SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED FINANCIAL STATEMENTS
WITH SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2013

AND

INDEPENDENT AUDITOR'S REPORT

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED FINANCIAL STATEMENTS
WITH SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2013

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BOLLUS LYNCH
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Seven Hills Foundation and Affiliates
Worcester, Massachusetts

Report on the Financial Statements

We have audited the accompanying combined financial statements of Seven Hills Foundation and Affiliates which comprise the combined statement of financial position as of June 30, 2013, the related combined statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audit. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2013, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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INDEPENDENT AUDITOR'S REPORT
(Continued)

Other Matter

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The combining and other supplementary information is presented for purposes of additional analysis rather than to present the results of operations of the individual entities and is not a required part of the combined financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The combining and other supplementary information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the combined financial statements as a whole.

Report on Summarized Comparative Information

We have previously audited Seven Hills Foundation and Affiliates' 2012 combined financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated November 12, 2012. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2012, is consistent, in all material respects, with the audited combined financial statements from which it has been derived.

Ballus Lynch, LLP

Worcester, Massachusetts
November 5, 2013

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED STATEMENT OF FINANCIAL POSITION

JUNE 30, 2013
(With Summarized Financial Information for 2012)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals 2013	Totals 2012
Assets					
Current assets					
Cash	$ 6,564,969	$ 322,608	$ 216,713	$ 7,104,290	$ 9,295,232
Deposits with trustees	2,085,311	-	-	2,085,311	2,283,642
Accounts receivable, less allowance for doubtful accounts of $143,324	14,048,064	-	-	14,048,064	14,508,128
Contributions receivable	158,498	-	-	158,498	10,695
Prepaid expenses and other assets	422,671	-	-	422,671	562,175
Notes receivable	160,000	-	-	160,000	250,000
Total current assets	23,439,513	322,608	216,713	23,978,834	26,909,872
Investments	17,918,656	3,774,151	355,263	22,048,070	14,736,647
Investment in unconsolidated affiliates	760,794	-	-	760,794	662,031
Deposits with trustees, net	5,053,029	-	-	5,053,029	4,899,047
Loan acquisition costs, net	3,004,362	-	-	3,004,362	3,023,838
Deposits and other assets	276,753	-	-	276,753	292,955
Property, plant, and equipment, net	100,985,868	215,000	-	101,200,868	89,012,140
Cash value of life insurance	2,400,737	-	-	2,400,737	1,971,876
	$ 153,839,712	$ 4,311,759	$ 571,976	$ 158,723,447	$ 141,508,406
Liabilities and Net Assets					
Current liabilities					
Notes payable, bank	$ 1,297,785	$ -	$ -	$ 1,297,785	$ 889,879
Current maturities of long-term debt	2,656,542	-	-	2,656,542	2,015,357
Current portion of capital lease obligation	154,903	-	-	154,903	148,691
Accounts payable	4,404,168	-	-	4,404,168	3,359,277
Accrued and other liabilities	8,288,169	-	-	8,288,169	7,089,474
Total current liabilities	16,801,567	-	-	16,801,567	13,502,678
Advances from the State of Rhode Island	1,061,048	-	-	1,061,048	1,115,304
Long-term debt, less current maturities	83,604,133	-	-	83,604,133	76,492,276
Long-term capital lease obligation	460,150	-	-	460,150	615,077
Hedging instrument liability	1,384,466	-	-	1,384,466	1,482,875
Deferred compensation liability	4,219,749	-	-	4,219,749	3,650,898
	107,531,113	-	-	107,531,113	96,859,108
Net assets					
Unrestricted					
Undesignated	32,012,137	-	-	32,012,137	32,002,409
Designated for endowment	14,296,462	-	-	14,296,462	11,901,393
Temporarily restricted	-	4,311,759	-	4,311,759	528,783
Permanently restricted	-	-	571,976	571,976	216,713
	46,308,599	4,311,759	571,976	51,192,334	44,649,298
	$ 153,839,712	$ 4,311,759	$ 571,976	$ 158,723,447	$ 141,508,406

See accompanying independent auditor’s report and notes to combined financial statements.

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED STATEMENT OF ACTIVITIES

YEAR ENDED JUNE 30, 2013
(With Summarized Financial Information for 2012)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals 2013	Totals 2012
Operating support and revenue:					
Government contracts and fees	$ 137,773,109	$ -	$ -	$ 137,773,109	$ 128,994,081
Government donated staff and transportation	29,292	-	-	29,292	29,292
H.U.D. rental subsidy	583,938	-	-	583,938	629,420
Private contracts and fees	3,997,306	-	-	3,997,306	3,319,857
Trainee production	229,056	-	-	229,056	266,085
Rent, vending, service fees	4,388,882	-	-	4,388,882	4,242,326
Interest income	168,598	24	-	168,622	85,489
Investment income	381,086	42,289	-	423,375	298,090
Net investment gains (losses)	1,516,516	127,298	-	1,643,814	(492,374)
Beano income	1,664,971	-	-	1,664,971	1,603,215
Contributions	887,986	-	-	887,986	708,816
Grants	416,989	-	-	416,989	158,283
Cafeteria	346,777	-	-	346,777	350,665
Other	1,517,716	-	-	1,517,716	4,819,372
Net assets release from restrictions:					
Satisfaction of purpose restrictions	94,623	(94,623)	-	-	-
Total support and revenue	153,996,845	74,988	-	154,071,833	145,012,617
Operating expenses:					
Program services					
Residential services	45,247,585	-	-	45,247,585	43,038,308
Family support	14,469,918	-	-	14,469,918	13,678,173
Vocational services	8,524,340	-	-	8,524,340	8,102,723
Nursing home services	11,768,368	-	-	11,768,368	11,798,942
Community services - Massachusetts	9,972,638	-	-	9,972,638	10,114,255
Community services - Rhode Island	22,085,000	-	-	22,085,000	23,186,769
Rental property operations	307,524	-	-	307,524	266,508
Child care services	19,240,866	-	-	19,240,866	16,843,721
Clinical services	6,746,751	-	-	6,746,751	6,927,968
School services	3,424,971	-	-	3,424,971	-
Global outreach	778,509	-	-	778,509	1,715,042
	142,566,470	-	-	142,566,470	135,672,409
Supporting services					
Management and general	11,081,310	-	-	11,081,310	9,633,901
Total expenses	153,647,780	-	-	153,647,780	145,306,310
Change in net assets from operations	349,065	74,988	-	424,053	(293,693)
Non-operating revenue (expense):					
Contributions associated with merger activity	1,529,225	3,707,988	355,263	5,592,476	-
Unrealized gain (loss) on hedging instruments	526,507	-	-	526,507	(504,621)
Impairment of goodwill	-	-	-	-	(1,126,463)
Change in net assets	2,404,797	3,782,976	355,263	6,543,036	(1,924,777)
Net assets, beginning of year	43,903,802	528,783	216,713	44,649,298	46,574,075
Net assets, end of year	$ 46,308,599	$ 4,311,759	$ 571,976	$ 51,192,334	$ 44,649,298

See accompanying independent auditor’s report and notes to combined financial statements.

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED JUNE 30, 2013
(With Summarized Financial Information for 2012)

	Program Services						
	Residential Services	Family Support	Vocational Services	Nursing Home	Community Services - MA	Community Services - RI	Rental Property Operations
Staff payroll	$ 28,470,742	$ 4,011,023	$ 4,257,658	$ 7,089,823	$ 5,854,720	$ 14,102,522	$ 1,511
Trainee payroll	-	-	240,046	-	-	122,164	-
Payroll taxes	2,448,415	377,929	370,921	528,514	494,281	1,194,068	136
Employee benefits	3,895,503	267,478	520,862	951,954	293,984	2,616,714	175
Government staff	-	-	29,292	-	-	-	-
Occupancy	3,025,072	207,296	722,168	759,435	576,439	663,576	113,497
Telephone	289,727	60,641	147,498	-	177,931	261,307	9,775
General insurance	90,500	46,988	72,557	160,669	152,625	115,475	12,028
Office and operating supplies	249,345	32,131	128,478	670,880	442,615	458,745	24,998
Dues and subscriptions	4,240	1,029	1,258	525	805	7,180	566
Printing and postage	4,934	4,303	11,513	-	16,981	20,057	-
Advertising	-	375	8,283	-	-	1,989	-
Legal and audit	935	2,462	-	-	-	76,182	173
Client transportation	1,523,105	227,450	371,829	26,570	213,666	491,617	40
Specialized home care	147,349	7,915,388	-	-	-	583,625	-
Clinical consultants	225,691	-	109,085	169,152	216,272	230,328	-
Purchased services	-	-	-	254,971	-	128,800	-
Family support	54,413	992,336	-	-	46,738	68,574	-
Staff training	8,029	7,423	1,875	5,301	11,328	6,930	-
Fund raising	-	-	-	-	-	-	-
Cafeteria and food	1,542,428	41,001	288,221	186,821	1,432	295,926	-
Interest	1,397,977	99,013	364,594	417,699	198,624	91,322	75,889
Beano expenses	514,270	-	392,754	-	-	-	-
Other	15,663	27,688	38,937	394	966,755	62,755	199
Total before depreciation	43,908,338	14,321,954	8,077,829	11,222,708	9,665,196	21,599,856	238,987
Depreciation and amortization	1,339,247	147,964	446,511	545,660	307,442	485,144	68,537
	$ 45,247,585	$ 14,469,918	$ 8,524,340	$ 11,768,368	$ 9,972,638	$ 22,085,000	$ 307,524

Program Services					Management	Totals	
Child Care Services	Clinical Services	School Services	Global Outreach	Total	and General	2013	2012
$ 1,113,809	$ 4,074,509	$ 2,087,176	$ 362,120	$ 71,425,613	$ 3,962,443	$ 75,388,056	$ 72,569,990
-	792	-	-	363,002	-	363,002	382,377
94,992	354,043	223,703	15,555	6,102,557	304,927	6,407,484	6,301,539
137,416	930,208	330,432	1,891	9,946,617	1,200,655	11,147,272	10,260,523
-	-	-	-	29,292	-	29,292	29,292
163,231	407,954	188,377	33,416	6,860,461	372,386	7,232,847	7,305,988
27,993	43,430	13,117	3,506	1,034,925	120,411	1,155,336	1,049,516
28,528	40,426	57,263	2,750	779,809	48,648	828,457	708,994
38,580	77,616	61,744	9,603	2,194,735	240,746	2,435,481	2,271,743
8,613	16,757	4,610	473	46,056	103,503	149,559	193,080
5,009	1,414	1,223	2,430	67,864	108,966	176,830	212,560
-	481	3,615	1,340	16,083	269,674	285,757	225,727
-	-	3,407	-	83,159	238,721	321,880	310,015
114,714	196,354	31,038	133,698	3,330,081	200,444	3,530,525	3,526,869
-	-	-	-	8,646,362	-	8,646,362	8,283,840
634,500	65,294	54,798	35,410	1,740,530	256,187	1,996,717	2,527,450
-	-	65,490	-	449,261	11,186	460,447	431,489
16,499,376	-	4,015	-	17,665,452	-	17,665,452	15,454,425
6,757	7,105	10,767	-	65,515	315,986	381,501	315,979
-	-	-	-	-	78,346	78,346	69,032
132,426	138,726	-	44	2,627,025	832	2,627,857	2,619,582
88,647	212,124	141,311	11,448	3,098,648	417,864	3,516,512	3,404,008
-	-	-	-	907,024	449,695	1,356,719	1,311,462
4,285	4,040	21,629	160,971	1,303,316	2,164,542	3,467,858	1,914,079
19,098,876	6,571,273	3,303,715	774,655	138,783,387	10,866,162	149,649,549	141,679,559
141,990	175,478	121,256	3,854	3,783,083	215,148	3,998,231	3,626,751
$ 19,240,866	$ 6,746,751	$ 3,424,971	$ 778,509	$ 142,566,470	$ 11,081,310	$ 153,647,780	$ 145,306,310

See accompanying independent auditor’s report and notes to combined financial statements.

SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2013
(With Summarized Financial Information for 2012)

	2013	2012
Cash flows from operating activities:		
Change in net assets	$ 6,543,036	$ (1,924,777)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Bad debt expense	476,996	265,902
Depreciation and amortization	3,998,231	3,626,751
Impairment of goodwill	-	1,126,463
Equity in (earnings) loss of unconsolidated affiliates	(98,763)	5,517
Unrealized (gain) loss on hedging instrument	(526,507)	504,621
Net investment (gains) losses	(1,643,814)	492,374
(Gain) loss on sale of property, plant, and equipment	64,403	(65,900)
Gain on sale of unconsolidated affiliate	-	(2,376,671)
Non-cash contributions	(5,592,476)	(215,000)
Deferred compensation expense	568,851	373,279
Decrease (increase) in operating assets:		
Accounts receivable	1,020,460	(1,056,345)
Contributions receivable	2,197	40,601
Prepaid expenses and other assets	398,843	(184,850)
Notes receivable	90,000	195,000
Increase (decrease) in operating liabilities:		
Accounts payable	448,773	(210,062)
Accrued and other liabilities	607,927	(128,244)
	(184,879)	2,393,436
Net cash provided by operating activities	6,358,157	468,659
Cash flows from investing activities:		
Payments for purchases of investments	(9,264,792)	(4,469,464)
Proceeds from sale and maturities of investments	8,375,618	3,501,772
Change in assets deposited with trustees	44,349	(1,190,756)
Expenditures for loan acquisition costs	(26,244)	(396,253)
(Increase) decrease in deposits and other assets	16,202	(4,409)
Expenditures for property, plant, and equipment	(7,414,190)	(7,725,758)
Expenditures for business assets	-	(1,535,027)
Proceeds from sale of property, plant, and equipment	273,447	1,354,281
Proceeds from sale of unconsolidated affiliate	-	1,705,120
Increase in cash value of life insurance	(428,861)	(180,166)
Net cash used in investing activities	(8,424,471)	(8,940,660)
Cash flows from financing activities:		
Net repayments on advances from the State of Rhode Island	(54,256)	-
Net proceeds (payments) on notes payable, bank	407,906	(5,410,038)
Proceeds from issuance of long-term debt	1,655,000	11,606,000
Principal payments of long-term debt	(2,175,987)	(3,006,347)
Principal payments of capital lease obligation	(148,715)	(36,232)
Contributions received for capital improvements	(150,000)	-
Net cash provided by (used in) financing activities	(466,052)	3,153,383
Net decrease in cash	(2,532,366)	(5,318,618)
Cash acquired through merger with Stetson Home, Inc. and Stetson School, Inc.	341,424	-
Cash, beginning of year	9,295,232	14,613,850
Cash, end of year	$ 7,104,290	$ 9,295,232

See accompanying independent auditor's report and 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 and the State of Rhode Island 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 Holding Corp; 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; I.F.S. Fiscal Intermediary; Individual & Family Support Centers, Inc.; Stetson School, Inc.; Stetson Home, 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 2013, the Board of Directors of the Foundation and the Board of Directors of Stetson School, Inc. and Stetson Home, Inc. (collectively, the "School") voted to authorize a merger with the Foundation. The Foundation has assumed the contracts of the School and continued the operations through June 30, 2013. Due to the nature of the transaction, the accompanying financial statements reflect the acquisition as of March 1, 2013 and include the following financial information of the School:

Assets	$ 15,376,399
Liabilities	9,783,923
Net assets	5,592,476
Contributions associated with merger activity	5,592,476

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 5, 2013, 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.

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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, 2012, 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.

Accounts receivable

Accounts receivable are carried at original invoice amount less an estimate made for doubtful accounts. The reserve for uncollectible accounts is recorded based on management's analysis of specific accounts and their estimate of amounts that may be uncollectible. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Contributions receivable

Contributions receivable are unconditional promises to give that are recognized as contributions when the promise is received. Contributions receivable that are expected to be collected within one year are reported at their net realizable value. Contributions receivable that are expected to be collected in more than one year are recorded at fair value at the date of promise. That fair value is computed using a present value technique applied to anticipated cash flows. Amortization of the resulting discount is recognized as additional contribution revenue. The allowance for uncollectable contributions receivable is determined based on management's evaluation of the collectability of individual promises. Promises that remain uncollected more than one year after their due dates are written off unless the donors indicate that payment is merely postponed.

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

Investments in equity securities with readily determinable fair values and all debt securities are reported at fair value. Alternative investments which do not have readily determinable fair values are carried at estimated fair values using the net asset value per share of the investment as reported by the investment managers. The Foundation reviews and evaluates the net asset values reported by the investment managers and has determined that the net asset values are calculated in a manner consistent with the measurement principles of FASB ASC Topic 946 as of the balance sheet date. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these securities existed.

Gains or losses on investments are reported in the statement of activities as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law. Investment income is recorded in unrestricted assets unless its use is temporarily or permanently restricted by explicit donor stipulations.

Endowment funds

The Foundation's endowment consists of both donor restricted endowment funds and 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. Endowment funds include invested gifts.

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.

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.

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Endowment funds (continued)

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor imposed restrictions require the Foundation to retain as a fund of perpetual duration. In accordance with generally accepted accounting principles, deficiencies of this nature are reported in unrestricted net assets. There were no such deficiencies as of June 30, 2013.

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 Empirical Asset Management, LLC which are accounted for by the equity method. During 2012, the Foundation sold its non-controlling investment in Seaquest Holding Company, LLC.

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 imposed 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 fair value on the date of the gift. Gifts of long-lived assets are reported as unrestricted support, unless specifically restricted by the donor. Time restrictions on gifts of long-lived assets, if any, expire when the assets are placed in service. 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.

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.

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2013) 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 in 2013 and 2012 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 $285,757 and $225,727 in 2013 and 2012, respectively.

Measure of operations

In its statement of activities, the Foundation includes in its definition of *operations* all revenues and expenses that are an integral part of its programs and supporting activities. Changes in the Foundation's contributions associated with mergers, fair value of the interest rate swap agreement, and impairment of long-term assets are recognized as non-operating activities.

2 - DEPOSITS WITH TRUSTEES

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

	2013	2012
Current		
Future debt service	$ 2,085,311	$ 2,283,642
Long-term		
Future debt service	5,028,549	3,797,438
Property, plant and equipment acquisition	24,480	1,101,609
	5,053,029	4,899,047
	$ 7,138,340	$ 7,182,689

2 - DEPOSITS WITH TRUSTEES (Continued)

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

	2013	2012
Cash and cash equivalents	$ 6,047,584	$ 6,091,933
Corporate bonds	1,090,756	1,090,756
	$ 7,138,340	$ 7,182,689

3 - INVESTMENTS

Investments are included in the following classes of net assets:

	2013	2012
Donor-restricted endowment funds:		
Temporarily restricted	$ 3,774,151	$ -
Permanently restricted	355,263	-
Board-designated endowment funds	14,296,462	11,901,393
Unrestricted assets	3,622,194	2,835,254
	$ 22,048,070	$ 14,736,647

Investments are composed of the following:

	2013		2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Bonds	$ 3,772,229	$ 3,851,667	$ 3,188,470	$ 3,332,785
Mutual funds	10,296,526	11,290,681	9,050,967	8,788,207
Common stock	222,095	275,188	1,030,658	1,251,069
Money market accounts	5,763,803	5,763,803	657,633	657,633
Partnership – Hedge funds	681,119	866,731	734,677	706,953
	$ 20,735,772	$ 22,048,070	$ 14,662,405	$ 14,736,647

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, 2013.

Investment management fees of $83,820 and $27,850 in 2013 and 2012, respectively, were automatically deducted from the investment income by the investment management companies.

4 - ENDOWMENT ASSETS

Endowment assets include Board-designated investments. Changes in endowment assets for the year ended June 30, 2013 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment assets, beginning of year	$ 11,901,393	$ -	$ 216,713	$ 12,118,106
Additions	724,005	3,699,167	355,263	4,778,435
Investment return:				
Investment income	388,574	42,289	-	430,863
Net appreciation (realized and unrealized)	1,187,887	127,298	-	1,315,185
Total investment return	1,576,461	169,587	-	1,746,048
Appropriation for expenditure	94,603	(94,603)	-	-
Endowment assets, end of year	$ 14,296,462	$ 3,774,151	$ 571,976	$ 18,642,589

5 - PROPERTY, PLANT, AND EQUIPMENT

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

	Estimated Useful Lives	2013	2012
Land	-	$ 12,057,252	$ 11,566,353
Buildings and improvements	20 - 40 years	103,270,615	91,057,435
Furniture and equipment	3 - 20 years	12,682,633	11,736,422
Motor vehicles	5 years	1,862,115	2,219,232
Construction in progress	-	4,755,355	2,763,954
		134,627,970	119,343,396
Less: Accumulated depreciation and amortization		33,427,102	30,331,256
		$ 101,200,868	$ 89,012,140

Depreciation and amortization expense for property, plant, and equipment was $3,869,071 and $3,506,180 in 2013 and 2012, 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 November, 2013, at which time the terms and conditions of the line of credit will be reviewed. The balance outstanding on this line of credit was $1,297,785 and $889,879 as of June 30, 2013 and 2012, respectively.

8 - LONG-TERM DEBT

Long-term debt consists of the following:

	2013	2012
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.	$ 10,890,000	$ 11,375,000
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.	12,570,000	12,915,000
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.	21,987,941	22,538,074
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.	11,270,000	11,525,000
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.	5,140,000	5,265,000
Due in annual installments of principal commencing January, 2013 with lump sum due December 2041. Interest is due monthly at 76% of the 30-Day LIBOR rate plus 2.00% during the life of the obligation.	7,875,374	8,051,000
Due in monthly payments of $42,694, plus interest at variable rates through October 2024. Principal payments increase by approximately 5.5% annually through October 2024.	8,113,386	-
Due in annual installments of principal commencing May, 2013 through May 2042. Interest is due monthly at 76% of the 30-Day LIBOR rate plus 2.00% during the life of the obligation.	3,530,000	3,555,000
Due in annual installments of principal commencing July, 2014 through June, 204. Interest is due monthly at 75% of the 30-Day LIBOR rate plus 2.00% during the life of the obligation.	1,655,000	-

8 - LONG-TERM DEBT (Continued)

	2013	2012
Mortgage notes payable, secured by real estate:		
Due in monthly installments of $532 including interest at 3.00% through March 2014 at which time the principal balance is due in full.	$ 3,969	$ 10,132
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.	592,967	622,700
Borrowings under construction credit facility. Due in monthly installments of $6,642 including interest at 9.00% through August 2032.	726,815	740,435
Due at varying maturities through June 2037.	1,889,155	1,889,155
Note payable, leasing company, secured by motor vehicle due in monthly installments of $569 including interest at 9.36% through March, 2017	16,068	21,137
	86,260,675	78,507,633
Less: Current maturities of long-term debt	2,656,542	2,015,357
	$ 83,604,133	$ 76,492,276

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:

2014	$ 2,656,542
2015	2,842,099
2016	2,963,405
2017	3,094,354
2018	3,227,174
Thereafter	71,477,101
	$ 86,260,675

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 five 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 are as follows:

9 - HEDGING INSTRUMENT (Continued)

Notional Amount	Interest Rate	Expiration Date	Value
$ 5,500,000	2.9700%	September, 2013	$ 40,051
8,113,386	5.3700%	September, 2014	340,049
6,847,301	2.6050%	December, 2016	86,410
8,000,000	3.3925%	September, 2018	893,247
5,500,000	1.3050%	September, 2018	24,709
			$ 1,384,466

Included in statement of activities is an unrealized gain (loss) of $526,507 and $(504,621) relating to the change in fair value of the swap agreements for the years ended June 30, 2013 and 2012, respectively.

10 - RESTRICTED NET ASSETS

Temporarily restricted net assets as of June 30, 2013 are available for the following purposes:

Capital expenditures	$ 215,000
Building renovation	210,850
Direct care services	102,937
Academic and residential program support	3,774,151
Scholarships	3,997
Other	4,824
	$ 4,311,759

Net assets were released from temporary donor restrictions by incurring expenses satisfying the restricted purpose or by occurrence of other events specified by donors as follows:

Investment return designated for current operations	$ 94,603
Expenditures for program activities	20
	$ 94,623

Permanently restricted net assets are restricted to:

	2013	2012
Investment in perpetuity, the income and appreciation from which is expendable to support:		
Children's Aid and Family Services operating activities	$ 216,713	$ 216,713
Academic and residential program support	355,263	-
	$ 571,976	$ 216,713

11 - BUSINESS ASSETS AND UNCONSOLIDATED AFFILIATES

During 2012, the Foundation sold its interest in an unconsolidated affiliate and recorded a gain of $2,376,671 which in included in other operating support and revenue in the combined statement of activities.

During 2012, the Foundation acquired an entity and performed an evaluation of the ongoing value of goodwill associated with this acquisition. Based on the evaluation, the Foundation determined that assets with a carrying value of $1,126,463 were impaired. No future cash flows were expected to be generated by this entity and accordingly, the assets were written off in 2012.

12 - LEASES

The Foundation leases office equipment, motor vehicles and certain property, plant, and equipment under various lease agreements classified as either capital or operating leases for financial statement purposes.

Property, plant and equipment includes the following equipment acquired under capital lease agreements:

	2013	2012
Furniture and equipment	$ 800,000	$ 800,000
Less: Accumulated depreciation	106,667	26,667
	$ 693,333	$ 773,333

Future minimum lease payments under these capital leases, together with the present value of future minimum lease payments as of June 30, 2013 are as follows:

Year Ending	Capital	Operating
2014	$ 177,262	$ 995,084
2015	177,262	928,525
2016	177,262	788,927
2017	147,718	528,051
2018	-	184,023
Thereafter	-	246,189
Total minimum lease payments	679,504	$ 3,670,799
Less: Amount representing interest	64,451	
Present value of minimum lease payments	$ 615,053	

13 - 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.

13 - STATE SURPLUS REVENUE RETENTION (Continued)

Through June 30, 2013, the Foundation did not have surpluses in excess of the 5% or 20% rules. As of June 30, 2013, the Foundation's surplus revenue retention was $(4,710,073) calculated as follows:

Balance, June 30, 2012	$ (763,376)
Surplus revenue retention associated with merger activity	(1,826,769)
Adjusted beginning balance	(2,590,145)
Year ended June 30, 2013	(2,119,928)
Balance, June 30, 2013	$ (4,710,073)

14 - 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 $185,345 and $177,656 in 2013 and 2012, 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 $2,400,737 and $1,971,876 at June 30, 2013 and 2012, respectively.

15 - ECONOMIC DEPENDENCY

The Foundation receives a significant portion of its support and revenue from the Commonwealth of Massachusetts, Department of Developmental Services (DDS) and Department of Early Education and Care (EEC). Total support and revenue included approximately $55,500,000 and $16,600,000 from the DDS and EEC, respectively, in 2013.

16 - STATEMENT OF CASH FLOWS

Supplemental disclosure of cash flows information is as follows:

	2013	2012
Cash paid during the year for interest	$ 3,534,852	$ 3,407,017

17 - COMMITMENTS AND CONTINGENCY

The Foundation has obtained two letters of credit in the amounts of $11,439,050 and $5,217,100 expiring in 2014 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 Foundation has negotiated a two year contract extension through June, 2014.

17 - COMMITMENTS AND CONTINGENCY (Continued)

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, 2013, or on the changes in net assets for the year then ended.

18 - RETIREMENT PLAN

The Foundation has a 403(b) retirement plan covering substantially all employees. The Foundation made matching contributions to the plan in the amount of $472,602 and $484,296 in 2013 and 2012, respectively.

19 - 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 2010.

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.

20 - RELATED PARTY TRANSACTIONS

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

	2013	2012
Notes receivable	$ 160,000	$ 250,000
Accounts payable	63,339	13,590
Expenditures for property, plant and equipment	314,374	307,952

The Foundation has a 5% ownership in an unconsolidated affiliate which is the investment advisor of certain investments in the amount of $265,676.

21 - FAIR VALUE MEASUREMENTS

The Foundation follows the provisions of Financial Accounting Standards Board Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures* (ASC Topic 820) which provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

21 - FAIR VALUE MEASUREMENTS (Continued)

The three levels of the fair value hierarchy under ASC Topic 820 are described as follows:

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 asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2013 and 2012.

Equities, U.S. government securities, money market funds and corporate debt securities: Valued at the closing price reported on the active market on which the individual securities are traded.

Privately managed partnership - hedge funds: The Foundation, as a practical expedient, estimates the fair value of its alternative investments based on the net asset value (or its equivalent) as reported by the fund manager. The Foundation has evaluated the audited financial statements of its holdings as of the balance sheet date and believe that reported net asset value (or its equivalent) is calculated consistent with the guidance of ASC 820-10-35-59. Classification within the fair value hierarchy is based on the existence of restrictions on the Foundation's ability to access its holdings.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Foundation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

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, 2013 as follows:

	Level 1	Level 2	Level 3	Total
Bonds	$ 3,851,667	$ -	$ -	$ 3,851,667
Mutual funds	11,290,681	-	-	11,290,681
Common stock	275,188	-	-	275,188
Money market	5,763,803	-	-	5,763,803
Partnership – Hedge funds	-	-	866,731	866,731
Total investments	$ 21,181,339	$ -	$ 866,731	$ 22,048,070

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

21 - FAIR VALUE MEASUREMENTS (Continued)

Balance, June 30, 2012	$ 706,953
Total unrealized gain included in changes in net assets	159,778
Balance, June 30, 2013	$ 866,731

As disclosed in footnote 1 to the financial statements, the Foundation estimates the fair value of its investments in certain entities using the net asset value per share of the investment. Further information about these investments is presented below.

	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Partnership – Hedge funds (a)	$ 866,731	$ -	monthly	30 days

(a) This privately managed partnership fund seeks to exploit fundamental flaws in valuation in order to provide investors with certain advantages that are not usually provided by most hedge funds including, but not limited to, low trading costs and favorable tax treatment. Gains will be provided by equities held long term while the equities that create losses will generally be held for less than one year. The fair value of the investments in this category has been estimated using the net asset value per share of the investments.

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, 2013 as follows:

	Level 1	Level 2	Level 3	Total
Hedging instruments	$ -	$ -	$ 1,384,466	$ 1,384,466

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

Beginning balance	$ (1,482,875)
Additions due to merger	(428,098)
Total unrealized gain included in changes in net assets	526,507
Ending balance	$ (1,384,466)

22 - RECLASSIFICATIONS

Certain amounts in the 2012 comparative information have been reclassified to conform with the 2013 presentation. Such reclassifications had no effect on the change in net assets as previously reported.