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**SEVEN HILLS FOUNDATION AND AFFILIATES**  
***COMBINED FINANCIAL STATEMENTS***  
***WITH SUPPLEMENTARY INFORMATION***  
***YEAR ENDED JUNE 30, 2016***  
***AND***  
***INDEPENDENT AUDITOR'S REPORT***

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SEVEN HILLS FOUNDATION AND AFFILIATES

COMBINED FINANCIAL STATEMENTS  
WITH SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2016

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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 (collectively, the "Foundation"), which comprise the combined statement of financial position as of June 30, 2016, 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 (collectively, the 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, 2016, 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)

**Emphasis of Matter**

As discussed in Note 2 of the combined financial statements, in 2016, Seven Hills Foundation and Affiliates adopted new accounting guidance, FASB Accounting Standards Update No. 2015-07, *Fair Value Measurements (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. Our opinion is not modified with respect to this matter.

**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' 2015 combined financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated November 10, 2015. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2015, is consistent, in all material respects, with the audited combined financial statements from which it has been derived.

*Ballus Lynch, LLP*

Worcester, Massachusetts  
November 29, 2016

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SEVEN HILLS FOUNDATION AND AFFILIATES  
COMBINED STATEMENT OF FINANCIAL POSITION

JUNE 30, 2016  
(With Summarized Financial Information for 2015)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2016	2015
<b>Assets</b>					
<b>Current assets</b>					
Cash	\$ 7,867,383	\$ 7,616	\$ 216,713	\$ 8,091,712	\$ 9,328,294
Deposits with trustees	4,555,947	-	-	4,555,947	22,183,191
Accounts receivable, less allowance for doubtful accounts of \$157,678 and \$169,357	26,745,263	-	-	26,745,263	19,571,885
Contributions receivable	55,000	-	-	55,000	220,000
Prepaid expenses and other assets	541,260	-	-	541,260	593,932
<b>Total current assets</b>	<b>39,764,853</b>	<b>7,616</b>	<b>216,713</b>	<b>39,989,182</b>	<b>51,897,302</b>
Contributions receivable	-	-	-	-	55,000
Investments	20,414,477	3,359,784	355,263	24,129,524	24,772,555
Investment in unconsolidated affiliates	1,854,064	-	-	1,854,064	1,141,927
Deposits with trustees	4,797,026	-	-	4,797,026	4,456,102
Loan acquisition costs, net	3,081,772	-	-	3,081,772	3,167,859
Deposits and other assets	272,406	-	-	272,406	277,197
Property, plant, and equipment, net	113,928,186	-	-	113,928,186	114,473,009
Cash value of life insurance	3,306,874	-	-	3,306,874	3,386,686
	<b>\$ 187,419,658</b>	<b>\$ 3,367,400</b>	<b>\$ 571,976</b>	<b>\$ 191,359,034</b>	<b>\$ 203,627,637</b>
<b>Liabilities and Net Assets</b>					
<b>Current liabilities</b>					
Notes payable, bank	\$ 7,698,322	\$ -	\$ -	\$ 7,698,322	\$ 2,850,114
Current maturities of long-term debt	3,262,221	-	-	3,262,221	23,803,275
Current portion of capital lease obligation	130,586	-	-	130,586	168,117
Accounts payable	4,896,295	-	-	4,896,295	4,727,742
Accrued and other liabilities	8,480,896	-	-	8,480,896	9,713,151
<b>Total current liabilities</b>	<b>24,468,320</b>	<b>-</b>	<b>-</b>	<b>24,468,320</b>	<b>41,262,399</b>
Advances from the State of Rhode Island	1,061,048	-	-	1,061,048	1,061,048
Long-term debt, less current maturities	93,139,983	-	-	93,139,983	94,402,426
Long-term capital lease obligation	-	-	-	-	130,610
Hedging instrument liability	624,190	-	-	624,190	824,351
Deferred compensation liability	6,023,079	-	-	6,023,079	5,228,293
	<b>125,316,620</b>	<b>-</b>	<b>-</b>	<b>125,316,620</b>	<b>142,909,127</b>
<b>Net assets</b>					
Unrestricted					
Undesignated	46,156,134	-	-	46,156,134	40,219,466
Designated for endowment	15,946,904	-	-	15,946,904	15,989,418
Temporarily restricted	-	3,367,400	-	3,367,400	3,937,650
Permanently restricted	-	-	571,976	571,976	571,976
	<b>62,103,038</b>	<b>3,367,400</b>	<b>571,976</b>	<b>66,042,414</b>	<b>60,718,510</b>
	<b>\$ 187,419,658</b>	<b>\$ 3,367,400</b>	<b>\$ 571,976</b>	<b>\$ 191,359,034</b>	<b>\$ 203,627,637</b>

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, 2016  
(With Summarized Financial Information for 2015)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2016	2015
Operating support and revenue:					
Government contracts and fees	\$ 178,051,830	\$ -	\$ -	\$ 178,051,830	\$ 168,329,810
Government donated staff and transportation	29,292	-	-	29,292	29,292
H.U.D. rental subsidy	541,802	-	-	541,802	542,115
Private contracts and fees	1,843,095	-	-	1,843,095	2,568,645
Trainee production	124,037	-	-	124,037	160,383
Rent, vending, service fees	5,325,920	-	-	5,325,920	5,007,103
Interest income	86,240	16	-	86,256	120,343
Investment income	545,308	27,431	-	572,739	573,908
Net investment losses	(583,899)	(4,563)	-	(588,462)	(437,726)
Beano income	1,716,432	-	-	1,716,432	1,583,061
Contributions	597,002	-	-	597,002	668,412
Grants	835,468	-	-	835,468	1,293,757
Cafeteria	303,903	-	-	303,903	357,546
Loss on sale of property and equipment	(313,986)	-	-	(313,986)	(165,715)
Other	1,548,327	-	-	1,548,327	1,562,596
Net assets release from restrictions:					
Satisfaction of purpose restrictions	593,134	(593,134)	-	-	-
Total support and revenue	<u>191,243,905</u>	<u>(570,250)</u>	<u>-</u>	<u>190,673,655</u>	<u>182,193,530</u>
Operating expenses:					
Program services					
Residential services	59,828,871	-	-	59,828,871	56,176,398
Family support	18,184,793	-	-	18,184,793	16,937,322
Vocational services	10,327,024	-	-	10,327,024	9,655,567
Nursing home services	14,245,111	-	-	14,245,111	12,935,893
Community services - Massachusetts	3,680,871	-	-	3,680,871	4,479,348
Community services - Rhode Island	23,698,611	-	-	23,698,611	23,415,638
Rental property operations	802,795	-	-	802,795	446,549
Child care services	29,099,239	-	-	29,099,239	27,946,873
Clinical services	-	-	-	-	1,217,147
School services	15,210,405	-	-	15,210,405	12,942,464
Global outreach	367,563	-	-	367,563	297,253
VSA - Massachusetts	609,640	-	-	609,640	406,482
	<u>176,054,923</u>	<u>-</u>	<u>-</u>	<u>176,054,923</u>	<u>166,856,934</u>
Supporting services					
Management and general	13,621,224	-	-	13,621,224	11,612,799
Total expenses	<u>189,676,147</u>	<u>-</u>	<u>-</u>	<u>189,676,147</u>	<u>178,469,733</u>
Change in net assets from operations	1,567,758	(570,250)	-	997,508	3,723,797
Non-operating revenue:					
Contributions associated with merger activity	-	-	-	-	366,440
Gain from discontinued operations	4,126,235	-	-	4,126,235	208,592
Unrealized gain on hedging instruments	200,161	-	-	200,161	224,493
Change in net assets	5,894,154	(570,250)	-	5,323,904	4,523,322
Net assets, beginning of year	<u>56,208,884</u>	<u>3,937,650</u>	<u>571,976</u>	<u>60,718,510</u>	<u>56,195,188</u>
Net assets, end of year	<u>\$ 62,103,038</u>	<u>\$ 3,367,400</u>	<u>\$ 571,976</u>	<u>\$ 66,042,414</u>	<u>\$ 60,718,510</u>

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

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SEVEN HILLS FOUNDATION AND AFFILIATES  
 COMBINED STATEMENT OF FUNCTIONAL EXPENSES  
 YEAR ENDED JUNE 30, 2016  
 (With Summarized Financial Information for 2015)

	Program Services						Rental Property Operations
	Residential Services	Family Support	Vocational Services	Nursing Home	Community Services - MA	Community Services - RI	
Staff payroll	\$ 39,273,492	\$ 5,856,622	\$ 5,643,773	\$ 8,484,666	\$ 2,145,743	\$ 14,537,572	\$ -
Trainee payroll	-	-	181,032	-	-	22,543	-
Payroll taxes	3,153,197	492,001	460,130	629,943	169,625	1,218,944	-
Employee benefits	5,034,803	520,472	618,296	1,015,087	288,652	2,869,720	-
Government staff	-	-	29,292	-	-	-	-
Occupancy	3,720,568	288,913	742,495	894,055	268,886	680,765	287,173
Telephone	308,742	97,222	183,274	21,165	75,693	360,716	21,501
General insurance	44,760	60,755	79,566	96,453	65,780	126,387	26,571
Office and operating supplies	362,611	48,729	134,797	1,229,811	109,967	215,209	31,256
Dues and subscriptions	15,628	2,812	6,682	775	176	23,552	418
Printing and postage	9,775	5,363	9,074	91	1,056	12,553	199
Advertising	1,154	200	-	-	16	595	-
Legal and audit	-	-	-	-	-	23,275	-
Client transportation	1,792,432	260,773	490,630	67,356	162,879	522,832	-
Specialized home care	83,949	9,233,575	-	-	-	702,488	-
Clinical consultants	451,316	-	127,345	137,069	127,475	183,698	-
Purchased services	-	-	-	292,819	-	1,215,783	-
Family support	50,330	938,962	-	-	47,860	79,754	-
Staff training	10,688	2,990	-	7,217	15,533	29,131	259
Fund raising	-	-	-	-	-	-	-
Cafeteria and food	1,837,082	49,026	311,945	223,833	2,473	263,603	56
Interest	1,522,414	87,118	375,591	504,623	38,853	96,908	214,626
Beano expenses	491,210	-	397,089	-	-	-	-
Other	75,993	62,989	34,982	64	51,824	61,231	206
<b>Total before depreciation</b>	<b>58,240,144</b>	<b>18,008,522</b>	<b>9,825,993</b>	<b>13,605,027</b>	<b>3,572,491</b>	<b>23,247,259</b>	<b>582,265</b>
Depreciation and amortization	1,588,727	176,271	501,031	640,084	108,380	451,352	220,530
<b>\$ 59,828,871</b>	<b>\$ 18,184,793</b>	<b>\$ 10,327,024</b>	<b>\$ 14,245,111</b>	<b>\$ 3,680,871</b>	<b>\$ 23,698,611</b>	<b>\$ 802,795</b>	

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Child Care Services	School Services	Program Services			Management and General	Totals	
		Global Outreach	VSA - Massachusetts	Total		2016	2015
\$ 1,432,231	\$ 9,054,694	\$ 96,501	\$ 444,233	\$ 86,969,527	\$ 5,103,722	\$ 92,073,249	\$ 87,064,841
-	-	-	-	203,575	-	203,575	278,809
114,852	675,587	8,204	36,941	6,959,424	372,559	7,331,983	7,043,549
167,489	1,190,985	7,780	15,437	11,728,721	1,728,115	13,456,836	12,159,831
-	-	-	-	29,292	-	29,292	29,292
181,326	1,602,651	9,139	47,264	8,723,235	431,147	9,154,382	8,635,520
24,299	80,482	3,341	3,419	1,179,854	183,184	1,363,038	1,312,212
32,770	161,841	7,139	1,833	703,855	79,211	783,066	752,732
34,923	214,318	9,968	9,080	2,400,669	283,248	2,683,917	2,221,162
4,358	35,368	2,829	1,548	94,146	131,394	225,540	228,506
5,915	10,482	2,885	2,631	60,024	182,211	242,235	214,467
-	-	-	-	1,965	354,916	356,881	375,991
-	656	-	-	23,931	305,270	329,201	266,605
100,599	170,655	31,185	9,125	3,608,466	150,799	3,759,265	3,473,271
-	-	-	-	10,020,012	-	10,020,012	9,572,122
626,109	697,433	9,243	34,404	2,394,092	549,408	2,943,500	2,595,229
-	4,210	-	-	1,512,812	41,664	1,554,476	1,424,121
26,012,413	25,779	-	-	27,155,098	-	27,155,098	25,908,566
3,102	13,679	1,116	2,518	86,233	446,905	533,138	481,620
-	-	-	-	-	81,913	81,913	78,486
132,906	371,398	250	556	3,193,128	3,077	3,196,205	3,081,063
95,305	425,984	2,416	-	3,363,838	400,701	3,764,539	3,900,288
-	-	-	-	888,299	440,226	1,328,525	1,268,795
4,349	78,705	170,696	651	541,690	1,968,527	2,510,217	1,750,343
28,972,946	14,814,907	362,692	609,640	171,841,886	13,238,197	185,080,083	174,117,421
126,293	395,498	4,871	-	4,213,037	383,027	4,596,064	4,352,312
<u>\$ 29,099,239</u>	<u>\$ 15,210,405</u>	<u>\$ 367,563</u>	<u>\$ 609,640</u>	<u>\$ 176,054,923</u>	<u>\$ 13,621,224</u>	<u>\$ 189,676,147</u>	<u>\$ 178,469,733</u>

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, 2016  
(With Summarized Financial Information for 2015)

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Change in net assets	\$ 5,323,904	\$ 4,523,322
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Bad debt expense	182,209	100,099
Depreciation and amortization	4,723,855	4,500,551
Equity in earnings of unconsolidated affiliates	(96,781)	(71,333)
Unrealized gain on hedging instrument	(200,161)	(224,493)
Net investment losses	588,462	437,726
Loss on sale of property, plant, and equipment	313,986	165,715
Gain on discontinued operations	(4,239,529)	-
Contributions and gifts for long-term investment	(1,040)	(158,310)
Non-cash contributions	-	(366,440)
Deferred compensation expense	794,786	391,945
Decrease (increase) in operating assets:		
Accounts receivable	(7,355,587)	(1,091,078)
Prepaid expenses and other assets	52,672	(179,151)
Increase (decrease) in operating liabilities:		
Accounts payable	351,055	(6,926)
Accrued and other liabilities	(1,232,255)	(372,646)
	<u>(6,118,328)</u>	<u>3,125,659</u>
Net cash provided by (used in) operating activities	<u>(794,424)</u>	<u>7,648,981</u>
Cash flows from investing activities:		
Payments for purchases of investments	(4,243,912)	(12,875,160)
Proceeds from sale and maturities of investments	4,298,481	12,483,204
Net investment in unconsolidated affiliate	(615,356)	(284,678)
Change in assets deposited with trustees	17,286,320	(20,224,854)
Expenditures for loan acquisition costs	(70,630)	(415,896)
Increase in deposits and other assets	-	(2,795)
Expenditures for property, plant, and equipment	(9,020,446)	(13,294,657)
Proceeds from sale of property, plant, and equipment	898,239	1,005,528
Proceeds from discontinued operations	7,837,591	-
(Increase) decrease in cash value of life insurance	79,812	(429,129)
Net cash provided by (used in) investing activities	<u>16,450,099</u>	<u>(34,038,437)</u>
Cash flows from financing activities:		
Net proceeds (payments) from note payable, bank	4,848,208	(18,408)
Proceeds from issuance of long-term debt	1,360,000	58,798,907
Principal payments of long-term debt	(23,153,364)	(28,886,989)
Principal payments of capital lease obligation	(168,141)	(161,399)
Contributions received for long-term investment	221,040	290,945
Net cash provided by (used in) financing activities	<u>(16,892,257)</u>	<u>30,023,056</u>
Net increase (decrease) in cash	(1,236,582)	3,633,600
Cash acquired through merger with VSA, Inc. and ICW, Inc.	-	186,507
Cash, beginning of year	<u>9,328,294</u>	<u>5,508,187</u>
Cash, end of year	<u>\$ 8,091,712</u>	<u>\$ 9,328,294</u>

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

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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 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 Aspire, Inc. (formerly known as 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; Seven Hills Neurocare, Inc.; Individual & Family Support Centers, Inc.; Stetson School, Inc.; Stetson Home, Inc.; Seven Hills WAARC Realty; Seven Hills New Jersey, Inc.; International Center of Worcester, Inc.; and VSA, Inc. (hereinafter collectively referred to as the "Foundation"). All material intercompany balances and transactions have been eliminated in combination.

Mergers

During 2015, the Board of Directors of the Foundation and the Board of Directors of Very Special Arts (VSA) (the "Organization") voted to authorize a merger with the Foundation. The Foundation has assumed the contracts of the Organization and continued its operations. Due to the nature of the transaction, the accompanying financial statements reflect the acquisition as of October 31, 2014 and the 2015 statements include the following financial information of the Organization:

Assets	\$	388,667
Liabilities		50,071
Net assets		338,596

During 2015, the Board of Directors of the Foundation and the Board of the International Center of Worcester (ICW) (the "Organization") voted to authorize a merger with the Foundation. The Foundation has assumed the contracts of the Organization and continued its operations. Due to the nature of the transaction, the accompanying financial statements reflect the acquisition as of December 31, 2014 and the 2015 statements include the following financial information of the Organization:

Assets	\$	65,562
Liabilities		37,718
Net assets		27,844

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 29, 2016, the date that the financial statements were available to be issued.

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

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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, 2015, 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.

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

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. Such discounts were not material to the financial statements as of June 30, 2016 and 2015. 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.

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.

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

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Endowment funds (continued)

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

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

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, 2016.

Loan acquisition costs

Loan acquisition costs represent fees and other costs associated with obtaining long-term financing. Such costs are being amortized on a straight-line basis, which approximates the level yield method, over the terms of the related debt obligations. 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 varying levels of investments in Group 7 Design, Inc., Empirical Asset Management, LLC, Wellesley/Front, LLC, and Honeydrop, Inc. which are accounted for by the equity method.

Property, plant, and equipment

All acquisitions of property, plant, and equipment in excess of \$5,000 are capitalized. 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.

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

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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, 2016 and 2015) 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 2016 and 2015 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 \$356,881 and \$375,991 in 2016 and 2015, 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 and fair values of interest rate swap agreements are recognized as non-operating activities.

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

2 - CHANGE IN ACCOUNTING PRINCIPLE

In May 2015, the FASB issued Accounting Standards Update (ASU) 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This ASU removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. This ASU also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value practical expedient. Rather, these disclosures are limited to investments for which the entity has elected to measure the fair value using the practical expedient. The ASU is effective for fiscal years beginning after December 31, 2016, with early adoption permitted. The Foundation has elected to adopt the ASU early

3 - DEPOSITS WITH TRUSTEES

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

	2016	2015
Current		
Future debt service	\$ 4,555,947	\$ 886,135
Cost of issuance	-	216,790
Bond refunding trust	-	21,080,266
	4,555,947	22,183,191
Long-term		
Future debt service	4,797,026	4,456,102
	\$ 9,352,973	\$ 26,639,293

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

	2016	2015
Cash and cash equivalents	\$ 8,397,923	\$ 5,559,706
Corporate bonds	955,050	21,079,587
	\$ 9,352,973	\$ 26,639,293

4 - INVESTMENTS

Investments are included in the following classes of net assets:

	2016	2015
Donor-restricted endowment funds		
Temporarily restricted	\$ 3,359,784	\$ 3,614,822
Permanently restricted	355,263	355,263
Board-designated endowment funds	15,946,904	15,989,418
Unrestricted assets	4,467,573	4,813,052
	\$ 24,129,524	\$ 24,772,555

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

4 - INVESTMENTS (Continued)

Investments are composed of the following:

	2016		2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Government bonds	\$ 1,588,459	\$ 1,609,290	\$ 1,940,815	\$ 1,925,003
Corporate bonds	708,267	703,216	909,426	906,483
Mutual funds	17,521,712	18,135,024	16,841,561	17,992,805
Common stock	295,727	329,401	296,611	292,559
Money market accounts	466,081	466,081	534,062	534,062
Exchange traded funds	2,100,694	2,335,713	2,300,942	2,262,712
Partnership - Hedge funds	382,725	550,799	512,858	858,931
	<u>\$ 23,063,665</u>	<u>\$ 24,129,524</u>	<u>\$ 23,336,275</u>	<u>\$ 24,772,555</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, 2016.

Investment management fees of \$59,015 and \$67,715 in 2016 and 2015, respectively, were automatically deducted from the investment income by the investment management companies.

5 - ENDOWMENT ASSETS

Endowment assets include Board-designated investments. Changes in endowment assets for the year ended June 30, 2016 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment assets, beginning of year	\$ 15,989,418	\$ 3,614,822	\$ 571,976	\$ 20,176,216
Investment return				
Investment income	394,735	27,431	-	422,166
Net depreciation (realized and unrealized)	(86,171)	(4,563)	-	(90,734)
Total investment return	308,564	22,868	-	331,432
Appropriation for expenditure	(351,078)	(277,906)	-	(628,984)
Endowment assets, end of year	<u>\$ 15,946,904</u>	<u>\$ 3,359,784</u>	<u>\$ 571,976</u>	<u>\$ 19,878,664</u>



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

**6 - PROPERTY, PLANT, AND EQUIPMENT**

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

	<u>Estimated Useful Lives</u>	<u>2016</u>	<u>2015</u>
Land	-	\$ 14,649,774	\$ 14,114,920
Buildings and improvements	20 - 40 years	125,593,085	123,146,603
Furniture and equipment	3 - 20 years	12,155,314	13,901,020
Motor vehicles	5 years	1,685,138	1,819,711
Construction in progress	-	<u>1,646,905</u>	<u>2,583,270</u>
		155,730,216	155,565,524
Less: Accumulated depreciation and amortization		<u>41,802,030</u>	<u>41,092,515</u>
		<u>\$ 113,928,186</u>	<u>\$ 114,473,009</u>

Depreciation and amortization expense for property, plant, and equipment was \$4,572,481 and \$4,354,503 in 2016 and 2015, respectively.

**7 - 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.

**8 - NOTE PAYABLE, BANK**

The Foundation has a \$10,000,000 revolving credit facility with a bank secured by substantially all assets of the Foundation. Interest is charged at the LIBOR lending rate plus 200 basis points (2.45% as of June 30, 2016). The line of credit is available through March, 2017, at which time the terms and conditions of the line of credit will be reviewed. The balance outstanding on this line of credit was \$7,698,322 and \$2,850,114 as of June 30, 2016 and 2015, respectively.

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

9 - LONG-TERM DEBT

Long-term debt consists of the following:

	2016	2015
Bond notes payable, secured by real estate and cash flows from provider contracts:		
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. This bond was paid in full during 2016 upon its first available call date.	\$ -	\$ 20,620,000
Due in annual installments of principal through September 2039. Interest is due monthly at a weekly rate of interest determined by the remarketing agent for each rate period to be the lowest rate on the basis of prevailing financial market conditions (0.41% as of June 30, 2016) during the life of the obligation. A letter of credit securing this note expired June 2016.	10,455,000	10,735,000
Due in annual installments of principal through September 2039. Interest is due monthly at a weekly rate of interest determined by the remarketing agent for each rate period to be the lowest rate on the basis of prevailing financial market conditions (0.41% as of June 30, 2016) during the life of the obligation. A letter of credit securing this note expired during 2016.	4,740,000	4,875,000
Due in annual installments of principal with lump sum due December 2041. Interest is due monthly at 76% of the sum of the 30-Day LIBOR rate plus 2.00% (1.88% as of June 30, 2016) during the life of the obligation.	7,318,764	7,509,393
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.	6,437,320	7,026,363
Due in annual installments of principal through May 2042. Interest is due monthly at 76% of the sum of the 30-Day LIBOR rate plus 2.00% (1.88% as of June 30, 2016) during the life of the obligation.	3,353,000	3,415,000
Due in annual installments of principal through June, 2043. Interest is due monthly at 76% of the sum of the 30-Day LIBOR rate plus 2.00% (1.88% as of June 30, 2016) during the life of the obligation.	1,489,499	1,544,666
Due in annual installments of principal commencing September, 2016 through September, 2045. Interest is due semi-annually at rates increasing from 3.039% to 5.00% during the life of the obligation.	47,485,000	47,485,000
Due in annual installments of principal through September 2045. Interest is due semi-annually at rates increasing from 3.039% to 5.00% during the life of the obligation.	7,542,157	8,350,000

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

9 - LONG-TERM DEBT (Continued)

	2016	2015
Mortgage notes payable, secured by real estate:		
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.	\$ 485,390	\$ 524,591
Borrowings under construction credit facility. Due in monthly installments of \$6,642 including interest at 9.00% through August 2032.	677,788	695,612
Due in monthly principal payments of \$5,667, together with interest thereon charged at the 30-Day LIBOR rate plus 2.00% (2.47% as of June 30, 2016) through February, 2021, at which time the principal balance is due in full.	1,331,667	-
Non-interest bearing contingent loans from various sources to assist in development of housing projects, generally not required to be repaid unless the project fails to comply with the conditions of the loan. It is the intention of the Board of Directors and management to maintain the property as required. Loans are due at varying maturities through June 2037.	2,254,093	2,254,093
Note payable, leasing company, secured by motor vehicle due in monthly installments of \$569 including interest at 9.36% through March, 2017. This note was paid in full during 2016.	-	4,402
Unamortized bond premiums	93,569,678 2,832,526	115,039,120 3,166,581
Less: Current maturities of long-term debt	96,402,204 3,262,221	118,205,701 23,803,275
	\$ 93,139,983	\$ 94,402,426

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

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

2017	\$ 3,262,221
2018	3,360,040
2019	3,517,486
2020	3,638,721
2021	4,708,646
Thereafter	75,082,564
	93,569,678
Unamortized bond premiums	2,832,526
	\$ 96,402,204

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

10 - 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 three 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:

Notional Amount	Interest Rate	Expiration Date	Value
\$ 6,363,352	2.6050%	December, 2016	\$ 23,333
7,605,000	3.3925%	September, 2018	489,827
5,500,000	1.3050%	September, 2018	111,030
			<u>\$ 624,190</u>

Included in statement of activities is an unrealized gain of \$200,161 and \$224,493 relating to the change in fair value of the swap agreements for the years ended June 30, 2016 and 2015, respectively.

11 - RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	2016	2015
Building renovation	\$ -	\$ 210,850
Direct care services	2,792	102,974
Academic and residential program support	3,359,784	3,614,984
Scholarships	4,824	4,824
Other	-	4,018
	<u>\$ 3,367,400</u>	<u>\$ 3,937,650</u>

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 appropriated for current operations	\$ 277,906
Direct care services	100,182
Building renovation	210,850
Other	4,196
	<u>\$ 593,134</u>

Permanently restricted net assets are restricted to:

	2016	2015
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	355,263
	<u>\$ 571,976</u>	<u>\$ 571,976</u>

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

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:

	2016	2015
Furniture and equipment	\$ 800,000	\$ 800,000
Less: Accumulated depreciation	400,000	320,000
	\$ 400,000	\$ 480,000

Future minimum lease payments under these capital leases, together with the present value of future minimum lease payments as of June 30, 2016 are as follows:

Year Ending	Capital	Operating
2017	\$ 147,718	\$ 937,796
2018	-	571,821
2019	-	333,551
2020	-	197,195
2021	-	126,231
Thereafter	-	1,505,398
Total minimum lease payments	147,718	\$ 3,671,992
Less: Amount representing interest	17,132	
Present value of minimum lease payments	\$ 130,586	

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.

Through June 30, 2016, the Foundation did not have surpluses in excess of the 5% or 20% rules. As of June 30, 2016, the Foundation's surplus revenue retention was \$477,424 calculated as follows:

Balance, June 30, 2015	\$ (1,965,362)
Year ended June 30, 2016	2,442,786
Balance, June 30, 2016	\$ 477,424

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SEVEN HILLS FOUNDATION AND AFFILIATES  
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(Continued)

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 \$410,984 and \$396,301 in 2016 and 2015, 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 \$3,306,874 and \$3,386,686 at June 30, 2016 and 2015, respectively.

15 - CONCENTRATION

The Foundation receives a significant portion of its support and revenue from the Commonwealth of Massachusetts, Department of Developmental Services and Department of Early Education and Care. Total support and revenue included the following:

	2016	2015
Department of Developmental Services	\$ 78,606,527	\$ 74,487,505
Department of Early Education and Care	28,655,311	25,043,299

16 - STATEMENT OF CASH FLOWS

Supplemental disclosure of cash flows information is as follows:

	2016	2015
Cash paid during the year for interest	\$ 4,259,225	\$ 3,936,417

17 - COMMITMENTS AND CONTINGENCY

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 200 employees who are represented by Local 5068, United Nurses & Allied Professionals. The Foundation had negotiated a six month contract extension through December 2015 and continues to operate under the terms of the expired contract until the contract is renegotiated.

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, 2016, or on the changes in net assets for the year then ended.

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

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 \$543,708 and \$559,083 in 2016 and 2015, 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 2013.

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:

	<u>2016</u>	<u>2015</u>
Accounts payable	\$ 14,836	\$ 15,521
Expenditures for property, plant and equipment	209,558	375,000

The Foundation has a 6% ownership in an unconsolidated affiliate which is the investment advisor of certain investments in the amount of \$617,228 and \$634,887 in 2016 and 2015, respectively.

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).

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

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, 2016 and 2015.

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

*Corporate bonds* - Valued at the closing price reported on the active market on which similar 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.



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

21 - 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, 2016 as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Investments</b>				
Government bonds	\$ 1,609,290	\$ -	\$ -	\$ 1,609,290
Corporate bonds	-	703,216		703,216
Mutual funds	18,135,024	-	-	18,135,024
Common stock	329,401	-	-	329,401
Money market	466,081	-	-	466,081
Exchange traded funds	<u>2,335,713</u>	<u>-</u>	<u>-</u>	<u>2,335,713</u>
Total investments within the fair value hierarchy	<u>22,875,509</u>	<u>703,216</u>	<u>-</u>	23,578,725
Investments measured at net asset value				<u>550,799</u>
Total investments				24,129,524
<b>Deposits with trustees</b>				
Cash and cash equivalents	8,397,923	-	-	8,397,923
Corporate bonds	<u>-</u>	<u>955,050</u>	<u>-</u>	<u>955,050</u>
Total deposits with trustees	<u>8,397,923</u>	<u>955,050</u>	<u>-</u>	<u>9,352,973</u>
Total recurring fair value measurements	<u>\$ 31,273,432</u>	<u>\$ 1,658,266</u>	<u>\$ -</u>	<u>\$ 33,482,497</u>

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, 2015 as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Investments</b>				
Government bonds	\$ 1,925,003	\$ -	\$ -	\$ 1,925,003
Corporate bonds	-	906,483		906,483
Mutual funds	17,992,805	-	-	17,992,805
Common stock	292,559	-	-	292,559
Money market	534,062	-	-	534,062
Exchange traded funds	<u>2,262,712</u>	<u>-</u>	<u>-</u>	<u>2,262,712</u>
Total investments within the fair value hierarchy	<u>23,007,141</u>	<u>906,483</u>	<u>-</u>	23,913,624
Investments measured at net asset value				<u>858,931</u>
Total investments				24,772,555
<b>Deposits with trustees</b>				
Cash and cash equivalents	5,559,706	-	-	5,559,706
Corporate bonds	<u>-</u>	<u>21,079,587</u>	<u>-</u>	<u>21,079,587</u>
Total deposits with trustees	<u>5,559,706</u>	<u>21,079,587</u>	<u>-</u>	<u>26,639,293</u>
Total recurring fair value measurements	<u>\$ 28,566,847</u>	<u>\$ 21,986,070</u>	<u>\$ -</u>	<u>\$ 51,411,848</u>

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

21 - FAIR VALUE MEASUREMENTS (Continued)

Transfer between levels

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management has evaluated the significance of transfers between levels based upon the nature of the financial instrument and the size of the transfer relative to total net assets available for benefits.

Amounts previously shown have been classified to conform to the current year presentation. Corporate bonds were previously categorized as Level 1, and have been changed to Level 2.

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)	\$ 550,799	\$ -	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, 2016 as follows:

	Level 1	Level 2	Level 3	Total
Hedging instruments	\$ -	\$ -	\$ 624,190	\$ 624,190

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, 2015 as follows:

	Level 1	Level 2	Level 3	Total
Hedging instruments	\$ -	\$ -	\$ 824,351	\$ 824,351

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

Beginning balance	\$ 824,351
Total unrealized gain included in changes in net assets	(200,161)
Ending balance	\$ 624,190

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

22 - DISCONTINUED OPERATIONS

During 2016, the Foundation sold certain operations, including related assets of Seven Hills Behavioral Health, Inc. to an unrelated entity. A gain from the sale of operations of \$4,239,519 is recorded in the gain from discontinued operations in the combined statement of activities.

23 - RECLASSIFICATIONS

Certain amounts in the 2015 comparative information have been reclassified to conform with the 2016 presentation. Such reclassifications had no effect on the change in net assets as previously reported.

<b>FY 16</b>
<b>Related Party Transactions</b>
<b><u>Name of Related Party:</u></b>
Group 7 Design Inc.
83 Cedar Street
Suite 100
Milford, MA 01757
Architectural Design Firm
<b><u>Investment in Related Party FY 16:</u></b>
Share of Total Income - 73.93%
Percentage Ownership - 73.93%
<b><u>Related Party Transactions FY 16:</u></b>
Seven Hills Foundation Management Fee \$15,000.00
Seven Hills Foundation Rent Income from Group 7 Design \$24,000.00
Seven Hills Foundation AAA Distribution from Group 7 Design Inc \$13,914.00
<b><u>Services Provided FY 16:</u></b>
Group Seven Design Inc., provided Architectural and Design Services to The Seven Hills Foundation Totaling \$229,016 in FY 16.
<b><u>Procedure Followed In Authorizing Transactions:</u></b>
All transactions are carried out as arm's length transactions.

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**GOVERNING BOARD OF DIRECTORS – 2016**

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