



NCPHS Foundation

**(a supporting organization of Northern California
Presbyterian Homes and Services, Inc.)**

**Report on Audits of Financial Statements
December 31, 2008 and 2007**

NCPHS Foundation
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December 31, 2008 and 2007

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Report of Independent Auditors

To the Board of Trustees
NCPHS Foundation

In our opinion, the accompanying statements of financial position, and the related statements of activities and cash flows present fairly, in all material respects, the financial position of the NCPHS Foundation (the "Foundation") at December 31, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 and 5 to the financial statements, the Foundation adopted new fair value measurement and disclosure accounting principles during the year ended December 31, 2008.

PricewaterhouseCoopers LLP

May 14, 2009

NCPHS Foundation
Statements of Financial Position
December 31, 2008 and 2007
(dollars in thousands)

	2008	2007
Assets		
Current assets		
Cash and cash equivalents	\$ 923	\$ 820
Marketable securities	11,135	19,630
Accounts receivables	1	17
Pledges receivable, current portion, net of allowance	1,282	614
	<u>13,341</u>	<u>21,081</u>
Other assets		
Investments held in trust	9,749	10,511
Trust contributions receivable	1,051	2,100
Pledges receivable, net of allowance, less current portion	1,047	1,071
	<u>11,847</u>	<u>13,682</u>
Total assets	<u>\$ 25,188</u>	<u>\$ 34,763</u>
Liabilities		
Related party payables		
	<u>\$ 79</u>	<u>\$ 31</u>
	<u>79</u>	<u>31</u>
Other liabilities		
Liability for payments to trust beneficiaries	4,720	4,330
Other long-term liabilities	651	617
	<u>5,371</u>	<u>4,947</u>
Total liabilities	<u>5,450</u>	<u>4,978</u>
Net assets		
Unrestricted net assets	4,280	7,144
Temporarily restricted net assets	9,211	16,779
Permanently restricted net assets	6,247	5,862
Total net assets	<u>19,738</u>	<u>29,785</u>
Total liabilities and net assets	<u>\$ 25,188</u>	<u>\$ 34,763</u>

The accompanying notes are an integral part of these financial statements.

NCPHS Foundation
Statements of Activities
Years Ended December 31, 2008 and 2007
(dollars in thousands)

	2008	2007
Changes in unrestricted net assets		
Revenues and gains		
Contributions	\$ 130	\$ 564
Investment income including realized gains and losses on investments	(642)	543
Unrealized (losses) gains on investments	(792)	197
	<u>(1,304)</u>	<u>1,304</u>
Net assets released from restrictions		
Satisfaction of program restrictions	5,595	2,658
Matured trust agreements	225	26
Administrative costs	64	77
	<u>5,884</u>	<u>2,761</u>
Total unrestricted revenues and gains	<u>4,580</u>	<u>4,065</u>
Expenses		
Support provided to Northern California Presbyterian Homes and Services, Inc. (NCPHS) programs	(7,444)	(3,379)
Change in unrestricted net assets	<u>(2,864)</u>	<u>686</u>
Changes in temporarily restricted net assets		
Contributions	2,330	1,609
Investment income including net realized gains on investments	(61)	623
Recovery of losses on pledges receivables	9	81
Change in value of split-interest agreements	(3,085)	91
Unrealized gain (loss) from investments held in trust	(850)	11
Net assets released from restrictions	(5,885)	(2,761)
Implementation of SFAS No 157 (Note 1)	(27)	-
Change in temporarily restricted net assets	<u>(7,569)</u>	<u>(346)</u>
Changes in permanently restricted net assets		
Contributions	1,112	222
Change in value of split-interest agreements	(696)	48
Implementation of SFAS No 157 (Note 1)	(30)	-
Change in permanently restricted net assets	<u>386</u>	<u>270</u>
(Decrease) increase in net assets	<u>(10,047)</u>	<u>610</u>
Net assets at beginning of year	<u>29,785</u>	<u>29,175</u>
Net assets at end of year	<u>\$ 19,738</u>	<u>\$ 29,785</u>

The accompanying notes are an integral part of these financial statements.

NCPHS Foundation
Statements of Cash Flows
Years Ended December 31, 2008 and 2007
(dollars in thousands)

	2008	2007
Cash flows from operating activities		
Cash received from contributions	\$ 4,179	\$ 3,520
Cash paid for grants to NCPHS	(7,405)	(3,419)
Investment income	(315)	1,209
Cash (used in) provided by operating activities	<u>(3,541)</u>	<u>1,310</u>
Cash flows from investing activities		
Proceeds from sale of investments	17,667	12,228
Purchase of investments	(15,096)	(14,388)
Cash provided by (used in) investing activities	<u>2,571</u>	<u>(2,160)</u>
Cash flows from financing activities		
Proceeds from endowment contributions	1,120	280
Proceeds from contributions held in trust	283	168
Payments to trust beneficiaries	(730)	(680)
Investment income from marketable securities held in trust	400	895
Cash provided by financing activities	<u>1,073</u>	<u>663</u>
Net increase (decrease) in cash	103	(187)
Cash and cash equivalents:		
Beginning of year	<u>820</u>	<u>1,007</u>
End of year	<u>\$ 923</u>	<u>\$ 820</u>
Reconciliation of change in net assets to cash from operating activities		
Change in net assets	\$ (10,047)	\$ 610
Adjustments to reconcile change in net assets to cash provided by operating activities		
Contribution revenue from trust gifts	2,517	236
Contribution revenue from endowment gifts	(1,110)	(222)
Change in liability to trust beneficiaries	3,838	(139)
Realized and unrealized loss (gain) from investments	2,030	(209)
Contribution of securities	(164)	(182)
Change in operating assets and liabilities		
Changes in receivables, other assets, payables and other accruals	38	5
Change in trust contributions and pledges receivable	(643)	1,211
Cash (used in) provided by operating activities	<u>\$ (3,541)</u>	<u>\$ 1,310</u>
Non cash transactions		
Contribution of securities	<u>\$ 164</u>	<u>\$ 182</u>

The accompanying notes are an integral part of these financial statements.

NCPHS Foundation
Notes to Financial Statements
Years Ended December 31, 2008 and 2007
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1. Organization and Summary of Significant Accounting Policies

The NCPHS Foundation (the Foundation) was incorporated in 1987 as a supporting organization of Northern California Presbyterian Homes and Services, Inc. (NCPHS). The purpose of the Foundation is to receive, account for, hold and distribute gifts to NCPHS. The Foundation also serves as a fiscal agent for the Retired Seniors Volunteer Program (RSVP). The Foundation qualifies for exemption from income and franchise taxes under Section 501(c) (3) and 23701(d) of the respective federal and state revenue codes.

Basis of Presentation

The Foundation's financial statements are prepared on the accrual basis of accounting and are presented in accordance with accounting principles generally accepted in the United States of America as applicable to not-for-profit organizations. Under these principles, net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the Foundation and changes therein are classified and reported as follows:

Unrestricted net assets

Net assets that are not subject to donor-imposed restrictions are classified as unrestricted. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors or otherwise limited by contractual arrangements with outside parties.

Temporarily restricted net assets

Net assets that are subject to donor-imposed restrictions which can be fulfilled either by actions of the Foundation pursuant to those restrictions and/or that expire with the passage of time. The majority of the Foundation's temporarily restricted net assets consist of charitable remainder trusts and other life income funds.

Permanently restricted net assets

Net assets that are subject to donor-imposed restrictions which require that they be maintained permanently by the Foundation. Generally, the donors of these assets permit the Foundation to use all or part of the income earned on related investments for general or specific purposes. Such assets consist primarily of the Foundation's permanent endowment funds and its interest in permanently restricted marketable securities held in trust.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains or losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Fair Value of Financial Instruments

On January 1, 2008, the Foundation adopted Financial Accounting Standards Board ("FASB") Statement No. 157, *Fair Value Measurements*, which establishes a framework for measuring fair value in conformity with generally accepted accounting principles and expands disclosures about fair value measurements. FASB Statement No. 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset

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or liability. As a basis for considering assumptions, FASB Statement No. 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- *Level 1* – Observable inputs such as quoted prices in active markets;
- *Level 2* – Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- *Level 3* – Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques noted in FASB Statement No. 157. The three valuation techniques are as follows:

- *Market approach* – Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;
- *Cost approach* – Amount that would be required to replace the service capacity of an asset (i.e., replacement cost); and
- *Income approach* – Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing models, and lattice models).

The carrying values reported on the balance sheet for current assets and liabilities approximate fair value. Investments, investments held in trust, and trust contribution receivables are carried at fair value. See Note 5 for fair value of the Company's financial assets and liabilities.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with maturities of three months or less at date of purchase that are not held for long-term investment.

Pledges Receivable

Pledges receivable include unconditional promises to give. Pledges receivable that are expected to be collected within one year are recorded at net realizable value. Pledges receivable that are expected to be collected in future years are recorded at fair value. See footnote 5 for the basis of fair value. Conditional promises to give are not included as support until the conditions are substantially met.

Marketable Securities and Investments Held in Trust

Equity and debt securities are carried at fair value with realized and unrealized gains and losses included in the statement of revenues, expenses and other changes in unrestricted net assets and the statement of changes in net assets. Realized gains or losses represent the difference between cost, on a first-in first-out basis, and the related market price at the sale date. A decline in the fair value of an investment in equity and debt securities that is other than temporary is accounted for as a realized loss, whereby the cost basis of the security is written down to fair value. Cash and cash equivalents, which consist of deposits and money market funds are carried at cost, which approximates fair value because of the short-term nature of these investments.

Investments Held in Trust and Liability for Payments to Trust Beneficiaries

Investments held in trust represent charitable remainder trusts and other deferred funds in which the donor, or stated beneficiary, has a life interest in the trust income and for which the Foundation is trustee and remainderman. Trust assets are carried at fair value remeasured on a recurring basis and the related liability for beneficiary payments is estimated based on fair value on a nonrecurring basis. See footnote 5 for the basis of fair value.

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Trust Contributions Receivable

Trust contributions receivable consist of gifts made to the Foundation through split-interest agreements in which the Foundation is a remainderman or has a perpetual income interest as beneficiary and for which there is an external trustee. These assets are carried at fair value based upon the present value of amounts anticipated to be received, using discount rates commensurate with the expected term to receipt of the assets using a discount rate of 4.5% at December 31, 2008 and a range of discount rates between 4.0% and 4.5% at December 31, 2007.

Contributions

Contributions, which may include unconditional promises to give (pledges), are recognized as revenues in the period received. Contributions with donor-imposed restrictions that are met in the same year as received are reported as temporarily restricted contribution revenues and a reclassification to unrestricted net assets is made to reflect the expiration of such restrictions. Donated securities, real property and contributions in kind are recorded at the fair value at the date of contribution. Contributions are derived primarily from donors in Northern California.

Contributions of trust interests in which the Foundation serves as the trustee are recognized at fair value in the period of receipt. Fair value is determined based upon the difference between the fair value of the assets received and the fair value of the estimated liability to beneficiaries. Contributions of trust interests in which the assets are invested and administered by outside trustees are recorded at fair value when notice of the interest is received.

As a subsidiary of NCPHS, all operating, administrative and fundraising costs are incurred by NCPHS on behalf of the Foundation.

Change in Value of Split-Interest Agreements

Changes in the value of split-interest agreements are the result of the following transactions and events related to the Foundation's deferred gifts:

- Accretion of the discounts on previously received deferred gifts.
- Revaluations of expected future benefits to be received, net of income earned and market changes on deferred gift assets.
- Revaluations of expected future payments to beneficiaries, net of payments made, based on changes in life expectancy and other actuarial assumptions.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates include pledges and contributions receivable and the liability for payment to trust beneficiaries. Actual results may differ from those estimates.

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California Laws and Regulations

In July 2006, the Uniform Law Commission approved Uniform Prudent Management of Institutional Funds Act (UPMIFA), as a modernized version of the Uniform Management of Institutional Funds Act of 1972 (UMIFA), the model act on which 46 states and the District of Columbia have based their primary laws governing the investment and management of donor-restricted endowment funds by not-for-profit organizations. UPMIFA provides guidance and authority to charitable organizations concerning the management and investment of funds held by those organizations, and UPMIFA imposes additional duties on those who manage and invest charitable funds. These duties provide additional protections for charities and also protect the interests of donors who want to see their contributions used wisely. Among its changes, UPMIFA prescribes new guidelines for expenditure of a donor-restricted endowment fund (in the absence of overriding, explicit donor stipulations). UPMIFA eliminates UMIFA's historic-dollar-value threshold, an amount below which an organization could not spend from the fund, in favor of a more robust set of guidelines about what constitutes prudent spending, explicitly requiring consideration of the duration and preservation of the fund. Currently the State of California's Assembly and Senate have passed SB 1329, a version of UPMIFA and signed into law by the Governor of the State of California effective January 1, 2009.

New Accounting Pronouncements

In August 2008, the FASB issued FSP Financial Accounting Standards No. 117 (FSP 117-1), which adopts the changes brought about by UPMIFA as adopted by the State of California. FSP 117-1 is effective for financial statements issued for fiscal years ending after December 15, 2008.

2. Pledges Receivable

Pledges receivable include promises to give end-of-life gifts from donors with remaining life expectancies between zero and 11 years. The majority of these contributions are restricted to the Continuum of Care and Health Services projects, which are part of the Foundation's programs.

Pledges receivable were due as follows as of December 31:

	2008	2007
Current portion	\$ 1,349	\$ 646
Less: allowance	<u>(67)</u>	<u>(32)</u>
Total current portion	<u>\$ 1,282</u>	<u>\$ 614</u>
Two to five years	\$ 791	\$ 837
Six to twenty years	<u>590</u>	<u>595</u>
	1,381	1,432
Less: allowance	(69)	(72)
Less: unamortized discount at 0.6% to 6.8%	<u>(265)</u>	<u>(289)</u>
Total non-current portion	<u>\$ 1,047</u>	<u>\$ 1,071</u>

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3. Marketable Securities

Marketable securities as of December 31, 2008 and 2007, at fair value, are summarized below. The majority of these are held with two investment firms:

	2008	2007
Cash equivalents	\$ 1,360	\$ 6,650
Common stocks	2,447	3,835
Equity mutual funds	6,037	7,035
Fixed income mutual funds	1,184	2,000
U.S. Government securities	107	110
	<u>\$ 11,135</u>	<u>\$ 19,630</u>

4. Investments Held in Trust

Investments held in trust at fair value as of December 31, 2008 and 2007 are summarized below. The majority of these are held with one investment firm.

	2008	2007
Cash equivalents	\$ 1,334	\$ 597
Equity mutual funds	4,937	6,400
Fixed income mutual funds	3,410	3,435
Corporate and government bonds	68	79
	<u>\$ 9,749</u>	<u>\$ 10,511</u>

5. Fair value of financial instruments

The fair values of our financial assets and liabilities that are measured on a recurring basis are as follows:

December 31, 2008	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets Measured at Fair Value on a Recurring Basis (1)				
Marketable Securities (2)				
Unrestricted	\$ 11,135	\$ 11,135	\$ -	\$ -
Investments held in trust	9,749	9,749	-	-
Trust Contributions Receivable (3)	1,051	-	-	1,051
	<u>\$ 21,935</u>	<u>\$ 20,884</u>	<u>\$ -</u>	<u>\$ 1,051</u>

(1) For cash and cash equivalents the net carrying value approximates fair value at period end.

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- (2) The fair values of our marketable securities are determined based on quoted market prices in active markets.
- (3) The fair value of our trust contributions receivable is determined using a present value calculation of expected future cash flows with assumptions for the risk-free interest rate, inherent risk, mortality risk, and the expected term of cash flows using the discount rate adjustment technique.

The change in the fair value of our trust contributions receivable are reflected in the change in value of split-interest agreements for temporarily and permanently restricted net assets in the consolidated statements of changes in net assets. The change in value of the trust contributions receivable valued using significant unobservable inputs (Level 3) is shown below:

Fair value at December 31, 2007	\$ 2,100
Implementation of SFAS No 157	(57)
New contributions and maturities	477
Total gains or losses (realized/unrealized) included in changes in net assets	(1,469)
Fair value at December 31, 2008	<u>\$ 1,051</u>

Total gains (losses) for the year included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2008	\$ (1,591)
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On a nonrecurring basis, we are required to measure unconditional promises to give (pledges) and the liability for payments to trust beneficiaries. None of the above fair value instruments were remeasured during the year. Pledges are estimated at fair value during the period received based on the present value of expected future cash flows using the discount rate adjustment technique. Liabilities for payments to trust beneficiaries are estimated at fair value at the time the related trust assets are received based on the present value of estimated future payments over the expected life of income beneficiaries using the discount rate adjustment technique. The discount rates utilized range from 0.6% to 6.8% at December 31, 2008 and 2007, and published actuarial life expectancy tables.

6. Endowments

The Foundation's endowment consists of seven individual donor-restricted funds established for a variety of purposes. The purpose restrictions consist of financial assistance, meal subsidies, improvements to the quality of life to residents of certain NPCHS facilities and maintenance of a resident garden. As required by accounting principles generally accepted in the United States, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The Board of Trustees of the NCPHS Foundation has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, NCPHS classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, and (b) the original value of subsequent gifts to the permanent endowment. The organization appropriates all investment income on the endowment funds for expenditure through temporarily restricted net assets.

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The net asset composition for donor restricted endowment funds by type of fund as of December 31 is as follows:

Donor-restricted endowment funds	2008	2007
Temporarily restricted	\$ 1,115	\$ 1,509
Permanently restricted	4,726	3,667
	<u>\$ 5,841</u>	<u>\$ 5,176</u>

Changes in endowment net assets for the fiscal year ended December 31 is as follows:

	Temporary Restricted	Permanently Restricted	Total
Endowment net assets, December 31, 2006	\$ 1,321	\$ 3,533	\$ 4,854
Investment return:			
Investment income (loss)	228	-	228
Net depreciation (realized and unrealized)	(35)	-	(35)
Total investment return	<u>193</u>	<u>-</u>	<u>193</u>
Contributions		134	134
Appropriation of endowment assets for expenditure	(5)	-	(5)
Endowment net assets, December 31, 2007	<u>\$ 1,509</u>	<u>\$ 3,667</u>	<u>\$ 5,176</u>
Investment return:			
Investment income (loss)	160	-	160
Net depreciation (realized and unrealized)	(500)	-	(500)
Total investment return	<u>(340)</u>	<u>-</u>	<u>(340)</u>
Contributions	-	1,109	1,109
Appropriation of endowment assets for expenditure	(54)	-	(54)
Other changes:			
Provision for bad debt on planned gifts		(50)	(50)
Endowment net assets, December 31, 2008	<u>\$ 1,115</u>	<u>\$ 4,726</u>	<u>\$ 5,841</u>

The entire balance of the Foundation's endowment funds are required to be retained permanently either by explicit donor stipulation or by UPMIFA. The Foundation does not hold term endowment funds or perpetual endowment funds subject to time restrictions under UPMIFA.

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Foundation to retain as a fund of perpetual duration. The organization had total deficiencies of \$234,000 of this nature in some of

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its endowment funds, which are reported in temporarily restricted net assets as of December 31, 2008. These deficiencies resulted from unfavorable market fluctuations. As of December 31, 2007, there were total deficiencies of \$239,000 in all of its endowment funds.

Return Objectives and Risk Parameters

The Foundation has adopted an investment policy for endowment assets that attempts to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the original gift value of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the Consumer Price Index by 3.25% annually, on average, while assuming a moderate level of investment risk. NCPHS expects its endowment funds, over time, to provide an average rate of return of at least 6.25% annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

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 organization targets a diversified asset allocation that places a greater emphasis on fixed income investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Foundation has a policy of appropriating the endowment fund's investment income for expenditure as the income is earned. In establishing this policy, the organization considered the long-term expected return on its endowment. This is consistent with the organization's objective to maintain the original gift value of the endowment assets held in perpetuity as well as to provide additional real growth through new gifts and investment returns.

7. Related Party Transactions

The Foundation supports NCPHS's projects and programs based upon NCPHS's requests for such support. NCPHS provides for all operating, administrative and fundraising services on behalf of the Foundation. The Foundation estimates that the value of the services received was approximately \$673 and \$580 in 2008 and 2007, respectively.