

SEVEN HILLS FOUNDATION AND AFFILIATES
COMBINED FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2011
AND
INDEPENDENT AUDITOR'S REPORT

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2011

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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, 2011, 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 2010 combined financial statements and, in our report, dated November 12, 2010, 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, 2011 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 8, 2011

SEVEN HILLS FOUNDATION AND AFFILIATES
COMBINED STATEMENT OF FINANCIAL POSITION

JUNE 30, 2011
(With Summarized Financial Information for 2010)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2011	2010
Assets					
Current assets					
Cash	\$ 14,040,425	\$ 356,712	\$ 216,713	\$ 14,613,850	\$ 12,315,515
Deposits with trustees	2,816,192	-	-	2,816,192	2,741,203
Accounts receivable, less allowance for doubtful accounts of \$451,847	12,217,685	-	-	12,217,685	13,485,586
Pledges receivable	51,296	-	-	51,296	86,296
Prepaid expenses and other assets	377,325	-	-	377,325	453,241
Notes receivable	445,000	-	-	445,000	472,187
Total current assets	29,947,923	356,712	216,713	30,521,348	29,554,028
Investments	14,261,329	-	-	14,261,329	11,575,129
Investment in unconsolidated affiliates	1,087,433	-	-	1,087,433	1,098,948
Deposits with trustees, net	3,175,741	-	-	3,175,741	3,168,700
Loan acquisition costs, net	2,758,291	-	-	2,758,291	2,884,441
Deposits and other assets	288,546	-	-	288,546	279,936
Property, plant, and equipment, net	85,290,565	-	-	85,290,565	80,025,850
Cash value of life insurance	1,791,710	-	-	1,791,710	1,203,564
	<u>\$ 138,601,538</u>	<u>\$ 356,712</u>	<u>\$ 216,713</u>	<u>\$ 139,174,963</u>	<u>\$ 129,790,596</u>
Liabilities and Net Assets					
Current liabilities					
Notes payable, bank	\$ 6,299,917	\$ -	\$ -	\$ 6,299,917	\$ 2,430,445
Current maturities of long-term debt	1,871,238	-	-	1,871,238	1,819,027
Accounts payable	3,793,963	-	-	3,793,963	3,177,581
Accrued and other liabilities	7,217,718	-	-	7,217,718	6,430,575
Total current liabilities	19,182,836	-	-	19,182,836	13,857,628
Advances from the State of Rhode Island	1,115,304	-	-	1,115,304	1,115,304
Long-term debt, less current maturities	68,046,875	-	-	68,046,875	69,903,622
Hedging instrument liability	978,254	-	-	978,254	1,019,540
Deferred compensation liability	3,277,619	-	-	3,277,619	2,728,787
	<u>92,600,888</u>	<u>-</u>	<u>-</u>	<u>92,600,888</u>	<u>88,624,881</u>
Net assets					
Unrestricted					
Undesignated	33,004,613	-	-	33,004,613	29,937,646
Designated for endowment	12,996,037	-	-	12,996,037	10,542,393
Temporarily restricted	-	356,712	-	356,712	468,963
Permanently restricted	-	-	216,713	216,713	216,713
	<u>46,000,650</u>	<u>356,712</u>	<u>216,713</u>	<u>46,574,075</u>	<u>41,165,715</u>
	<u>\$ 138,601,538</u>	<u>\$ 356,712</u>	<u>\$ 216,713</u>	<u>\$ 139,174,963</u>	<u>\$ 129,790,596</u>

See accompanying notes to combined financial statements.

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED STATEMENT OF ACTIVITIES

YEAR ENDED JUNE 30, 2011

(With Summarized Financial Information for 2010)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2011	2010
Operating support and revenue:					
Government contracts and fees	\$ 130,687,704	\$ -	\$ -	\$ 130,687,704	\$ 129,567,678
Government donated staff and transportation	29,292	-	-	29,292	87,876
H.U.D. rental subsidy	635,389	-	-	635,389	630,471
Private contracts and fees	3,884,776	-	-	3,884,776	3,764,588
Trainee production	292,571	-	-	292,571	264,660
Rent, vending, service fees	4,278,683	-	-	4,278,683	4,164,249
Interest income	168,877	56	-	168,933	176,529
Investment income	202,443	-	-	202,443	237,966
Net investment gains	2,367,462	-	-	2,367,462	1,275,196
Beano income	1,662,451	-	-	1,662,451	1,692,342
Contributions	476,624	-	-	476,624	583,943
Grants	230,712	6,934	-	237,646	157,124
Cafeteria	294,390	-	-	294,390	307,158
Gain (loss) on sale of property, plant and equipment	128,589	-	-	128,589	(39,686)
Other	1,309,756	-	-	1,309,756	853,977
Net assets release from restrictions:					
Satisfaction of purpose restrictions	119,241	(119,241)	-	-	-
Total support and revenue	<u>146,768,960</u>	<u>(112,251)</u>	<u>-</u>	<u>146,656,709</u>	<u>143,724,071</u>
Operating expenses:					
Program services					
Residential services	40,290,065	-	-	40,290,065	37,803,869
Family support	12,761,927	-	-	12,761,927	11,957,782
Vocational services	7,620,819	-	-	7,620,819	7,783,101
Nursing home services	11,338,960	-	-	11,338,960	10,532,115
Community services - Massachusetts	9,261,734	-	-	9,261,734	8,857,840
Community services - Rhode Island	23,160,010	-	-	23,160,010	21,909,630
Rental property operations	323,822	-	-	323,822	343,217
Child care services	19,589,261	-	-	19,589,261	22,153,207
Clinical services	6,921,815	-	-	6,921,815	6,874,560
Global outreach	386,175	-	-	386,175	-
	<u>131,654,588</u>	<u>-</u>	<u>-</u>	<u>131,654,588</u>	<u>128,215,321</u>
Supporting services					
Management and general	9,635,047	-	-	9,635,047	8,422,245
Total expenses	<u>141,289,635</u>	<u>-</u>	<u>-</u>	<u>141,289,635</u>	<u>136,637,566</u>
Change in net assets from operations	5,479,325	(112,251)	-	5,367,074	7,086,505
Non-operating revenue (expense):					
Unrealized gain (loss) on hedging instrument	41,286	-	-	41,286	(557,890)
Change in net assets	5,520,611	(112,251)	-	5,408,360	6,528,615
Net assets, beginning 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>
Net assets, end of year	<u>\$ 46,000,650</u>	<u>\$ 356,712</u>	<u>\$ 216,713</u>	<u>\$ 46,574,075</u>	<u>\$ 41,165,715</u>

See accompanying notes to combined financial statements.

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED JUNE 30, 2011

(With Summarized Financial Information for 2010)

	Program Services					
	Residential Services	Family Support	Vocational Services	Nursing Home	Community Services - MA	Community Services - RI
Staff payroll	\$ 25,019,770	\$ 2,929,925	\$ 3,769,554	\$ 6,653,208	\$ 5,778,590	\$ 15,039,885
Trainee payroll	-	-	268,541	-	-	248,346
Payroll taxes	2,137,030	260,263	333,215	477,448	488,046	1,245,715
Employee benefits	3,171,413	279,784	690,482	862,211	153,330	2,360,314
Government staff	-	-	29,292	-	-	-
Occupancy	2,774,617	241,234	606,546	773,986	745,761	1,195,322
Telephone	235,201	46,338	51,228	3,145	175,417	129,018
General insurance	94,716	25,937	47,861	171,376	74,917	150,248
Office and operating supplies	261,196	33,615	106,294	652,208	401,390	177,412
Dues and subscriptions	2,508	1,233	2,547	315	1,571	6,511
Printing and postage	208	5,769	8,732	156	13,784	37,561
Advertising	106	-	-	301	-	55,656
Legal and audit	-	-	1,331	-	-	87,738
Client transportation	1,500,731	184,806	334,462	26,899	190,543	448,634
Specialized home care	159,386	7,350,460	-	-	-	307,998
Clinical consultants	333,032	-	93,180	104,898	223,383	486,472
Purchased services	-	-	-	463,921	-	143,386
Family support	31,818	1,123,387	25	-	47,344	67,392
Staff training	3,686	2,099	220	5,995	7,229	39,280
Fund raising	-	-	-	-	-	-
Cafeteria and food	1,476,212	38,328	299,190	195,360	3,245	319,673
Interest	1,416,696	105,524	273,999	430,772	189,035	52,074
Beano expenses	515,032	-	393,177	-	-	-
Other	6,888	27,576	35,577	551	478,723	124,633
Total before depreciation	39,140,246	12,656,278	7,345,453	10,822,750	8,972,308	22,723,268
Depreciation and amortization	1,149,819	105,649	275,366	516,210	289,426	436,742
	<u>\$ 40,290,065</u>	<u>\$ 12,761,927</u>	<u>\$ 7,620,819</u>	<u>\$ 11,338,960</u>	<u>\$ 9,261,734</u>	<u>\$ 23,160,010</u>

Rental Property Operations	Child Care Services	Program Services			Total	Management and General	Totals	
		Clinical Services	Global Outreach				2011	2010
\$ 1,252	\$ 1,009,160	\$ 4,473,972	\$ 157,080	\$ 64,832,396	\$ 3,535,422	\$ 68,367,818	\$ 64,862,087	
-	-	-	-	516,887	-	516,887	618,223	
108	86,417	385,670	13,540	5,427,452	277,891	5,705,343	5,649,552	
-	110,029	622,626	6,483	8,256,672	981,755	9,238,427	8,838,205	
-	-	-	-	29,292	-	29,292	87,876	
96,604	169,896	332,826	3,251	6,940,043	375,315	7,315,358	6,212,128	
7,865	30,329	42,875	260	721,676	134,924	856,600	638,725	
2,561	15,067	21,792	2,500	606,975	29,222	636,197	671,432	
14,080	32,558	64,203	7,346	1,750,302	310,237	2,060,539	1,932,974	
56	5,370	13,767	51	33,929	56,527	90,456	110,232	
128	11,916	1,041	1,382	80,677	102,188	182,865	215,032	
-	-	421	1,587	58,071	195,783	253,854	214,951	
287	-	4,997	-	94,353	347,954	442,307	311,440	
4,708	103,960	230,682	45,140	3,070,565	217,163	3,287,728	2,904,236	
-	-	-	-	7,817,844	-	7,817,844	7,033,122	
2,265	601,702	91,067	43,864	1,979,863	395,560	2,375,423	2,635,235	
-	-	-	-	607,307	6,920	614,227	534,376	
-	17,042,273	-	-	18,312,239	-	18,312,239	20,697,559	
-	4,683	7,785	-	70,977	338,316	409,293	281,783	
-	-	-	-	-	62,350	62,350	59,376	
-	126,680	135,870	325	2,594,883	4,413	2,599,296	2,433,856	
71,746	85,706	293,179	-	2,918,731	404,564	3,323,295	3,298,006	
-	-	-	-	908,209	460,170	1,368,379	1,383,167	
48,788	1,915	4,718	102,927	832,296	1,204,638	2,036,934	1,776,422	
250,448	19,437,661	6,727,491	385,736	128,461,639	9,441,312	137,902,951	133,399,995	
73,374	151,600	194,324	439	3,192,949	193,735	3,386,684	3,237,571	
<u>\$ 323,822</u>	<u>\$ 19,589,261</u>	<u>\$ 6,921,815</u>	<u>\$ 386,175</u>	<u>\$ 131,654,588</u>	<u>\$ 9,635,047</u>	<u>\$ 141,289,635</u>	<u>\$ 136,637,566</u>	

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2011

(With Summarized Financial Information for 2010)

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Change in net assets	\$ 5,408,360	\$ 6,528,615
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	3,386,684	3,237,571
Equity in loss of unconsolidated affiliates	11,515	136,484
Unrealized (gain) loss on hedging instrument	(41,286)	557,890
Net investment gains	(2,367,462)	(1,275,196)
Loss (gain) on sale of property, plant, and equipment	(128,589)	39,686
Contributions received for capital improvements	(35,000)	(3,807)
Deferred compensation expense	548,832	708,324
Decrease (increase) in operating assets:		
Accounts receivable	1,267,901	(658,290)
Pledges receivable	35,000	121,499
Prepaid expenses and other assets	75,916	(165,365)
Notes receivable	27,187	(269,440)
Increase (decrease) in operating liabilities:		
Accounts payable	616,382	(2,741,349)
Accrued and other liabilities	787,143	43,262
	<u>4,184,223</u>	<u>(268,731)</u>
Net cash provided by operating activities	<u>9,592,583</u>	<u>6,259,884</u>
Cash flows from investing activities:		
Payments for purchases of investments	(3,606,957)	(1,678,728)
Proceeds from sale and maturities of investments	3,288,219	1,127,614
Change in assets deposited with trustees	(82,030)	1,834,607
(Increase) decrease in deposits and other assets	(8,610)	400
Expenditures for property, plant, and equipment	(8,624,683)	(6,128,479)
Proceeds from sale of property, plant, and equipment	217,889	999,297
Increase in cash value of life insurance	(588,146)	(599,356)
	<u>(9,404,318)</u>	<u>(4,444,645)</u>
Cash flows from financing activities:		
Net proceeds on notes payable, bank	3,869,472	1,149,818
Proceeds from issuance of long-term debt	27,200	876,000
Principal payments of long-term debt	(1,821,602)	(1,392,981)
Contributions received for capital improvements	35,000	3,807
	<u>2,110,070</u>	<u>636,644</u>
Net increase in cash	2,298,335	2,451,883
Cash, beginning of year	<u>12,315,515</u>	<u>9,863,632</u>
Cash, end of year	<u>\$ 14,613,850</u>	<u>\$ 12,315,515</u>

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, Seven Hills Behavioral Health, Inc., Seven Hills Global Outreach, Seven Hills Rhode Island (formerly known as “Seven Hills 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.

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 8, 2011, 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.

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.

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

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial statement presentation (continued)

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, 2010, 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.

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.

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

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Endowment funds (continued)

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 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

Four residential programs and one day program operated by Seven Hills Rhode Island are located in buildings owned by the State of Rhode Island and are provided to Seven Hills Rhode Island at no cost. The estimated value of this space (\$386,400 for the period ended June 30, 2011) 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 \$29,292 and \$87,876 in 2011 and 2010, respectively, 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 \$253,854 and \$214,951 in 2011 and 2010, respectively.

2 - DEPOSITS WITH TRUSTEES

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

	<u>2011</u>	<u>2010</u>
Current		
Future debt service	\$ <u>2,816,192</u>	\$ <u>2,741,203</u>
Long-term		
Future debt service	3,175,738	3,168,697
Property, plant and equipment acquisition	<u>3</u>	<u>3</u>
	<u>3,175,741</u>	<u>3,168,700</u>
	<u>\$ 5,991,933</u>	<u>\$ 5,909,903</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>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 4,901,177	\$ 4,819,147
Corporate bonds	<u>1,090,756</u>	<u>1,090,756</u>
	<u>\$ 5,991,933</u>	<u>\$ 5,909,903</u>

3 - INVESTMENTS

Investments are included in the following classes of net assets:

	<u>2011</u>	<u>2010</u>
Board-designated endowment funds	\$ 12,996,037	\$ 10,542,393
Unrestricted assets	<u>1,265,292</u>	<u>1,032,736</u>
	<u>\$ 14,261,329</u>	<u>\$ 11,575,129</u>

Investments are composed of the following:

	<u>2011</u>		<u>2010</u>	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Bonds	\$ 3,195,331	\$ 3,341,745	\$ 2,847,335	\$ 2,866,011
Mutual funds	8,473,033	8,695,184	9,180,297	7,263,360
Common stock	724,710	921,993	732,128	834,537
Money market accounts	<u>1,302,407</u>	<u>1,302,407</u>	<u>611,221</u>	<u>611,221</u>
	<u>\$ 13,695,481</u>	<u>\$ 14,261,329</u>	<u>\$ 13,370,981</u>	<u>\$ 11,575,129</u>

As discussed in Note 1, the Foundation's investments are reported at fair value. Market value in the investment markets has been volatile since June 30, 2011.

4 - ENDOWMENT ASSETS

Endowment assets include Board-designated investments. Changes in endowment assets for the year ended June 30, 2011 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment assets, beginning of year	\$ 10,542,393	\$ -	\$ 216,713	\$ 10,759,106
Investment return:				
Investment income	230,800	-	-	230,800
Net appreciation (realized and unrealized)	<u>2,222,844</u>	<u>-</u>	<u>-</u>	<u>2,222,844</u>
Total investment return	<u>2,453,644</u>	<u>-</u>	<u>-</u>	<u>2,453,644</u>
Endowment assets, end of year	<u>\$ 12,996,037</u>	<u>\$ -</u>	<u>\$ 216,713</u>	<u>\$ 13,212,750</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:

	Estimated Useful Lives	2011	2010
Land	-	\$ 10,955,257	\$ 10,286,983
Buildings and improvements	20 - 40 years	84,705,783	80,700,985
Furniture and equipment	3 - 20 years	10,696,203	9,271,908
Motor vehicles	5 years	1,963,868	1,772,055
Construction in progress	-	5,716,838	3,601,987
		114,037,949	105,633,918
Less: Accumulated depreciation and amortization		28,747,384	25,608,068
		\$ 85,290,565	\$ 80,025,850

Depreciation and amortization expense for property, plant, and equipment was \$3,270,667 and \$3,121,615 in 2011 and 2010, respectively.

6 - ADVANCES FROM THE STATE OF RHODE ISLAND

Seven Hills Rhode Island 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 Seven Hills Rhode Island 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 - NOTE 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, 2011, at which time the terms and conditions of the line of credit will be reviewed. The balance outstanding on this line of credit was \$6,299,917 and \$2,430,445 as of June 30, 2011 and 2010, respectively.

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

8 - LONG-TERM DEBT

Long-term debt consists of the following:

	<u>2011</u>	<u>2010</u>
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.	\$ 11,840,000	\$ 12,290,000
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.	13,245,000	13,560,000
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.	23,068,208	23,583,342
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.	11,765,000	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.	5,385,000	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
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.	419,887	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.	423,739	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.	18,039	23,019
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.	649,833	674,577
Borrowings under construction credit facility. Due in monthly installments of \$6,642 including interest at 9.00% through August 2032.	752,886	764,277
Due in monthly installments of \$6,116, including interest at 7.30% through November 2013	161,940	220,953
Due in monthly installments of \$5,313 including interest at 7.25% through November 2017	270,588	325,311
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	3,085	10,449
Note payable, leasing company, secured by motor vehicle due in monthly installments of \$569 including interest at 9.36% through March, 2017	<u>25,754</u>	<u>-</u>
	69,918,113	71,722,649
Less: Current maturities of long-term debt	<u>1,871,238</u>	<u>1,819,027</u>
	<u>\$ 68,046,875</u>	<u>\$ 69,903,622</u>

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:

2012	\$ 1,871,238
2013	1,955,415
2014	1,999,498
2015	2,792,692
2016	2,106,088
Thereafter	<u>59,193,182</u>
	<u>\$ 69,918,113</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 gain (loss) of \$41,286 and (\$557,890) relating to the change in fair value of the swap agreements for the years ended June 30, 2011 and 2010 respectively.

10 - RESTRICTED NET ASSETS

Temporarily restricted net assets as of June 30, 2011 are available for the following purposes:

Building renovation	\$ 253,845
Direct care services	<u>102,867</u>
	<u>\$ 356,712</u>

During 2011, temporarily restricted net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes as specified by donors for the following purpose:

Building renovation	\$ 100,000
Direct care services	<u>19,241</u>
	<u>\$ 119,241</u>

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.

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

11 - LEASES (Continued)

Future minimum lease payments as of June 30, 2011 are as follows:

2012	\$ 730,361
2013	468,296
2014	404,446
2015	309,320
2016	240,831
Thereafter	<u>386,649</u>
	<u>\$ 2,539,903</u>

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, 2011, the Foundation did not have surpluses in excess of the 5% or 20% rules. As of June 30, 2011, the Foundation's surplus revenue retention was \$159,282 calculated as follows:

Balance, June 30, 2010	\$ (737,281)
Year ended June 30, 2011	<u>896,563</u>
Balance, June 30, 2011	<u>\$ 159,282</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 \$403,192 and \$567,313 in 2011 and 2010, 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 \$1,791,710 and \$1,203,564 at June 30, 2011 and 2010, 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 \$48,283,522 and \$19,442,225 from the DDS of OCCS, respectively, in 2011.

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

15 - STATEMENT OF CASH FLOWS

Supplemental disclosure of cash flows information is as follows:

	<u>2011</u>	<u>2010</u>
Cash paid during the year for interest	\$ 3,339,539	\$ 3,309,557

16 - COMMITMENTS AND CONTINGENCY

The Foundation has obtained two letters of credit in the amounts of \$11,941,475 and \$5,465,775 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.

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.

As of year-end, the Foundation had approximately 178 employees who are represented by Local 5068, United Nurses & Allied Professionals. The labor contract was effective through June, 2011. The Foundation is in negotiations to extend the contract through June, 2012. In the opinion of management, the negotiations are not expected to have a material adverse effect on the Foundation's results of operations.

The contracts with the states have been expended according to their respective terms contained in the agreements and are subject to possible final audit determination by certain governmental agencies. In the opinion of management, the results of such audits, if any, will not have a material effect on the combined financial position of the Foundation as of June 30, 2011, or on the changes in net assets for the year then ended.

17 - TAX-EXEMPT STATUS

The Foundation qualifies as a tax-exempt, nonprofit organization under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for federal income tax is required. Management annually reviews for uncertain tax positions along with any related interest and penalties and believes that the Foundation has no uncertain tax positions that would have a material adverse effect, individually or in the aggregate upon the Foundation's statements of financial position, or the related statements of activities, or cash flows. 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 2008.

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.

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

18 - RELATED PARTY TRANSACTIONS

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

	<u>2011</u>	<u>2010</u>
Notes receivable	\$ 445,000	\$ 445,000
Accounts payable	56,688	
Expenditures for property, plant and equipment	187,711	143,899

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”(ASC Topic 820). 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 uses 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.

Fair Value Hierarchy

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.

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

19 - FAIR VALUE MEASUREMENTS (Continued)

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, 2011 as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Bonds	\$ 3,341,745	\$ -	\$ -	\$ 3,341,745
Mutual funds	8,695,184	-	-	8,695,184
Common stock	921,993	-	-	921,993
Money market	<u>1,302,407</u>	<u>-</u>	<u>-</u>	<u>1,302,407</u>
Total investments	<u>\$ 14,261,329</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 14,261,329</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, 2011 as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Hedging instruments	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 978,254</u>	<u>\$ 978,254</u>

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

Beginning balance	\$ (1,019,540)
Total unrealized gain included in changes in net assets	<u>41,286</u>
Ending balance	<u>\$ (978,254)</u>

20 - SUBSEQUENT EVENTS

Subsequent to June 30, 2011, the Foundation sold its investment in Sequest Holding Company, LLC (an unconsolidated affiliate) in which it had a non-controlling interest recording a gain on the transaction.