

The McLean Hospital Corporation

**Report on Federal Awards in
Accordance with OMB Circular A-133
September 30, 2007
EIN 042697981**

The McLean Hospital Corporation
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Part I

Financial Statements

Report of Independent Auditors

To the Board of Trustees of
The McLean Hospital Corporation

In our opinion, the accompanying balance sheets and the related statements of operations, changes in net assets and cash flows present fairly, in all material respects, the financial position of The McLean Hospital Corporation at September 30, 2007 and 2006, and the results of its operations, its changes in 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 McLean Hospital Corporation'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2007 on our consideration of The McLean Hospital Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters for the year ended September 30, 2007. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards for the year ended September 30, 2007 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.



December 20, 2007

The McLean Hospital Corporation
Balance Sheets
September 30, 2007 and 2006

(dollars in thousands)

	2007	2006
Assets		
Current assets		
Cash and equivalents	\$ 8,700	\$ 7,698
Investments	11,189	9,598
Current portion of investments limited as to use	16,158	23,997
Patient accounts receivable, net of allowance for bad debts: 2007 - \$1,948; 2006 - \$1,902	7,687	7,177
Research grants receivable	5,468	2,565
Other current assets	4,439	3,793
Receivable for settlements with third-party payers	-	419
Total current assets	<u>53,641</u>	<u>55,247</u>
Investments limited as to use, less current portion	19,185	11,623
Long-term investments	8,539	6,917
Pledges receivable, net, less current portion	2,197	3,528
Interest in the net assets of The Massachusetts General Hospital	80,436	70,446
Property and equipment, net	<u>55,589</u>	<u>49,438</u>
Total assets	<u>\$ 219,587</u>	<u>\$ 197,199</u>
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term obligations	\$ 3,332	\$ 2,529
Accounts payable and accrued expenses	5,044	6,775
Accrued compensation and benefits	7,092	6,172
Accrual for settlements with third-party payers	1,440	876
Unexpended funds on research grants	7,145	9,311
Due to affiliates	<u>1,502</u>	<u>867</u>
Total current liabilities	<u>25,555</u>	<u>26,530</u>
Other liabilities		
Accrued professional liability	800	813
Accrued employee benefits	2,883	2,769
Accrued other	<u>255</u>	<u>243</u>
	<u>3,938</u>	<u>3,825</u>
Long-term obligations, less current portion	<u>22,835</u>	<u>20,890</u>
Total liabilities	<u>52,328</u>	<u>51,245</u>
Commitments and contingencies		
Net assets		
Unrestricted	86,964	74,972
Temporarily restricted	53,453	44,225
Permanently restricted	<u>26,842</u>	<u>26,757</u>
Total net assets	<u>167,259</u>	<u>145,954</u>
Total liabilities and net assets	<u>\$ 219,587</u>	<u>\$ 197,199</u>

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

The McLean Hospital Corporation
Statements of Operations
Years Ended September 30, 2007 and 2006

<i>(dollars in thousands)</i>	2007	2006
Operating revenue		
Net patient service revenue	\$ 91,562	\$ 84,321
Direct academic and research revenue	37,206	36,363
Indirect academic and research revenue	12,818	13,002
Other revenue	10,404	9,917
Total operating revenue	<u>151,990</u>	<u>143,603</u>
Operating expenses		
Employee compensation and benefits	70,002	63,090
Supplies and other expenses	31,423	28,758
Direct academic and research expenses	37,206	36,363
Depreciation and amortization	5,029	5,455
Provision for bad debts	1,903	2,159
Interest	1,122	1,203
Total operating expenses	<u>146,685</u>	<u>137,028</u>
Income from operations	<u>5,305</u>	<u>6,575</u>
Nonoperating gains (expenses)		
Income from investments	7,308	1,062
Gifts and other	(352)	(140)
Academic and research gifts, net of expenses	292	2,288
System development funding	(2,740)	(2,636)
Total nonoperating gains, net	<u>4,508</u>	<u>574</u>
Excess of revenues over expenses	9,813	7,149
Other changes in net assets		
Change in net unrealized appreciation on marketable investments	-	(3)
Funds utilized for property and equipment	2,028	545
Transfers from affiliates, net	1	4,999
Other	-	(578)
Change in funded status of defined benefit plan	150	-
Cumulative effect of accounting changes	-	(1,113)
Increase in unrestricted net assets	<u>\$ 11,992</u>	<u>\$ 10,999</u>

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

The McLean Hospital Corporation
Statements of Changes in Net Assets
Years Ended September 30, 2007 and 2006

<i>(dollars in thousands)</i>	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets at October 1, 2005	\$ 63,973	\$ 41,506	\$ 26,296	\$ 131,775
Increases (decreases)				
Income from operations	6,575	-	-	6,575
Income from investments	1,062	3,715	-	4,777
Gifts and other	(140)	(1,175)	62	(1,253)
Academic and research gifts, net of expenses	2,288	-	-	2,288
Change in net unrealized appreciation on marketable investments	(3)	-	-	(3)
System development funding	(2,636)	-	-	(2,636)
Funds utilized for property and equipment	545	-	-	545
Transfers from affiliates, net	4,999	-	-	4,999
Other	(578)	179	399	-
Cumulative effect of accounting changes	(1,113)	-	-	(1,113)
Change in net assets	<u>10,999</u>	<u>2,719</u>	<u>461</u>	<u>14,179</u>
Net assets at September 30, 2006	<u>74,972</u>	<u>44,225</u>	<u>26,757</u>	<u>145,954</u>
Increases (decreases)				
Income from operations	5,305	-	-	5,305
Income from investments	7,308	8,719	-	16,027
Gifts and other	(352)	509	85	242
Academic and research gifts, net of expenses	292	-	-	292
System development funding	(2,740)	-	-	(2,740)
Funds utilized for property and equipment	2,028	-	-	2,028
Transfers from affiliates, net	1	-	-	1
Change in funded status of defined benefit plan	150	-	-	150
Change in net assets	<u>11,992</u>	<u>9,228</u>	<u>85</u>	<u>21,305</u>
Net assets at September 30, 2007	<u>\$ 86,964</u>	<u>\$ 53,453</u>	<u>\$ 26,842</u>	<u>\$ 167,259</u>

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

The McLean Hospital Corporation
Statements of Cash Flows
Years Ended September 30, 2007 and 2006

<i>(dollars in thousands)</i>	2007	2006
Cash flows from operating activities		
Change in net assets	\$ 21,305	\$ 14,179
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Cumulative effect of accounting changes	-	1,113
Change in funded status of defined benefit plan	(150)	-
Depreciation and amortization	5,029	5,455
Provision for bad debts	1,903	2,159
Gain on sale of property	-	(506)
Net realized and change in unrealized appreciation on investments	(17,440)	(8,077)
Change in interest in the net assets of The Massachusetts General Hospital	1,936	1,659
Transfers from affiliates, net	(1)	(4,999)
Restricted contributions	(3,634)	(545)
Increase (decrease) in cash resulting from a change in		
Patient accounts receivable	(2,413)	(3,416)
Research grants receivable	(2,903)	1,500
Other current assets	(435)	(119)
Pledges receivable	1,120	(514)
Accounts payable and accrued expenses	(1,731)	4,148
Accrued compensation and benefits	920	222
Accrual for settlements with third-party payers	983	(5,219)
Unexpended funds on research grants	(2,166)	723
Accrued employee benefits and other	263	(222)
Due to affiliates	635	786
Net cash provided by operating activities	<u>3,221</u>	<u>8,327</u>
Cash flows from investing activities		
Purchase of property and equipment	(11,180)	(9,624)
Proceeds from sale of property	-	581
Purchase of investments	(27,575)	(47,276)
Proceeds from sales of investments	30,153	51,325
Net cash used for investing activities	<u>(8,602)</u>	<u>(4,994)</u>
Cash flows from financing activities		
Payments on long-term obligations	(2,529)	(2,321)
Proceeds from long-term obligations	5,277	2,058
Transfers from (to) affiliates	1	(1)
Restricted contributions	3,634	545
Net cash provided by financing activities	<u>6,383</u>	<u>281</u>
Net increase in cash and equivalents	1,002	3,614
Cash and equivalents at beginning of year	7,698	4,084
Cash and equivalents at end of year	<u>\$ 8,700</u>	<u>\$ 7,698</u>

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

The McLean Hospital Corporation

Notes to Financial Statements

September 30, 2007 and 2006

(dollars in thousands)

1. Organization

The McLean Hospital Corporation (McLean) operates a psychiatric hospital established to provide healthcare services to patients primarily from the Greater Boston area as well as New England and beyond. In addition, McLean conducts research and provides education for physicians and other healthcare professionals. As such, operating revenue includes those generated from direct patient care and reimbursement of research and educational activities. McLean HealthCare, Inc. (MHC) is the sole member of McLean.

The Massachusetts General Hospital (MGH) is the sole member of MHC, The General Hospital Corporation, Inc. (General), Massachusetts General Physicians Organization Inc., The MGH Institute of Health Professions, Inc. and The MGH Health Services Corporation.

Partners HealthCare System, Inc. (PHS) is the sole member of MGH, The Brigham and Women's/Faulkner Hospitals, Inc., The North Shore Medical Center, Inc., Newton-Wellesley Hospital, Partners Continuing Care, Inc. and Partners International Medical Services, LLC (PIMS). PHS appoints the two physicians who are the members of Partners Community HealthCare, Inc. PHS, together with all of its affiliates, is referred to as "Partners HealthCare."

McLean and its parent are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code.

2. Summary of Significant Accounting Policies

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting. McLean follows the accounting policies and practices of PHS and these statements should be read in conjunction with the Partners HealthCare consolidated financial statements.

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 period. Actual results could differ from those estimates. Significant estimates are made in the areas of patient accounts receivable, research grants receivable, investments, receivables and accruals for settlements with third-party payers, accrued professional liability, accrued compensation and employee benefits and accrued other.

Fair Value of Financial Instruments

The fair value of financial instruments approximates the carrying amount reported in the balance sheets for cash and equivalents, investments, investments limited as to use, interest in the net assets of MGH, patient accounts receivable, research grants receivable, pledges receivable and accounts payable, except for long-term obligations which is disclosed in Note 6.

Cash and Equivalents

Cash and equivalents represent money market and highly liquid debt instruments with a maturity at the date of purchase of three months or less.

The McLean Hospital Corporation

Notes to Financial Statements

September 30, 2007 and 2006

(dollars in thousands)

Investments

McLean holds investments which represent units in a partnership (Note 3) and are recorded on the equity method of accounting at fair value, with the change in net unrealized appreciation included in excess of revenues over expenses as a component of income from investments. Separately invested investments (marketable investments) are measured at fair value, generally based on quoted market prices, with the change in net unrealized appreciation excluded from excess of revenues over expenses.

Income from investments (including realized gains and losses, change in net unrealized appreciation on equity method investments, interest, dividends, and endowment income distributions) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law. Income from investments is reported net of investment-related expenses.

A write-down in the cost basis of securities is recorded when the decline in fair value of certain investments below costs has been judged to be other-than-temporary. Depending on any donor-imposed restrictions on the underlying investments, the amount of the write-down is reported as a realized loss in either temporarily restricted net assets or in excess of revenues over expenses as a component of income from investments, with no adjustment in the cost basis for subsequent recoveries in fair value.

Partners HealthCare has an endowment spending policy for pooled endowment funds. A fixed distribution rate for spending is determined each year which will come from either income and/or net accumulated gains in fair value.

Investments Limited as to Use

Investments limited as to use primarily include assets whose use is contractually limited by external parties and assets set aside by the Board of Trustees (or management) for identified purposes, over which the Board (or management) retains control and may, at its discretion, subsequently use for other purposes. Certain investments corresponding to deferred compensation are accounted for such that all income and appreciation (depreciation) is recorded as a direct addition (reduction) to the asset balance and corresponding liability balance.

Patient Accounts Receivable

McLean receives payments for services rendered from federal and state agencies (under the Medicare and Medicaid programs), managed care payers, commercial insurance companies, and patients. Patient accounts receivable are reported net of contractual allowances and reserves for denials, uncompensated care, and doubtful accounts. The level of reserves is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in federal and state governmental and private employer health care coverage and other collection indicators.

Research Grants Receivable

McLean receives research funding from departments and agencies of the U.S. Government, industry and corporate sponsors, and other private sponsors. Research grants receivable include amounts due from these sponsors of externally funded research. The amounts have been billed or are billable to the sponsor, or in limited circumstances, represent accelerated spending in anticipation of future funding. Research grants receivable are reported net of reserves for uncollectible accounts.

The McLean Hospital Corporation

Notes to Financial Statements

September 30, 2007 and 2006

(dollars in thousands)

Interest in the Net Assets of The Massachusetts General Hospital

MGH holds investment assets for the benefit of McLean. Due to the corporate relationship between MGH, MHC and McLean, these organizations are all financially interrelated. Accordingly, McLean recognizes its interest in the net assets of MGH and adjusts that interest for its share of the change in the net assets of MGH. Changes due to gifts, investment income (including realized gains and losses) and unrealized appreciation are recognized in nonoperating activity.

Property and Equipment

Property and equipment is reported on the basis of cost less accumulated depreciation. Donated items, exclusive of transfers from related organizations, are recorded at fair value at the date of contribution. All research grants received for capital are recorded in the year of expenditure as a change in net assets. Property and equipment is reviewed for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

Depreciation of property and equipment is calculated by use of the straight-line method at rates intended to depreciate the cost of assets over their estimated useful lives, which generally range from three to forty years. Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized, net of any interest earned, as a component of the cost of acquiring those assets.

Asset Retirement Obligations

Asset retirement obligations, reported in accrued other, are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. McLean records changes in the liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. McLean reduces these liabilities when the related obligations are settled.

Compensated Absences

In accordance with formal policies concerning vacation and other compensated absences, accruals of approximately \$3,398 and \$3,077 were recorded as of September 30, 2007 and 2006, respectively.

Unexpended Funds on Research Grants

Research grants received in advance of corresponding grant expenditures are accounted for as a direct addition to investments limited as to use and unexpended funds on research grants.

Self-Insurance Reserves

McLean is self-insured for employee healthcare, workers' compensation and certain other employee benefits. These costs are accounted for on an accrual basis to include estimates of future payments for claims incurred.

The McLean Hospital Corporation

Notes to Financial Statements

September 30, 2007 and 2006

(dollars in thousands)

Net Assets

Permanently restricted net assets include only the historical dollar amounts of gifts which are required by donors to be permanently retained. Temporarily restricted net assets include gifts, and income and gains on permanently restricted net assets which can be expended but for which restrictions have not yet been met. Such restrictions include purpose restrictions where donors have specified the purpose for which the net assets are to be spent, or time restrictions imposed by donors or implied by the nature of the gift (capital projects, pledges to be paid in the future, life income funds) or by interpretations of law (gains available for appropriation but not appropriated in the current period).

Realized gains and losses are classified as unrestricted net assets unless they are restricted by the donor or law. Unless permanently restricted by the donor, realized gains and unrealized net appreciation on permanently restricted gifts are classified as temporarily restricted until appropriated for spending by McLean in accordance with policies established by Partners HealthCare and the Massachusetts Management of Institutional Funds Act. Net losses on permanently restricted endowment funds are classified as a reduction to unrestricted net assets until such time as the fair value exceeds book value. Unrestricted net assets include all the remaining net assets of McLean. See Note 12 for further information on the composition of restricted net assets.

Gifts and Grants

Unconditional promises to give cash and other assets to McLean are reported at fair value at the date the promise is received. Conditional promises to give are recognized when the conditions are substantially met. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted gifts in the accompanying financial statements.

Gifts of long-lived assets with explicit restrictions that specify use of assets and gifts of cash or other assets that must be used to acquire long-lived assets are reported as additions to temporarily restricted net assets if the assets are not placed in service during the year.

Grants and contracts normally provide for the recovery of direct and indirect costs, subject to audit. McLean recognizes revenue associated with direct and indirect costs as direct costs are incurred. The recovery of indirect costs is based on predetermined rates for U.S. government grants and contracts and negotiated rates for other grants and contracts.

Statements of Operations

All activities of McLean deemed by management to be ongoing, major and central to the provision of healthcare services, training and research activities are reported as operating revenue and expenses. Other activities are deemed to be nonoperating and include unrestricted gifts (net of fund-raising expenses), net change in unexpended academic and research gifts, substantially all income from investments and system development funding. System development funding represents payments made to PHS for corporate expenses and to support clinical and other

The McLean Hospital Corporation

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September 30, 2007 and 2006

(dollars in thousands)

initiatives provided by PHS for the benefit of Partners HealthCare. Academic and research gifts largely consist of donor contributions (and the related investment income including realized gains and losses) designated to support the clinical, teaching or research efforts of a physician or department as directed by the donor. These gifts are reported as unrestricted support as any donor restrictions are of a general nature that are inherent in the normal activities of the organization and do not require classification of these gifts as temporarily or permanently restricted.

The statements of operations include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses include change in unrealized appreciation on marketable investments, transfers of assets to and from affiliates, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for acquisition of such assets) and change in funded status of the defined benefit plan.

In September 2006, the Securities and Exchange Commission staff issued Staff Accounting Bulletin ("SAB") No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify and assess the materiality of financial statement misstatements. Although the SAB was directly applicable to public companies, McLean elected to follow the prescribed guidance.

Prior to fiscal 2006, McLean recorded estimated accruals for settlements with third-party payers and certain other liabilities above specific accrual amounts. In addition, changes in third-party payer settlement estimates were generally amortized into income over a period not to exceed five years rather than recorded in total in the year of the change in estimate. The adoption of SAB 108 as of October 1, 2005 resulted in a decrease in accruals for settlements with third-party payers of \$869 and a decrease in accounts payable and accrued expenses of \$1,297. Adjustment of other differences resulted in a decrease in property and equipment of \$1,943. The impact of these adjustments resulted in a net increase of \$223 in unrestricted net assets. For the years ended September 30, 2007 and 2006, adjustments to prior year estimates resulted in an increase to income from operations of \$1,733 and \$2,130, respectively.

Net Patient Service Revenue

McLean maintains agreements with the Centers for Medicare and Medicaid Services (CMS) of the United States Department of Health and Human Services (DHHS) under the Medicare Program, The Commonwealth of Massachusetts under the Medical Assistance Program (Medicaid) and various managed care payers that govern payment to McLean for services rendered to patients covered by these agreements. The agreements generally provide for payments based on allowable costs, subject to certain limitations, or per diem rates for inpatient care and discounted charges or fee schedules for outpatient care.

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payers, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Contracts, laws and

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Notes to Financial Statements

September 30, 2007 and 2006

(dollars in thousands)

regulations governing the Medicare and Medicaid programs and managed care payer arrangements are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Charity Care

McLean provides either full or partial charity care to patients who cannot afford to pay for their medical services based on income and family size. Charity care is reported at gross charges with an offsetting allowance, as there is no expectation of collection. Accordingly, there is no net patient service revenue related to charity care.

Other Revenue

Other revenue primarily consists of institutional revenue (for example, billing for services provided to other healthcare providers) and tuition revenue.

3. Investments and Investments Limited as to Use

Investments are either separately invested or included in pooled investment funds. The Partners HealthCare System Pooled Investment Accounts (Partnership) is structured as a single general partnership composed of four investment pools, with PHS and substantially all of its affiliates participating in the pools as partners. Each partner's interest in the Partnership is based on its underlying investments in one or more of the four separate pools. Amounts included in the investment pools are accounted for using the fair value method whereby each partner is assigned a number of units based on the fair value of the assets of a pool at the time of entry of the funds into the pool. Current fair value is used to determine the number of units allocated to additional amounts placed in a pool and to value withdrawals from a pool. Income from investments of the pools, including realized gains and losses, is allocated on a unitized basis to a partner based on the partner's share of units in a pool.

The Partnership participates in a securities lending program with its custodian bank whereby securities are loaned to qualified financial institutions in exchange for collateral. Investments that have been loaned to another institution are reported as pledged assets in the consolidated financial statements of Partners HealthCare. Cash or investments received as collateral on the securities lending transaction are also reported as assets in the consolidated balance sheets. Because the collateral must be returned in the future, a corresponding liability is reported in the consolidated financial statements.

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

The composition of investments and investments limited as to use is as follows:

		September 30, 2007		
	Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value
Pooled investments				
Invested cash equivalents	\$ 2,845	\$ -	\$ -	\$ 2,845
Equities	11,550	2,850	-	14,400
U.S. Government, domestic and foreign fixed income securities	16,084	319	(61)	16,342
Private partnerships and other	13,309	4,726	(33)	18,002
Accruals, net	187	-	-	187
	<u>43,975</u>	<u>7,895</u>	<u>(94)</u>	<u>51,776</u>
Separately invested				
Invested cash equivalents	661	-	-	661
Equities	1,731	-	-	1,731
U.S. Government and domestic fixed income securities	903	-	-	903
	<u>3,295</u>	<u>-</u>	<u>-</u>	<u>3,295</u>
	<u>\$ 47,270</u>	<u>\$ 7,895</u>	<u>\$ (94)</u>	<u>\$ 55,071</u>
		September 30, 2006		
	Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value
Pooled investments				
Invested cash equivalents	\$ 3,081	\$ -	\$ -	\$ 3,081
Equities	9,400	1,248	(130)	10,518
U.S. Government, domestic and foreign fixed income securities	18,728	169	(224)	18,673
Private partnerships and other	14,012	2,861	(6)	16,867
Accruals, net	218	-	-	218
	<u>45,439</u>	<u>4,278</u>	<u>(360)</u>	<u>49,357</u>
Separately invested				
Invested cash equivalents	424	-	-	424
Equities	1,519	-	(3)	1,516
U.S. Government and domestic fixed income securities	838	-	-	838
	<u>2,781</u>	<u>-</u>	<u>(3)</u>	<u>2,778</u>
	<u>\$ 48,220</u>	<u>\$ 4,278</u>	<u>\$ (363)</u>	<u>\$ 52,135</u>

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

The fair value and gross unrealized depreciation of investments and investments limited as to use, with a fair value less than cost, that are not deemed to be other-than-temporarily impaired at September 30, 2007 are as follows:

	Less than 12 Months		12 Months or Greater	
	Fair	Gross	Fair	Gross
	Value	Unrealized	Value	Unrealized
		Depreciation		Depreciation
Pooled investments				
U.S. Government, domestic and foreign fixed income securities	\$ 304	\$ (52)	\$ 360	\$ (9)
Private partnerships and other	584	(33)	-	-
	<u>\$ 888</u>	<u>\$ (85)</u>	<u>\$ 360</u>	<u>\$ (9)</u>

Securities with unrealized depreciation are reviewed each quarter to determine whether these investments are other-than-temporarily impaired. Externally managed marketable investments with fair value below cost are considered to be other-than-temporarily impaired and, accordingly, the unrealized depreciation is recognized as realized losses. All other investments are subject to a further review, which considers factors including the anticipated holding period for the investment and the extent and duration of below cost valuation. Based on management's evaluation of investments with a fair value less than cost at September 30, 2007, no other-than-temporary impairment was determined to have occurred.

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

Investments and investments limited as to use are recorded in the balance sheet as follows:

	September 30,	
	2007	2006
Current assets		
Investments	\$ 11,189	\$ 9,598
Current portion of investments limited as to use	<u>16,158</u>	<u>23,997</u>
	27,347	33,595
Investments limited as to use, less current portion	19,185	11,623
Long-term investments	<u>8,539</u>	<u>6,917</u>
	<u>\$ 55,071</u>	<u>\$ 52,135</u>

Investments limited as to use consist of the following:

	September 30, 2007		September 30, 2006	
	Current Portion	Long-Term Portion	Current Portion	Long-Term Portion
Internally designated funds				
Reserve for capital expenditures	\$ 4,466	\$ -	\$ 5,531	\$ -
Unexpended academic and research gifts	-	13,048	-	6,031
Other	<u>4,045</u>	<u>5,860</u>	<u>7,000</u>	<u>5,557</u>
	8,511	18,908	12,531	11,588
Externally limited funds				
Unexpended funds on research	7,145	-	9,311	-
Held by trustees under debt and other agreements	<u>502</u>	<u>277</u>	<u>2,155</u>	<u>35</u>
	<u>\$ 16,158</u>	<u>\$ 19,185</u>	<u>\$ 23,997</u>	<u>\$ 11,623</u>

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

Investment income and gains (losses) from cash and equivalents, investments (including long-term) and investments limited as to use are comprised of the following:

	Years Ended September 30,	
	2007	2006
Unrestricted		
Dividends and interest income	\$ 1,178	\$ 1,046
Endowment income distributions, net of reinvested gains	2,322	2,147
Net realized gains (losses) on investments		
Trading gains	2,373	4,275
Other-than-temporary impairment	(289)	(14)
Change in net unrealized appreciation on equity method investments	<u>5,172</u>	<u>(1,124)</u>
Total investment activity included in excess of revenues over expenses	10,756	6,330
Change in net unrealized appreciation on marketable investments	<u>-</u>	<u>(3)</u>
Total unrestricted investment activity	<u>10,756</u>	<u>6,327</u>
Temporarily restricted		
Dividends and interest income	857	913
Endowment income distributions	(2,322)	(2,141)
Net realized gains (losses) on investments		
Trading gains	2,750	6,371
Other-than-temporary impairment	<u>(121)</u>	<u>(5)</u>
	1,164	5,138
Change in net unrealized appreciation on equity method investments	<u>7,555</u>	<u>(1,423)</u>
Total temporarily restricted investment activity	<u>8,719</u>	<u>3,715</u>
	<u>\$ 19,475</u>	<u>\$ 10,042</u>

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

Investment income included in operating results and excess of revenues over expenses are comprised of the following:

	Years Ended September 30,	
	2007	2006
Investment income included in operations and reported in		
Other revenue	\$ 649	\$ 619
Investment income included in nonoperating gains (expenses) and reported in		
Income from investments	7,308	1,062
Academic and research gifts, net of expenses	<u>2,799</u>	<u>4,649</u>
Total investment activity included in excess of revenues over expenses	<u>\$ 10,756</u>	<u>\$ 6,330</u>

4. Pledges Receivable

Pledges receivable represent unconditional promises to give and are net of allowances for uncollectible amounts. Pledges are recorded at the present value of their estimated future cash flows. Pledges collectible within one year are classified as other current assets and total \$1,508 and \$1,297 as of September 30, 2007 and 2006, respectively. Estimated cash flows due after one year are discounted using published treasury bond and note yields that are commensurate with estimated collection risks. The blended discount rate was 4.1% and 4.6% for 2007 and 2006, respectively. Pledges are expected to be collected as follows:

	September 30,	
	2007	2006
Amounts due		
Within one year	\$ 1,808	\$ 1,318
In one to five years	2,482	4,170
In more than five years	<u>20</u>	<u>34</u>
Total pledges receivable	4,310	5,522
Less: Unamortized discount	<u>259</u>	<u>597</u>
	4,051	4,925
Less: Allowance for uncollectibles	<u>346</u>	<u>100</u>
Net pledges receivables	<u>\$ 3,705</u>	<u>\$ 4,825</u>

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

5. Property and Equipment

Property and equipment consists of the following:

	September 30,	
	2007	2006
Land and land improvements	\$ 1,550	\$ 1,672
Buildings and building improvements	87,443	89,598
Equipment	11,977	10,480
Construction in progress	10,131	4,979
	<u>111,101</u>	<u>106,729</u>
Accumulated depreciation	<u>(55,512)</u>	<u>(57,291)</u>
Property and equipment, net	<u>\$ 55,589</u>	<u>\$ 49,438</u>

For the years ended September 30, 2007 and 2006, fully depreciated assets with an original cost of \$6,808 and \$5,553, respectively, were written off.

In 2005, McLean sold 26.2 acres of land to Northland Development Company for \$14,376 and recorded a net gain of \$10,567. McLean has also executed purchase and sale agreements to sell 24.7 acres of land for development of a senior housing community and a research and development facility. The sale is expected to take place in 2008, after the necessary permits are obtained.

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. ("FIN") 47, *Accounting for Conditional Asset Retirement Obligations*. Under FIN 47 an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Uncertainty about the timing or method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists.

McLean implemented FIN 47 at September 30, 2006 and recorded conditional asset retirement obligations of approximately \$243. These conditional asset retirement obligations relate to certain materials requiring specific remediation efforts. Upon implementation of FIN 47, McLean recorded a \$243 reduction in unrestricted net assets which was recorded as a cumulative effect of a change in accounting principle.

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

6. Long-Term Obligations

Long-term obligations consist of the following:

	September 30,	
	2007	2006
Note payable to PHS		
Partners HealthCare Capital Framework Loan, variable interest rate of 5.10% and 5.11% at September 30, 2007 and 2006, respectively, final maturity in 2015	\$ 26,167	\$ 23,419
Less current portion	<u>3,332</u>	<u>2,529</u>
	<u>\$ 22,835</u>	<u>\$ 20,890</u>

The Partners HealthCare Capital Framework Loan bears interest at a variable rate based upon the weighted average cost of Partners HealthCare's debt, reset annually, effective October 1.

Aggregate maturities and payments of long-term obligations during the next five years are as follows: 2008 - \$3,332; 2009 - \$3,463; 2010 - \$3,636, 2011 - \$3,160 and 2012 - \$3,325.

Long-term obligations have variable interest rates that reflect currently available terms and conditions for similar debt. The carrying amounts for this debt is a reasonable estimate of its fair value.

Interest expense approximates interest paid during the years ended September 30, 2007 and 2006.

7. Leases

McLean has noncancelable operating leases for certain equipment and a building. Rental expense under these and other contracts approximated \$2,080 and \$2,106 in 2007 and 2006, respectively. Minimum future lease commitments under noncancelable leases are as follows:

	Operating Leases
2008	\$ 707
2009	<u>119</u>
Total lease payments	<u>\$ 826</u>

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

8. Pension and Postretirement Healthcare Plans

Pension Plan

Substantially all employees of MGH and its affiliates are covered under The Massachusetts General Hospital Cash Balance Retirement Plan (MGH Plan), a noncontributory defined benefit plan. Benefits under the MGH Plan consist of annual allocations to participants' accounts based on the participants' age, years of service and salary. Interest is credited to participants' accounts annually at market rates.

Pension expense under the MGH Plan for all affiliates amounted to \$67,026 in 2007 and \$46,371 in 2006. The amount of pension expense allocated to McLean was \$3,952 in 2007 and \$3,235 in 2006.

Postretirement Healthcare Benefit Plan

McLean also provides subsidized healthcare benefits for qualified retired employees on a self-insured basis. These benefits are administered through an insurance company and are accounted for on the accrual basis, which includes an estimate of future payments for claims incurred. McLean uses a measurement date of June 30 for the postretirement healthcare benefit plan.

Benefit Obligation

Change in Benefit Obligation	2007	2006
Benefit obligation at beginning of year	\$ 4,165	\$ 5,133
Service cost	2	3
Interest cost	245	280
Assumption changes	-	(66)
Actuarial (gain) loss	302	(648)
Benefits paid	<u>(500)</u>	<u>(537)</u>
Benefit obligation at end of year	<u>\$ 4,214</u>	<u>\$ 4,165</u>

Weighted-Average Assumptions Used to Determine End of Year Benefit Obligation

	2007	2006
Discount rate	6.25%	6.25%
Healthcare cost trend rate for next year	9.00%	9.00%
Rate to which the cost trend rate is to decline	5.00%	5.00%
Year that rate reaches the ultimate trend rate	2012	2011

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the healthcare plan. A one-percentage-point change in assumed healthcare cost trend rates would have the following effect:

	One-Percentage-Point Increase	One-Percentage-Point Decrease
Effect on postretirement benefit obligation	\$ 181	\$ (166)

Plan Assets

Change in Plan Assets	2007	2006
Fair value of plan assets at beginning of year	\$ 4,689	\$ 5,076
Actual return on plan assets	738	236
Net employer contributions (disbursements)	(44)	(86)
Benefits paid	(500)	(537)
Fair value of plan assets at end of year	<u>\$ 4,883</u>	<u>\$ 4,689</u>

McLean's benefit plan weighted-average target asset allocation ranges as well as actual allocations by asset category for 2007 and 2006 are as follows:

Asset Category	Target Allocation	Percentage of Plan Assets	
		2007	2006
Domestic equity securities	40% - 60%	50.4%	49.0%
Foreign equity securities	10% - 30%	24.9%	22.4%
Fixed income securities	20% - 40%	24.7%	28.6%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

The investment objective is to achieve the highest reasonable total return after considering (i) plan liabilities, (ii) funding status and projected cash flows, (iii) projected market returns, valuations and correlations for various asset classes, and (iv) Partners' ability and willingness to incur market risk.

Funded Status

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158). SFAS 158 focuses primarily on balance sheet reporting for the funded status of benefit plans and requires recognition of benefit liabilities for under-funded plans and benefit assets for over-funded plans, with offsetting impacts to unrestricted net assets. McLean elected to early adopt the balance sheet recognition provisions of SFAS 158 as of September 30, 2006. The impact of adoption resulted in a net decrease of \$1,093 in unrestricted net assets, which was recorded as a cumulative effect of a change in accounting principle.

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

SFAS 158 also requires companies to measure benefit plan assets and liabilities and determine the discount rate for subsequent year expense recognition as of the balance sheet date for financial reporting purposes, thus eliminating the opportunity to use a measurement date up to 90 days prior to the balance sheet date. The effective date for this change is 2009. McLean currently uses a June 30 measurement date and will adopt a September 30 measurement date in 2009 as required. Converting to the new measurement date will require a one-time adjustment to unrestricted net assets per the transition guidance in SFAS 158.

The funded status of the plan, and the related amounts recognized in the balance sheet, follows:

End of Year	2007	2006
Fair value of plan assets at measurement date	\$ 4,883	\$ 4,689
Net disbursements recorded after measurement date	(364)	(408)
Benefit obligation at measurement date	<u>(4,214)</u>	<u>(4,165)</u>
Funded status	<u>\$ 305</u>	<u>\$ 116</u>
Amounts recognized in the balance sheet consist of:		
Noncurrent assets	\$ 305	\$ 116
Amounts recognized in unrestricted net assets consist of:		
Actuarial net loss	\$ 943	\$ 1,093

Expected Cash Flows

Information about the expected cash flows for the postretirement healthcare benefit plan follows:

Expected employer contributions 2008	\$ 519	
	Gross Benefit Payments	Medicare Subsidy
Expected benefit payments (receipts) 2008	\$ 567	\$ (48)
2009	570	(47)
2010	555	(46)
2011	532	(44)
2012	502	(41)
2013 and thereafter	1,986	(161)

Net Periodic Benefit Cost	2007	2006
Service cost	\$ 2	\$ 3
Interest cost	245	280
Expected return on plan assets	(352)	(381)
Amortization of actuarial net loss	66	124
Net periodic benefit cost (benefit)	<u>\$ (39)</u>	<u>\$ 26</u>

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

The actuarial net loss of McLean for the retirement healthcare benefit plan that will be amortized from unrestricted net assets into net periodic benefit cost in 2008 is \$50.

Weighted-Average Assumptions Used to Determine Net Periodic Cost	2007	2006
Discount rate	6.25%	5.75%
Expected return on plan assets	7.50%	7.50%
Healthcare cost trend rate for this year	9.00%	10.00%
Rate to which the cost trend rate is to decline	5.00%	5.00%
Year that rate reaches the ultimate trend rate	2011	2011

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the healthcare plans. A one-percentage-point change in assumed healthcare cost trend rates would have the following effect:

	One-Percentage-Point Increase	One-Percentage-Point Decrease
Effect on service and interest cost	\$ 11	\$ (10)

9. Professional Liability Insurance

McLean insures substantially all of its professional and general liability risk on a claims-made basis in cooperation with PHS affiliates and other organizations in the Greater Boston area through a captive insurance company, Controlled Risk Insurance Company Ltd. (CRICO). The policy covers claims made during its term, but not those occurrences for which claims may be made after expiration of the policy, except for certain tail liabilities which CRICO has assumed on an occurrence basis through December 31, 2007. Management intends to renew its coverage on a claims-made basis and has no reason to believe that it will be prevented from such renewal.

McLean follows the accounting policy of establishing reserves to cover all professional liability claims incurred but not reported to the insurance company as of the end of the year (tail liability), excluding the tail liability assumed by CRICO. These reserves have been estimated by consulting actuaries on a discounted basis using an interest rate of 5.75% at September 30, 2007 and 2006.

Management is not aware of any claims against McLean or factors affecting CRICO that would cause the expense for professional liability risks to vary materially from the amount provided.

10. Transactions with Affiliated Corporations

McLean received fund-raising, investment management, legal, financial and administrative services from PHS and affiliates. These services are reimbursed on an estimated cost basis and amounted to \$13,940 in 2007 and \$12,421 in 2006. McLean received salary and other expense reimbursements from PHS of \$346 in 2007 and \$415 in 2006.

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

During 2007 and 2006, McLean received net funds from PHS. These equity transfers are reported separately as changes in net assets and are excluded from excess of revenues over expenses. Amounts transferred were as follows:

	Years Ended September 30,	
	2007	2006
Transfers from (to)		
PHS	\$ 1	\$ (1)
Liability transfer to PHS	-	5,000
	<u>\$ 1</u>	<u>\$ 4,999</u>

11. Concentration of Credit Risk

Financial instruments that potentially subject McLean to concentration of credit risk consist of patient accounts receivable, research grants receivable, pledges receivable and certain investments. McLean receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payers, including Medicare, Medicaid, Blue Cross and Blue Shield of Massachusetts, Harvard Pilgrim Health Care and Tufts Associated Health Plan. Research funding is provided through many government and private sponsors. Pledges receivable are due from multiple donors. McLean considers the credit risk for pledges to be minimal based on history and the financial wherewithal of donors, most of which are individuals or organizations well known to the hospital. Investments, which include government and agency securities, stocks and corporate bonds, and private partnerships and other investments are not concentrated in any corporation or industry or with any single counterparty. McLean has not historically incurred any significant credit losses outside the normal course of business.

12. Restricted Net Assets

Restricted net assets are available for the following purposes:

	September 30,	
	2007	2006
Temporarily restricted		
Charity care	\$ 6,051	\$ 5,241
Buildings and equipment	7,037	5,016
Clinical care, research and academic	40,365	33,968
	<u>\$ 53,453</u>	<u>\$ 44,225</u>
Permanently restricted		
Charity care	\$ 454	\$ 452
Clinical care, research and academic	26,388	26,305
	<u>\$ 26,842</u>	<u>\$ 26,757</u>

The McLean Hospital Corporation
Notes to Financial Statements
September 30, 2007 and 2006

(dollars in thousands)

13. Functional Expenses

Total operating expenses by function are as follows:

	Years Ended September 30,	
	2007	2006
Healthcare services	\$ 82,726	\$ 76,219
Research and academic	50,024	49,365
General and administrative	<u>13,935</u>	<u>11,444</u>
	<u>\$ 146,685</u>	<u>\$ 137,028</u>

14. Investment Transfer

Effective October 1, 2007, the Board of Trustees of McLean approved the permanent transfer of substantially all unrestricted investments to its parent, MHC. In addition, in conjunction with the board resolution, all system development funding will become the responsibility of MHC. Temporarily and permanently restricted investments, as well as externally limited investments, will continue to be included in the financial statements of McLean. McLean will account for this transaction as a net asset transfer in fiscal 2008. The impact of this transfer will be to reduce investments and unrestricted net assets by \$56,643.

15. Contingencies

McLean is subject to complaints, claims and litigation which have risen in the normal course of business. In addition, McLean is subject to reviews by various federal and state government agencies to assure compliance with applicable laws, some of which are subject to different interpretations. Recently, governmental review of compliance by healthcare institutions, including McLean, has increased.

The McLean Hospital Corporation

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2007

	Federal CFDA Number	Pass-Through Number	Total Federal Expenditures
RESEARCH AND DEVELOPMENT AND RESEARCH TRAINING CLUSTER			
Research and Development Direct Programs			
Department of Health and Human Services			
National Institutes of Health			
National Institute on Deafness & Other Communication Disorders	93.173		\$ 227,461
National Center for Complementary & Alternative Medicine	93.213		1,382,170
Mental Health Research Grant	93.242		10,201,163
Alcohol Research Programs	93.273		(37,485)
Drug Abuse Research Programs	93.279		12,139,718
National Center for Research Resources	93.389		300,160
Neurological Disorders Research	93.853		3,596,015
Biological Basis Research	93.854		(33,551)
Child Health and Human Development	93.865		97,516
Aging Research	93.866		613,005
Subtotal - Department of Health and Human Services			<u>28,486,172</u>
Department of Defense			
Military Medical Research and Development	12.420		<u>1,155,974</u>
Subtotal - Department of Defense			<u>1,155,974</u>
Department of Education & United States Secret Service			
	21.000		<u>(28,303)</u>
Subtotal - Department of Education & United States Secret Service			<u>(28,303)</u>
National Science Foundation			
Education and Human Resources	47.076		<u>261,911</u>
Subtotal - National Science Foundation			<u>261,911</u>
Total Research and Development Direct Programs			<u>29,875,754</u>
Research and Development Passed Through Other Organizations			
Department of Health and Human Services			
National Institutes of Health			
Albany Medical College	93.213	1 R21 AT003371-01A1	27,745
Brigham and Women's Hospital, Inc.	93.226	1 P01 HS11534-04	(2,149)
Brigham and Women's Hospital, Inc.	93.273	1 R01 AA016318-01	9,434
Eagle Vision Pharmaceutical Corporation	93.848	R43 DK076429	3,425
Harvard Medical School	93.121	K12 DE014528	107,348
Harvard Medical School	93.156	6 D01 HP000002-01-03	(4,164)
Harvard Medical School	93.242	5 R01 MH069721	840
Harvard Medical School	93.242	5 R01 MH59559-04	78,239
Harvard Medical School	93.242	K01 MH071714	139,971
Harvard School of Public Health	93.853	5 P30 AG024409-03	4,952
Harvard University	93.242	2 R01 MH31340	19,251
Joslin Diabetes Center	93.827	1 R01 DK60754	3,692
Joslin Diabetes Center	93.847	1 R01 DK073843-01A2	35,424
Massachusetts General Hospital	93.279	5 U01 DA019378-02	138,526
McGill University	93.242	N01MH90002	103,671
Molecular Insight Pharmaceuticals, Inc.	93.865	1 R43 HD046194-01	(113,911)
MyNeuroLab.com	93.853	1 R43 NS055600-01	3,335
Natural Pharmacia International	93.213	R42 AT00766-01	(410)
Natural Pharmacia International	93.273	2 R44 AA015220-03A2	69,598
Research Foundation for Mental Hygiene	93.242	N01MH60012	29,154
Research Foundation for Mental Hygiene	93.866	1 R01 AG16381-01A1	102,534
Research Foundation for Mental Hygiene	93.866	P01 AG017617-06	129,421

The McLean Hospital Corporation
Schedule of Expenditures of Federal Awards
Year Ended September 30, 2007

	Federal CFDA Number	Pass-Through Number	
University of Chicago	93.279	R01 DA014644-06	\$ 9
University of Chicago	93.279	R01 DA017323-02	28,307
University of Cincinnati	93.279	5 R01 DA14644-03	1,640
University of Cincinnati	93.279	1 R01 DA017323-01A2	14,069
University of Maryland	93.213	5 P01 AT002605-02	52,470
University of Texas Southwestern Medical	93.242	5 P50 MH66172-05	63,006
University of Texas Southwestern Medical	93.242	5 P50 MH66172-05	73,741
University of Texas Southwestern Medical	93.279	5 P01 DA008227-16	44,401
Yale University	93.242	5 R21 MH067066-02	(138)
Yale University	93.865	2 U19 HD35482-10	<u>53,757</u>
Subtotal - Department of Health and Human Services			<u>1,217,188</u>
Department of the Navy			
University of Arizona	12.300	N00014-05-1-0807	<u>(6,497)</u>
Subtotal - Department of the Navy			<u>(6,497)</u>
Department of Education			
Southwest Educational Development Laboratory	84.133	ED-03-CO-0048	<u>7,962</u>
Subtotal - Department of Education			<u>7,962</u>
Total Research and Development Pass-Through Programs			<u>1,218,653</u>
Total Research and Development			<u>31,094,407</u>
Research Training Direct Programs			
Department of Health and Human Services			
National Institutes of Health			
Alcohol Research Career Development Awards	93.271		135,621
Drug Abuse Research Programs	93.278		264,559
Drug Abuse Research Service Awards	93.277		464,104
Mental Health Research Career/Scientist Development Awards	93.281		162,678
Drug Abuse and Addiction Research Programs	93.279		<u>920,058</u>
Subtotal - Department of Health and Human Services			<u>1,947,020</u>
Total Research Training Direct Programs			<u>1,947,020</u>
Research Training Passed Through Other Organizations			
Department of Health and Human Services			
National Institute of Health			
Harvard Medical School	93.242	5 T32 MH016259-28	<u>57,695</u>
Subtotal - Department of Health and Human Services			<u>57,695</u>
Department of Education			
City of Boston	84.334	BPS06221	<u>1,132</u>
Subtotal - Department of Education			<u>1,132</u>
Total Research Training Pass-Through Programs			<u>58,827</u>
Total Research Training			<u>2,005,847</u>
Total Research and Development and Research Training Cluster			<u>33,100,254</u>
OTHER PROGRAMS			
Passed Through from the Commonwealth of Massachusetts			
Temporary Assistance for Needy Families	93.558		350
Social Services Block Grant	93.667		<u>274</u>
Total Other Programs			<u>624</u>
Total Federal Expenditures			<u>\$ 33,100,878</u>

The McLean Hospital Corporation
Notes to Schedule of Expenditures of Federal Awards
September 30, 2007

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant transactions of The McLean Hospital Corporation (the "Hospital") recorded on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in or used in the preparation of the basic financial statements. Negative amounts represent adjustments or credits to amounts reported as expenditures in prior years. Pass-through numbers are provided where available.

2. Facilities and Administrative Costs

The predetermined facilities and administrative cost rates were based on financial information submitted utilizing the method prescribed in OASC-3. The Hospital negotiated and was awarded a predetermined facilities and administrative cost rate of 61% for the period October 1, 2003 through September 30, 2007 for research and development. The Hospital also was awarded a fixed fringe benefit rate of 25% for the period October 1, 2006 through September 30, 2007.

3. Subrecipients

During fiscal 2007, the Hospital provided to subrecipients in the Research and Development and Research Training Program \$2,682,516, as follows. These amounts are included in the accompanying Schedule of Expenditures of Federal Awards:

Adcare Hospital	\$ 26,240
Autism Speaks	222,706
Beth Israel Deaconess Hospital	76,707
Boston University	163,620
Brandeis University	179,883
Brown University	7,758
Cab Health and Recovery Services	15,655
Exploratorium	24,615
Massachusetts General Hospital	370,511
Mercy Hospital	95,456
Northeastern University	320,061
Research Foundation Mental Hygiene	156,202
Research Foundation of the State University of New York	89,353
Reginald Clark and Associates	13,602
Rhode Island Hospital	10,322
Stanley Street Treatment Resources	373,413
Temple University	76,634
Tufts University	3,858
University of California	29,067
University of New Mexico	29,875
University of North Carolina	101,773
University of Rochester	100,211
University of Texas	136,468
Wellesley College	58,526
	<u>\$ 2,682,516</u>

Part II

Reports on Compliance and Internal Controls

Report of Independent Auditors on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Trustees of
The McLean Hospital Corporation

We have audited the financial statements of The McLean Hospital Corporation as of and for the year ended September 30, 2007 and have issued our report thereon dated December 20, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered The McLean Hospital Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of The McLean Hospital Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of The McLean Hospital Corporation's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control

that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether The McLean Hospital Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of The McLean Hospital Corporation in a separate letter dated December 19, 2007.

This report is intended solely for the information and use of The McLean Hospital Corporation's Board of Trustees, management, federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

December 20, 2007

**Report of Independent Auditors on Compliance with Requirements
Applicable to Each Major Program and on Internal Control over Compliance
in Accordance with OMB Circular A-133**

To the Board of Trustees of
The McLean Hospital Corporation

Compliance

We have audited the compliance of The McLean Hospital Corporation with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2007. The McLean Hospital Corporation's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of The McLean Hospital Corporation's management. Our responsibility is to express an opinion on The McLean Hospital Corporation's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about The McLean Hospital Corporation's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of The McLean Hospital Corporation's compliance with those requirements.

In our opinion, The McLean Hospital Corporation complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2007.

Internal Control over Compliance

The management of The McLean Hospital Corporation is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered The McLean Hospital Corporation's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly we do not express an opinion on the effectiveness of The McLean Hospital Corporation's internal control over compliance.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of The McLean Hospital Corporation's Board of Trustees, management, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

December 20, 2007

Part III
Findings

The McLean Hospital Corporation
Schedule of Findings and Questioned Costs
Year Ended September 30, 2007

I. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued Unqualified

Internal control over financial reporting

Material weakness(es) identified? ___ yes X no

Significant deficiency(ies) identified that are not considered to be material weaknesses? ___ yes X none reported

Noncompliance material to financial statements noted? ___ yes X no

Federal Awards

Internal control over major programs

Material weakness(es) identified? ___ yes X no

Significant deficiency(ies) identified that are not considered to be material weaknesses? ___ yes X none reported

Type of auditor's report issued on compliance for major programs Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? ___ yes X no

Identification of Major Programs	Name of Federal Program or Cluster
Various CFDA numbers	Research and Development and Research Training Cluster
Dollar threshold used to distinguish between Type A and Type B programs	\$993,026
Auditee qualified as low-risk auditee?	<u>X</u> yes ___ no

II. Financial Statement Findings

There were no findings noted in the current year.

III. Federal Award Findings and Questioned Costs

There were no findings or questioned costs noted in the current year.

The McLean Hospital Corporation
Summary Schedule of the Status of Prior Audit Findings

There were no findings from prior years to update.