	<u>143,724,071</u>	<u>135,944,072</u>
Operating expenses:					
Program services					
Residential services	37,803,869	-	-	37,803,869	35,757,572
Family support	11,957,782	-	-	11,957,782	13,467,721
Vocational services	7,783,101	-	-	7,783,101	7,863,459
Nursing home services	10,532,115	-	-	10,532,115	10,737,513
Community services - Massachusetts	8,857,840	-	-	8,857,840	8,573,986
Community services - Rhode Island	21,909,630	-	-	21,909,630	10,946,899
Rental property operations	343,217	-	-	343,217	391,128
Child care services	22,153,207	-	-	22,153,207	25,711,721
Clinical services	6,874,560	-	-	6,874,560	7,181,318
	<u>128,215,321</u>	<u>-</u>	<u>-</u>	<u>128,215,321</u>	<u>120,631,317</u>
Supporting services					
Management and general	8,422,245	-	-	8,422,245	8,272,344
Total expenses	<u>136,637,566</u>	<u>-</u>	<u>-</u>	<u>136,637,566</u>	<u>128,903,661</u>
Change in net assets from operations	7,092,120	(5,615)	-	7,086,505	7,040,411
Non-operating expense:					
Unrealized loss on hedging instrument	(557,890)	-	-	(557,890)	(461,650)
Change in net assets	6,534,230	(5,615)	-	6,528,615	6,578,761
Net assets, beginning of year	<u>33,945,809</u>	<u>474,578</u>	<u>216,713</u>	<u>34,637,100</u>	<u>28,058,339</u>
Net assets, end of year	<u>\$ 40,480,039</u>	<u>\$ 468,963</u>	<u>\$ 216,713</u>	<u>\$ 41,165,715</u>	<u>\$ 34,637,100</u>

See accompanying notes to combined financial statements.

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED JUNE 30, 2010

(With Summarized Financial Information for 2009)

	Program Services					
	Residential Services	Family Support	Vocational Services	Nursing Home	Community Services - MA	Community Services - RI
Staff payroll	\$ 23,627,873	\$ 2,507,701	\$ 3,906,450	\$ 6,218,506	\$ 5,471,040	\$ 14,316,604
Trainee payroll	-	-	283,204	-	-	335,019
Payroll taxes	2,143,557	235,546	366,057	453,145	494,905	1,173,928
Employee benefits	2,818,583	254,488	681,240	859,079	189,460	2,068,276
Government staff	-	-	87,876	-	-	-
Occupancy	2,301,248	111,230	481,846	680,282	586,712	1,086,847
Telephone	197,548	18,039	34,520	2,087	101,488	120,630
General insurance	126,652	38,221	58,893	150,078	63,359	115,428
Office and operating supplies	204,898	14,139	115,793	581,644	367,321	205,103
Dues and subscriptions	-	-	-	-	16,914	16,382
Printing and postage	6,789	4,451	5,933	-	15,595	30,797
Advertising	904	230	-	301	425	19,849
Legal and audit	-	-	-	-	-	170,700
Client transportation	1,387,878	179,546	384,434	16,363	170,748	318,092
Specialized home care	170,245	6,862,877	-	-	-	-
Clinical consultants	378,481	-	87,038	142,701	195,609	723,607
Purchased services	130	-	-	315,653	-	211,792
Family support	33,487	1,514,970	-	-	59,192	65,148
TEACH program	-	-	-	-	-	-
Staff training	3,404	-	-	4,555	5,923	68,116
Fund raising	25	-	25	-	-	-
Cafeteria and food	1,398,725	41,881	279,246	167,797	4,085	295,116
Interest	1,399,280	84,912	290,094	437,614	188,880	26,662
Beano expenses	526,612	-	398,235	-	-	-
Other	59,425	12,130	37,977	4,911	644,445	68,120
Total before depreciation	36,785,744	11,880,361	7,498,861	10,034,716	8,576,101	21,436,216
Depreciation and amortization	1,018,125	77,421	284,240	497,399	281,739	473,414
	<u>\$ 37,803,869</u>	<u>\$ 11,957,782</u>	<u>\$ 7,783,101</u>	<u>\$ 10,532,115</u>	<u>\$ 8,857,840</u>	<u>\$ 21,909,630</u>

Rental Property Operations	Program Services			Total	Management and General	Totals	
	Child Care Services	Clinical Services				2010	2009
\$ 1,418	\$ 1,305,737	\$ 4,481,460	\$ 61,836,789	\$ 3,025,298	\$ 64,862,087	\$ 57,242,989	
-	-	-	618,223	-	618,223	404,252	
129	120,142	407,796	5,395,205	254,347	5,649,552	4,949,007	
-	178,168	562,338	7,611,632	1,226,573	8,838,205	7,887,389	
-	-	-	87,876	-	87,876	87,876	
118,245	232,332	304,826	5,903,568	308,560	6,212,128	5,694,203	
10,738	30,886	41,762	557,698	81,027	638,725	677,967	
9,398	27,067	31,955	621,051	50,381	671,432	742,912	
19,648	63,537	73,894	1,645,977	286,997	1,932,974	1,690,378	
28	5,925	14,200	53,449	56,783	110,232	108,985	
476	19,258	654	83,953	131,079	215,032	205,361	
-	1,168	301	23,178	191,773	214,951	175,069	
1,931	-	-	172,631	138,809	311,440	255,482	
22	94,414	210,214	2,761,711	142,525	2,904,236	2,677,711	
-	-	-	7,033,122	-	7,033,122	6,685,017	
54	693,564	90,416	2,311,470	323,765	2,635,235	2,385,229	
-	-	-	527,575	6,801	534,376	298,343	
-	19,024,704	58	20,697,559	-	20,697,559	24,979,540	
-	-	-	-	-	-	21,922	
-	3,205	2,820	88,023	193,760	281,783	218,061	
-	-	-	50	59,326	59,376	85,827	
-	114,617	132,389	2,433,856	-	2,433,856	2,179,100	
96,648	87,080	306,909	2,918,079	379,927	3,298,006	3,424,568	
-	-	-	924,847	458,320	1,383,167	1,424,243	
280	21,215	7,249	855,752	920,670	1,776,422	1,598,637	
259,015	22,023,019	6,669,241	125,163,274	8,236,721	133,399,995	126,100,068	
84,202	130,188	205,319	3,052,047	185,524	3,237,571	2,803,593	
<u>\$ 343,217</u>	<u>\$ 22,153,207</u>	<u>\$ 6,874,560</u>	<u>\$ 128,215,321</u>	<u>\$ 8,422,245</u>	<u>\$ 136,637,566</u>	<u>\$ 128,903,661</u>	

See accompanying notes to combined financial statements.

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2010
(With Summarized Financial Information for 2009)

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Change in net assets	\$ 6,528,615	\$ 6,578,761
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	3,237,571	2,803,593
Equity in (earnings) loss of unconsolidated affiliates	136,484	(35,432)
Unrealized loss on hedging instrument	557,890	461,650
Net investment (gains) losses	(1,275,196)	2,564,200
Loss (gain) on sale of property, plant, and equipment	39,686	(176,349)
Contributions received for capital improvements	(3,807)	(236,142)
Non-cash contributions	-	(4,622,984)
Deferred compensation expense	708,324	565,048
Decrease (increase) in operating assets:		
Accounts receivable	(658,290)	(1,854,593)
Pledges receivable	121,499	(112,309)
Prepaid expenses and other assets	(165,365)	(70,522)
Notes receivable	(269,440)	(137,799)
Increase (decrease) in operating liabilities:		
Accounts payable	(2,741,349)	2,441,356
Accrued and other liabilities	43,262	(267,370)
	<u>(268,731)</u>	<u>1,322,347</u>
Net cash provided by operating activities	<u>6,259,884</u>	<u>7,901,108</u>
Cash flows from investing activities:		
Payments for purchases of investments	(1,678,728)	(2,613,930)
Proceeds from sale and maturities of investments	1,127,614	2,019,884
Change in assets deposited with trustees	1,834,607	(1,796,773)
Expenditures for loan acquisition costs	-	(552,177)
(Increase) decrease in deposits and other assets	400	(1,656)
Expenditures for property, plant, and equipment	(6,128,479)	(7,094,193)
Proceeds from sale of property, plant, and equipment	999,297	664,023
Increase in cash value of life insurance	(599,356)	(58,447)
	<u>(4,444,645)</u>	<u>(9,433,269)</u>
Net cash used in investing activities		
Cash flows from financing activities:		
Net proceeds (repayments) on notes payable, bank	1,149,818	(3,886,991)
Proceeds from issuance of long-term debt	876,000	17,500,000
Principal payments of long-term debt	(1,392,981)	(9,109,192)
Contributions received for capital improvements	3,807	236,142
	<u>636,644</u>	<u>4,739,959</u>
Net cash provided by financing activities		
Net increase in cash	2,451,883	3,207,798
Cash acquired through merger with Homestead Group	-	2,661,858
Cash, beginning of year	<u>9,863,632</u>	<u>3,993,976</u>
Cash, end of year	<u>\$ 12,315,515</u>	<u>\$ 9,863,632</u>

See accompanying notes to combined financial statements.

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Seven Hills Foundation and Affiliates (the "Foundation") has contracts with the Commonwealth of Massachusetts to provide an array of health services and clinical support to children and adults challenged by emotional, behavioral, cognitive, physical or developmental disabilities.

The combined financial statements include the accounts of Seven Hills Foundation and the following affiliates which are under common control: Seven Hills Family Services, Inc.; Seven Hills Occupational & Rehabilitation Services, Inc.; Seven Hills Community Services, Inc.; Seven Hills Clinical Association, Inc., Seven Hills Seaside Education Association, Inc.; Seven Hills Disability Resources & Advocacy, Inc., Seven Hills Children's Aid & Family Services, Inc.; Seven Hills Pediatric Center (formerly known as 'Seven Hills Extended Care Center at Groton, Inc. '), Seven Hills Behavioral Health, Inc., Seven Hills Global Outreach, Seven Hills Homestead Group (formerly known as 'The Homestead Group'), I.F.S. Fiscal Intermediary, Individual & Family Support Centers, Inc., and Seven Hills WAARC Realty (hereinafter collectively referred to as the "Foundation"). All material intercompany balances and transactions have been eliminated in combination.

Merger

During 2008, the Board of Directors of the Foundation and the Board of Directors of Homestead Group voted to authorize a merger with the Foundation. The Foundation has assumed the contracts of Homestead Group and had continued the operations as a program under the name of The Homestead Group through June 30, 2009. Due to the nature of the transaction, the accompanying 2009 financial statements reflect the acquisition as if it had occurred January 1, 2009 and include the following financial information of Homestead Group:

Operating support and revenue	\$ 11,650,750
Operating expenses	10,946,899

Accounting estimates

The preparation of combined 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 combined financial statements and the reported amounts of revenue and expenses. Actual results could differ from those estimates.

Subsequent events

The Foundation has evaluated the financial statement impact of subsequent events occurring through November 12, 2010 the date that the financial statements were available to be issued.

Method of accounting

The combined financial statements have been prepared on the accrual method of accounting. Accordingly, assets are recorded when the Foundation obtains the rights of ownership or is entitled to claims for receipt, and liabilities are recorded when the obligation is incurred.

Financial statement presentation

The Foundation presents information regarding its financial position and activities according to three classifications of net assets described as follows:

Unrestricted - All resources over which the governing board has discretionary control. The governing board may elect to designate such resources for specific purposes. This designation may be removed at the board's discretion.

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS
(Continued)

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial statement presentation (continued)

Temporarily Restricted - Resources accumulated through donations or grants for specific operating or capital purposes. Such resources will become unrestricted when the requirements of the donor or grantee have been satisfied through expenditure for the specified purpose or program or through the passage of time.

Permanently Restricted - Endowment resources accumulated through donations or grants that are subject to the restriction in perpetuity that the principal be invested. Investment income may be either an unrestricted or temporarily restricted resource when earned, determined according to the gift instruments.

The combined financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Foundation's financial statements for the year ended June 30, 2009, from which the summarized information was derived.

Concentration of credit risk

The Foundation maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Foundation has not experienced any losses in such accounts. The Foundation believes it is not exposed to any significant credit risk on cash and cash equivalents.

Investments

Investments in equity securities with readily determinable fair values and all debt securities are reported at fair value.

Investment return, including income, gains and losses, is recorded in unrestricted assets unless its use is temporarily or permanently restricted by law or explicit donor stipulations.

Endowment funds

The Foundation's endowment consists of funds designated by the Board of Directors to function as endowments. As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed or legal restrictions.

The Board of Directors has interpreted state law as allowing the utilization of appreciation on permanently restricted assets unless explicit donor stipulations specify how net appreciation must be used. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard of prudence prescribed by state law.

In accordance with the Uniform Prudent Management of Institutional Funds Act, the Foundation may consider the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: the duration and preservation of the fund; the purposes of the organization and the donor-restricted endowment fund; general economic conditions; the possible effect of inflation and deflation; the expected total return from income and the appreciation of investments; other resources of the organization; and the investment policies of the organization.

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS
(Continued)

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Endowment funds (continued)

The Foundation has adopted investment and spending policies for its board-designated endowment assets that attempt to provide a predictable stream of funding for its programs while seeking to maintain the purchasing power of the endowment assets. Under this policy, as approved by the Board, the Foundation's Investment Committee shall seek to invest the endowment funds in such a manner that the investments will provide a spendable return consistent with a long-term goal of preserving the funds in real terms. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Foundation has invested in debt and equity securities that target a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Pledges

Pledges are recorded as receivables in the year the pledge is made. Pledges for support of current operations are recorded as unrestricted support. Pledges for support of future operations, plant asset acquisitions, and endowment are recorded as temporarily restricted or permanently restricted support.

Loan acquisition costs

Loan acquisition costs represent fees and other costs associated with obtaining long-term financing. Such costs are being amortized over the term of the related debt obligation. The difference between straight line amortization and level of yield method of amortization is not material to the combined financial statements.

Investment in unconsolidated affiliates

The Foundation has non-controlling investments in Group 7 Design, Inc. and Sequest Holding Company, LLC which are accounted for by the equity method.

Property, plant, and equipment

Property, plant, and equipment are carried at cost. Depreciation and amortization are computed using the straight-line method.

Derivative instruments

Derivative instruments, including interest rate swaps, are recorded on the balance sheets as either assets or liabilities measured at their fair value. All changes in the fair value of derivatives are recognized currently in the statement of activities of not-for-profit organizations.

Rent, vending, service fees

Rental income represents amounts received from residents of residential homes. Vending income represents amounts received under the vocational services program. Service fees represents amounts received under the respite care, and various day programs.

Contributions, gifts, grants

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and nature of any donor restrictions. Contributions may include actual gifts or promises to give. Such contributions are considered to be available for unrestricted use unless specifically restricted by the donor or grantor. Contributions of assets other than cash are recorded at their estimated fair value on the date of the gift. Restricted gifts or promises to give are required to be reported as restricted support in the period received and are then reclassified to unrestricted net assets upon satisfaction of the donor restriction.

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS
(Continued)

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Functional expenses

Expenses are charged to each program based upon direct expenditures incurred. Expenditures not directly chargeable are allocated to each program based upon related payroll costs.

Impairment of long-lived assets and long-lived assets to be disposed of

The Foundation reviews the carrying values of certain long-lived assets and certain identifiable intangibles whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Where indicated, the carrying value of such assets is reduced through a charge to operations. The adjusted carrying values represent management's estimate of the amount expected to be recovered from these assets in the future.

Contributed facilities

Three of the group homes and one program operated by The Homestead Group are located in buildings owned by the State of Rhode Island and are provided to The Homestead Group at no cost. The estimated value of this space (\$67,650 for the period ended June 30, 2010) has been recorded in the combined statement of activities as both a revenue and expense item.

Donated services

Certain employees of the Commonwealth of Massachusetts donate their services to the Foundation. Donated services amounting to \$87,876 in 2010 are reflected in the accompanying combined financial statements. The accompanying combined financial statements do not reflect other donated services since no objective basis is available to measure the value of such services.

Advertising and promotion

All costs associated with advertising and promoting the Foundation are expensed in the year incurred. Advertising expense was \$214,951 and \$175,069 in 2010 and 2009, respectively.

2 - DEPOSITS WITH TRUSTEES

Deposits with trustees are held in various escrow accounts and are available for the following purposes:

	<u>2010</u>	<u>2009</u>
Current		
Future debt service	\$ 2,741,203	\$ 2,775,304
Long-term		
Future debt service	3,168,697	3,215,103
Property, plant and equipment acquisition	3	1,754,103
	<u>3,168,700</u>	<u>4,969,206</u>
	<u>\$ 5,909,903</u>	<u>\$ 7,744,510</u>

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS
(Continued)

2 - DEPOSITS WITH TRUSTEES (Continued)

Deposits with trustees are carried at cost, which approximates fair value, and are composed of the following:

	<u>2010</u>	<u>2009</u>
Cash and cash equivalents	\$ 4,819,147	\$ 6,653,755
Corporate bonds	<u>1,090,756</u>	<u>1,090,755</u>
	<u>\$ 5,909,903</u>	<u>\$ 7,744,510</u>

3 - INVESTMENTS

Investments are included in the following classes of net assets:

	<u>2010</u>	<u>2009</u>
Board-designated endowment funds	\$ 10,542,393	\$ 9,056,482
Unrestricted assets	<u>1,032,736</u>	<u>692,337</u>
	<u>\$ 11,575,129</u>	<u>\$ 9,748,819</u>

Investments are composed of the following:

	<u>2010</u>		<u>2009</u>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Bonds	\$ 2,847,335	\$ 2,866,011	\$ 2,690,001	\$ 2,585,358
Mutual funds	9,180,297	7,263,360	9,410,738	6,465,728
Common stock	732,128	834,537	58,079	62,990
Money market accounts	<u>611,221</u>	<u>611,221</u>	<u>634,743</u>	<u>634,743</u>
	<u>\$ 13,370,981</u>	<u>\$ 11,575,129</u>	<u>\$ 12,793,561</u>	<u>\$ 9,748,819</u>

4 - ENDOWMENT ASSETS

Endowment assets include Board-designated investments. Changes in endowment assets for the year ended June 30, 2010 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment assets, beginning of year	\$ 9,056,482	\$ -	\$ 216,713	\$ 9,273,195
Investment return:				
Investment income	214,166	-	-	214,166
Net appreciation (realized and unrealized)	<u>1,271,745</u>	<u>-</u>	<u>-</u>	<u>1,271,745</u>
Total investment return	<u>1,485,911</u>	<u>-</u>	<u>-</u>	<u>1,485,911</u>
Endowment assets, end of year	<u>\$ 10,542,393</u>	<u>\$ -</u>	<u>\$ 216,713</u>	<u>\$ 10,579,106</u>

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS
(Continued)

5 - PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment, together with estimated useful lives, consists of the following:

	<u>Estimated Useful Lives</u>	<u>2010</u>	<u>2009</u>
Land	-	\$ 10,286,983	\$ 10,620,033
Buildings and improvements	20 - 40 years	80,700,985	74,221,615
Furniture and equipment	3 - 20 years	9,271,908	8,713,130
Motor vehicles	5 years	1,772,055	1,530,291
Construction in progress	-	<u>3,601,987</u>	<u>5,730,786</u>
		105,633,918	100,815,855
Less: Accumulated depreciation and amortization		<u>25,608,068</u>	<u>22,757,886</u>
		<u>\$ 80,025,850</u>	<u>\$ 78,057,969</u>

Depreciation and amortization expense for property, plant, and equipment was \$3,121,615 and \$2,692,253 in 2010 and 2009, respectively.

6 - ADVANCES FROM THE STATE OF RHODE ISLAND

The Homestead Group has an agreement with the State of Rhode Island to operate residential facilities and day programs. Under this agreement, the State of Rhode Island advances The Homestead Group an amount equivalent to forty-five days funding per client at the agreed-upon per diem rate to provide cash flow for the programs. This advance has been classified as long-term debt as these funds are to be repaid to the State of Rhode Island at the termination of the agreement. However, it is anticipated that the programs will continue to operate and the State of Rhode Island will continue to provide these funds.

7 - NOTES PAYABLE, BANK

The Foundation has a \$7,000,000 working capital line of credit with a bank secured by substantially all assets of the Foundation. Interest is charged at the U.S. prime rate. The line of credit is available through September, 2010, at which time the terms and conditions of the line of credit will be reviewed. The balance outstanding on this line of credit was \$2,430,445 and \$1,280,627 as of June 30, 2010 and 2009, respectively.

The Foundation had a \$5,000,000 non-revolving real estate line of credit with a bank secured by substantially all assets of the Foundation. Interest was charged at the U.S. prime rate. The line of credit was available through December, 2008.

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS
(Continued)

8 - LONG-TERM DEBT

Long-term debt consists of the following:

	2010	2009
Bond notes payable, secured by real estate and cash flows from provider contracts:		
Due in annual installments of principal through September 2028. Interest is due semi-annually at rates increasing from an initial 4.40% to 5.15% during the life of the obligation.	\$ 12,290,000	\$ 12,720,000
Due in annual installments of principal through September 2032. Interest is due semi-annually at rates increasing from an initial 4.00% to 5.50% during the life of the obligation.	13,560,000	13,860,000
Due in annual installments of principal through September 2035. Interest is due semi-annually at rates increasing from an initial 3.15% to 5.00% during the life of the obligation.	23,583,342	24,078,475
Due in annual installments of principal through September 2039. Interest is due monthly at variable rates during the life of the obligation and secured by a letter of credit.	12,000,000	12,000,000
Due in annual installments of principal through September 2039. Interest is due monthly at variable rates during the life of the obligation and secured by a letter of credit.	5,500,000	5,500,000
Mortgage notes payable, secured by real estate:		
Due in monthly installments of \$1,475 including interest at 3.00% through April 2011 at which time the principal balance is due in full.	14,244	29,244
Due in monthly installments of \$3,076 including interest at 5.81% through February 2015 at which time the principal balance is due in full.	431,681	-
Due in monthly installments of \$3,104 including interest at 5.81% through February 2015 at which time the principal balance is due in full.	435,642	-
Due in monthly installments of \$532 including interest at 3.00% through March 2014 at which time the principal balance is due in full.	23,019	27,999
Due in monthly installments of \$7,174 including interest at 9.25% through June 2024 at which time the principal balance is due in full.	674,577	697,100
Borrowings under construction credit facility. Due in monthly installments of \$6,642 including interest at 9.00% through August 2032.	764,277	774,678
Due in monthly installments of \$6,116, including interest at 7.30% through November 2013	220,953	275,768
Due in monthly installments of \$5,313 including interest at 7.25% through November 2017	325,311	378,800
Due at varying maturities through June 2037.	1,889,154	1,889,154
Note payable, bank, due in monthly installments of \$614 including interest at 1.49% through December, 2011	10,449	18,543
	71,722,649	72,249,764
Less: Current maturities of long-term debt	1,819,027	1,733,459
	\$ 69,903,622	\$ 70,516,305

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS
(Continued)

8 - LONG-TERM DEBT (Continued)

In connection with certain note payable agreement, the Foundation has agreed to various restrictive covenants.

Maturities of long-term debt in subsequent years are as follows:

2011	\$ 1,819,027
2012	1,866,743
2013	1,950,347
2014	1,993,106
2015	2,785,920
Thereafter	<u>61,307,506</u>
	<u>\$ 71,722,649</u>

9 - HEDGING INSTRUMENT

The Foundation maintains an interest-rate risk-management strategy that uses derivative instruments to minimize significant, unanticipated earnings fluctuations caused by interest-rate volatility.

The Foundation has entered into two interest rate swap agreements related to its long-term debt. The swaps are utilized to manage interest rate exposures and are designated as a highly effective cash flow hedges. The differential to be paid or received on the swap agreements is accrued as interest rates change and is recognized over the life of the agreement in interest expense. The swap agreements expire in September, 2013 and September, 2018 and have rates of 2.97% and 3.3925%, respectively. The notional amounts are \$5,500,000 and \$8,000,000, respectively. Included in statement of activities is an unrealized loss of \$557,890 and \$461,650 relating to the change in fair value of the swap agreements for the years ended June 30, 2010 and 2009 respectively.

10 - RESTRICTED NET ASSETS

Temporarily restricted net assets as of June 30, 2010 are available for the following purposes:

Building renovation	\$ 162,800
Direct care services	<u>306,163</u>
	<u>\$ 468,963</u>

During 2010, temporarily restricted net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes as specified by donors for direct case services of \$9,565.

Permanently restricted net assets of \$216,713 are restricted to investment in perpetuity, the income of which is expendable to support specified program activities of the Foundation.

11 - LEASES

The Foundation leases certain property, plant, and equipment under various lease agreements classified as operating leases for financial statement purposes.

Future minimum lease payments as of June 30, 2010 are as follows:

2011	\$ 1,050,871
2012	472,613
2013	219,656
2014	153,790
2015	91,375
Thereafter	<u>525,708</u>
	<u>\$ 2,514,013</u>

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS
(Continued)

12 - STATE SURPLUS REVENUE RETENTION

The Commonwealth of Massachusetts has regulations governing the excess of state revenue over expenses for not-for-profit organizations subject to the Division of Purchased Services' Authority. Such a surplus, up to 5% of current year state revenue, shall be retained by the organization for its charitable purposes. The sum of these annual surpluses may not exceed 20% of the organization's prior year state revenues. If an organization has a surplus in excess of the 5% or 20% rules, the Commonwealth may stipulate the use of such excess by the Agency, request the return of the surplus to the state, or reduce state funding in future years. Amounts within the 5% or 20% rules are included in net assets. Any amount in excess of these rules is owed to the Commonwealth.

Through June 30, 2010, the Foundation did not have surpluses in excess of the 5% or 20% rules. As of June 30, 2010, the Foundation's surplus revenue retention was \$(736,986) calculated as follows:

Balance, June 30, 2009	\$ (3,484,261)
Year ended June 30, 2010	<u>2,747,275</u>
Balance, June 30, 2010	<u><u>\$ (736,986)</u></u>

13 - DEFERRED COMPENSATION LIABILITY AND LIFE INSURANCE

The Foundation has deferred compensation agreements providing benefits to certain key employees commencing at retirement. Deferred compensation expense related to these agreements was \$708,324 and \$565,048 in 2010 and 2009, respectively. These amounts are required to accrue the present value of benefits at retirement.

The Foundation is the owner and beneficiary of life insurance policies on the lives of certain management. The policies had an aggregate cash surrender value of \$1,203,564 and \$604,208 at June 30, 2010 and 2009, respectively.

14 - ECONOMIC DEPENDENCY

The Foundation receives a significant portion of its support and revenue from the Commonwealth of Massachusetts, Department of Developmental Services (DDS) and Office of Child Care Services (OCCS). Total support and revenue included approximately \$49,492,986 and \$21,395,762 from the DDS of OCCS, respectively, in 2010.

15 - STATEMENT OF CASH FLOWS

Supplemental disclosure of cash flows information is as follows:

	<u>2010</u>	<u>2009</u>
Cash paid during the year for interest	\$ 3,309,557	\$ 3,513,236

16 - COMMITMENTS AND CONTINGENCY

The Foundation has obtained two letters of credit in the amounts of \$12,180,000 and \$5,582,500 expiring in 2013 to secure certain bond notes payable. These letters of credit are secured by substantially all assets of the Foundation.

The Foundation has claims and pending legal proceedings. The proceedings are, in the opinion of management, ordinary routine matters incidental to the normal business conducted by the Foundation. In the opinion of management and the Foundation's outside legal counsel, such proceeding is not expected to have a material adverse effect on the Foundation's financial position, results of operations or cash flows.

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS
(Continued)

16 - COMMITMENTS AND CONTINGENCY (Continued)

The Foundation has signed non-interest bearing facilities consolidation promissory notes with the Community Economic Development Assistance Corporation that is secured by real estate. The terms of the agreements require the Foundation to hold the properties for a period of 30 years. In the event the Foundation disposes of these properties prior to the required timeframe, the entire principal balance(s) will become due.

The Homestead Group entered into a three-year employment agreement through September 30, 2010 with its Vice President. The terms of the agreement require the Foundation to pay compensation equal to salary and fringe benefits as severance pay if the board of directors terminates the Vice President without cause for the duration of the agreement.

As of year-end, the Foundation had approximately 178 employees who are represented by Local 5068, United Nurses & Allied Professionals. The labor contract is effective through June, 2011.

17 - TAX-EXEMPT STATUS

The Foundation qualifies as a tax-exempt, not-for-profit organization under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income tax is required. The Foundation files income tax returns in the U.S. federal jurisdiction. The Foundation is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2007.

The State of Rhode Island imposes a Health Care Provider Tax at a rate of 6% of Medicaid revenues. This tax is included in other expense on the combined statement of functional expenses. The amounts paid by the Foundation for this tax are reimbursed by Medicaid funds.

18 - RELATED PARTY TRANSACTIONS

The Foundation had the following balances and transactions with its unconsolidated affiliates:

	2010	2009
Notes receivable	\$ 445,000	\$ 150,000
Expenditures for property, plant and equipment	143,899	371,982

19 - FAIR VALUE MEASUREMENTS

The Foundation follows the provisions of the Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic No. 820, "Fair Value Measurements". This Topic defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements.

Determination of Fair Value

The Foundation use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with ASC Topic 820, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based on quoted market prices. However, in many instances, there are no quoted market prices for the Foundation's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

SEVEN HILLS FOUNDATION AND AFFILIATES
NOTES TO COMBINED FINANCIAL STATEMENTS
(Continued)

19 - FAIR VALUE MEASUREMENTS (Continued)

Fair Value Hierarchy (continued)

In accordance with ASC Topic 820, the Foundation groups their financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The Foundation's financial assets that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at June 30, 2010 as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Bonds	\$ 2,866,011	\$ -	\$ -	\$ 2,866,011
Mutual Funds	7,263,360	-	-	7,263,360
Common Stock	834,537	-	-	834,537
Money Market	<u>611,221</u>	<u>-</u>	<u>-</u>	<u>611,221</u>
Total investments	<u>\$ 11,575,129</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 11,575,129</u>

The Foundation's financial liabilities that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at June 30, 2010 as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Hedging instruments	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,019,540</u>	<u>\$ 1,019,540</u>

A reconciliation of liabilities measured at fair value using significant unobservable inputs (level 3) follows:

Beginning balance	\$ (461,650)
Total unrealized losses included in changes in net assets	<u>(557,890)</u>
Ending balance	<u>\$ (1,019,540)</u>

20 - RECLASSIFICATIONS

Certain amounts in the 2009 comparative information have been reclassified to conform with the 2010 presentation. Such reclassifications had no effect on the change in net assets as previously reported.