

The Spaulding Rehabilitation Hospital Corporation

**Report on Federal Awards in
Accordance with OMB Circular A-133
September 30, 2008
EIN 042551124**

The Spaulding Rehabilitation Hospital Corporation
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Part I

Financial Statements

Report of Independent Auditors

To the Board of Trustees of
The Spaulding Rehabilitation 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 Spaulding Rehabilitation Hospital Corporation at September 30, 2008 and 2007, 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 Spaulding Rehabilitation 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 19, 2008 on our consideration of The Spaulding Rehabilitation 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, 2008. 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, 2008 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 19, 2008

The Spaulding Rehabilitation Hospital Corporation
Balance Sheets
September 30, 2008 and 2007

<i>(dollars in thousands)</i>	2008	2007
Assets		
Current assets		
Cash and equivalents	\$ 2,459	\$ 1,836
Investments	5	-
Current portion of investments limited as to use	457	476
Patient accounts receivable, net of allowance for bad debts: 2008 - \$1,133; 2007 - \$1,193	11,515	14,059
Due from affiliates	368	3,723
Research grants receivable	796	349
Other current assets	1,060	3,350
Receivable for settlements with third-party payers	1,320	1,146
Total current assets	<u>17,980</u>	<u>24,939</u>
Investments limited as to use, less current portion	943	1,093
Long-term investments	4,730	3,936
Pledges receivable, net, less current portion	1,687	2,352
Property and equipment, net	30,693	31,529
Other assets	73	93
Total assets	<u>\$ 56,106</u>	<u>\$ 63,942</u>
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term obligations	\$ 5,089	\$ 12,350
Accounts payable and accrued expenses	1,405	1,673
Accrued compensation and benefits	10,665	8,406
Unexpended funds on research grants	119	138
Total current liabilities	<u>17,278</u>	<u>22,567</u>
Other liabilities		
Accrued employee benefits	1,478	1,837
Accrued other	401	378
	<u>1,879</u>	<u>2,215</u>
Long-term obligations, less current portion	<u>30,825</u>	<u>34,948</u>
Total liabilities	<u>49,982</u>	<u>59,730</u>
Commitments and contingencies		
Net assets (deficit)		
Unrestricted	(1,340)	(4,186)
Temporarily restricted	7,151	8,090
Permanently restricted	313	308
Total net assets	<u>6,124</u>	<u>4,212</u>
Total liabilities and net assets	<u>\$ 56,106</u>	<u>\$ 63,942</u>

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

The Spaulding Rehabilitation Hospital Corporation
Statements of Operations
Years Ended September 30, 2008 and 2007

<i>(dollars in thousands)</i>	2008	2007
Operating revenue		
Net patient service revenue	\$ 84,028	\$ 84,990
Direct academic and research revenue	2,148	2,481
Indirect academic and research revenue	681	856
Other revenue	<u>2,168</u>	<u>3,643</u>
Total operating revenue	<u>89,025</u>	<u>91,970</u>
Operating expenses		
Employee compensation and benefits	63,937	60,113
Supplies and other expenses	25,214	27,749
Direct academic and research expenses	2,148	2,481
Depreciation and amortization	3,201	4,397
Provision for bad debts	912	926
Interest	<u>1,992</u>	<u>1,608</u>
Total operating expenses	<u>97,404</u>	<u>97,274</u>
Loss from operations	<u>(8,379)</u>	<u>(5,304)</u>
Nonoperating gains (expenses)		
Income from investments	23	39
Gifts and other	<u>8</u>	<u>80</u>
Total nonoperating gains, net	<u>31</u>	<u>119</u>
Deficit of revenues over expenses	(8,348)	(5,185)
Other changes in net assets		
Funds utilized for property and equipment	13	21
Transfers from (to) affiliates, net	11,147	(4,171)
Change in funded status of defined benefit plan	<u>34</u>	<u>34</u>
Increase (decrease) in unrestricted net assets	<u>\$ 2,846</u>	<u>\$ (9,301)</u>

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

The Spaulding Rehabilitation Hospital Corporation
Statements of Changes in Net Assets
Years Ended September 30, 2008 and 2007

<i>(dollars in thousands)</i>	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets at October 1, 2006	<u>\$ 5,115</u>	<u>\$ 6,287</u>	<u>\$ 263</u>	<u>\$ 11,665</u>
Increases (decreases)				
Loss from operations	(5,304)	-	-	(5,304)
Income from investments	39	99	-	138
Gifts and other	80	1,704	45	1,829
Funds utilized for property and equipment	21	-	-	21
Transfers to affiliates, net	(4,171)	-	-	(4,171)
Change in funded status of defined benefit plan	34	-	-	34
Change in net assets	<u>(9,301)</u>	<u>1,803</u>	<u>45</u>	<u>(7,453)</u>
Net assets (deficit) at September 30, 2007	<u>(4,186)</u>	<u>8,090</u>	<u>308</u>	<u>4,212</u>
Increases (decreases)				
Loss from operations	(8,379)	-	-	(8,379)
Income (loss) from investments	23	(16)	-	7
Gifts and other	8	(923)	5	(910)
Funds utilized for property and equipment	13	-	-	13
Transfers from affiliates, net	11,147	-	-	11,147
Change in funded status of defined benefit plan	34	-	-	34
Change in net assets	<u>2,846</u>	<u>(939)</u>	<u>5</u>	<u>1,912</u>
Net assets (deficit) at September 30, 2008	<u>\$ (1,340)</u>	<u>\$ 7,151</u>	<u>\$ 313</u>	<u>\$ 6,124</u>

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

The Spaulding Rehabilitation Hospital Corporation
Statements of Cash Flows
Years Ended September 30, 2008 and 2007

<i>(dollars in thousands)</i>	2008	2007
Cash flows from operating activities		
Change in net assets	\$ 1,912	\$ (7,453)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Change in funded status of defined benefit plan	(34)	(34)
Depreciation and amortization	3,201	4,397
Provision for bad debts	912	926
Gain on sale of property	-	(80)
Net realized and change in unrealized appreciation on investments	180	(99)
Transfers to (from) affiliates, net	(11,147)	4,171
Restricted contributions	(1,002)	(1,467)
Increase (decrease) in cash resulting from a change in		
Patient accounts receivable	1,632	3,496
Research grants receivable	(447)	(180)
Other current assets	1,228	230
Pledges receivable	1,727	279
Accounts payable and accrued expenses	(268)	(275)
Accrued compensation and benefits	2,253	1,133
Settlements with third-party payers	(174)	(1,299)
Unexpended funds on research grants	(19)	(22)
Accrued employee benefits and other	(296)	(524)
Due from affiliates	3,355	(3,118)
Net cash provided by operating activities	<u>3,013</u>	<u>81</u>
Cash flows from investing activities		
Purchase of property and equipment	(2,345)	(6,615)
Proceeds from sale of property	-	80
Purchase of investments	(3,335)	(2,876)
Proceeds from sales of investments	2,525	1,344
Net cash used for investing activities	<u>(3,155)</u>	<u>(8,067)</u>
Cash flows from financing activities		
Payments on long-term obligations	(4,773)	(4,012)
Proceeds from long-term obligations	1,159	11,198
Transfers from (to) affiliates, net	3,377	22
Restricted contributions	1,002	1,467
Net cash provided by financing activities	<u>765</u>	<u>8,675</u>
Net increase in cash and equivalents	623	689
Cash and equivalents at beginning of year	1,836	1,147
Cash and equivalents at end of year	<u>\$ 2,459</u>	<u>\$ 1,836</u>

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

The Spaulding Rehabilitation Hospital Corporation

Notes to Financial Statements

September 30, 2008 and 2007

(dollars in thousands)

1. Organization

The Spaulding Rehabilitation Hospital Corporation (Spaulding) operates a specialized rehabilitation hospital established to provide healthcare services to patients primarily from the Greater Boston area as well as New England and beyond. As such, operating revenue includes those generated from direct patient care and reimbursement of research and educational activities. Partners Continuing Care, Inc. (PCC) is the sole corporate member of Spaulding.

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

Spaulding is a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code.

Due to the significance of the transactions between Spaulding, PHS and other members of Partners HealthCare, the operating results of Spaulding may not be indicative of the results that would have been attained if Spaulding was not an affiliate of PHS. Spaulding follows the accounting policies and practices of PHS and these statements should be read in conjunction with the Partners HealthCare consolidated financial statements.

2. Summary of Significant Accounting Policies

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting.

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 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, patient accounts receivable, research grants receivable, pledges receivable, and accounts payable, except for long-term obligations which is disclosed in Note 7.

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 Spaulding Rehabilitation Hospital Corporation

Notes to Financial Statements

September 30, 2008 and 2007

(dollars in thousands)

Investments

Spaulding holds investments which represent units in a partnership (Note 4) and are recorded on the equity method of accounting, with the change in net unrealized appreciation included in deficit 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 deficit of revenues over expenses.

Income from investments (including realized gains and losses, change in net unrealized appreciation on equity method investments, interest and dividends) is included in deficit 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.

Investments with unrealized depreciation are reviewed each quarter to determine whether these investments are other-than-temporarily impaired. This review considers factors including the anticipated holding period for the investment and the extent and duration of below cost valuation.

A write-down in the cost basis of securities is recorded when the decline in fair value of certain investments below cost 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 deficit 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

Spaulding 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.

The Spaulding Rehabilitation Hospital Corporation

Notes to Financial Statements

September 30, 2008 and 2007

(dollars in thousands)

Research Grants Receivable

Spaulding 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.

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. Spaulding 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. Spaulding reduces these liabilities when the related obligations are settled.

Other Assets

Other assets consist of deferred financing costs. Deferred financing costs are amortized over the terms of the related obligations.

Compensated Absences

In accordance with formal policies concerning vacation and other compensated absences, accruals of approximately \$3,773 and \$3,549 were recorded as of September 30, 2008 and 2007, 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

Spaulding is self-insured for employee healthcare, disability, 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 Spaulding Rehabilitation Hospital Corporation

Notes to Financial Statements

September 30, 2008 and 2007

(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). Unrestricted net assets include all the remaining net assets of Spaulding. See Note 14 for further information on the composition of restricted net assets.

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 Spaulding 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.

Gifts and Grants

Unconditional promises to give cash and other assets to Spaulding 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. Spaulding 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 Spaulding 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 to PHS for corporate expenses and to support clinical and other 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 Spaulding Rehabilitation Hospital Corporation

Notes to Financial Statements

September 30, 2008 and 2007

(dollars in thousands)

Spaulding recognizes changes in third-party payer settlements and other estimates in the year of the change in estimate. For the years ended September 30, 2008 and 2007, adjustments to prior year estimates resulted in an increase to income from operations of \$0 and \$13, respectively.

The statements of operations include deficit of revenues over expenses. Changes in unrestricted net assets which are excluded from deficit 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 defined benefit plan.

Net Patient Service Revenue

Spaulding 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 Spaulding for services rendered to patients covered by these agreements. The agreements generally provide for per case 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 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

Spaulding provides charity care to patients who cannot afford to pay for their medical services. 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 includes institutional revenue (for example, billing for services provided to other healthcare providers), ambulance services revenue and joint venture income (Note 12).

3. Investment Transfer

Effective October 1, 2006, the Board of Trustees of Spaulding approved the permanent transfer of substantially all unrestricted investments to PCC. As a result, substantially all unrestricted investments, related investment income, gifts and expenses, and all system development funding have been eliminated on Spaulding's financial statements as of and for the year ended September 30, 2007. Temporarily and permanently restricted investments, as well as externally limited investments, will continue to be included in the financial statements of Spaulding. Spaulding has accounted for this transaction as a net asset transfer in fiscal 2007. The impact of this transfer was to reduce investments and unrestricted net assets by \$4,193.

The Spaulding Rehabilitation Hospital Corporation
Notes to Financial Statements
September 30, 2008 and 2007

(dollars in thousands)

4. 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 balance sheets of Partners HealthCare. Cash or investments received as collateral on the securities lending transaction are also reported as assets in such consolidated balance sheets. Because the collateral must be returned in the future, a corresponding liability is reported in such consolidated balance sheets.

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

		September 30, 2008		
	Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value
Pooled investments				
Invested cash equivalents	\$ 2,499	\$ -	\$ -	\$ 2,499
Equities	554	13	(118)	449
U.S. Government, domestic and foreign fixed income securities	1,018	10	(17)	1,011
Private partnerships and other	894	72	(103)	863
Accruals, net	14	-	-	14
	<u>4,979</u>	<u>95</u>	<u>(238)</u>	<u>4,836</u>
Separately invested				
Invested cash equivalents	704	-	-	704
U.S. Government and domestic fixed income securities	595	-	-	595
	<u>1,299</u>	<u>-</u>	<u>-</u>	<u>1,299</u>
	<u>\$ 6,278</u>	<u>\$ 95</u>	<u>\$ (238)</u>	<u>\$ 6,135</u>

The Spaulding Rehabilitation Hospital Corporation
Notes to Financial Statements
September 30, 2008 and 2007

(dollars in thousands)

		September 30, 2007		
	Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value
Pooled investments				
Invested cash equivalents	\$ 1,948	\$ -	\$ -	\$ 1,948
Equities	767	31	-	798
U.S. Government, domestic and foreign fixed income securities	586	4	(1)	589
Private partnerships and other	657	50	-	707
Accruals, net	14	-	-	14
	<u>3,972</u>	<u>85</u>	<u>(1)</u>	<u>4,056</u>
Separately invested				
Invested cash equivalents	871	-	-	871
U.S. Government and domestic fixed income securities	578	-	-	578
	<u>1,449</u>	<u>-</u>	<u>-</u>	<u>1,449</u>
	<u>\$ 5,421</u>	<u>\$ 85</u>	<u>\$ (1)</u>	<u>\$ 5,505</u>

Subsequent to September 30, 2008 the U.S. and global financial markets have experienced significant volatility and illiquidity, due in part, to current economic conditions and declines in the financial sector. Spaulding's investment portfolio has experienced similar negative volatility. However, Spaulding has been able to maintain its liquidity and its operations have not been significantly impacted.

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

	September 30,	
	2008	2007
Current assets		
Investments	\$ 5	\$ -
Current portion of investments limited as to use	<u>457</u>	<u>476</u>
	462	476
Investments limited as to use, less current portion	943	1,093
Long-term investments	<u>4,730</u>	<u>3,936</u>
	<u>\$ 6,135</u>	<u>\$ 5,505</u>

The Spaulding Rehabilitation Hospital Corporation
Notes to Financial Statements
September 30, 2008 and 2007

(dollars in thousands)

Investments limited as to use consist of the following:

	September 30, 2008		September 30, 2007	
	Current Portion	Long-Term Portion	Current Portion	Long-Term Portion
Internally designated funds				
Deferred compensation	\$ -	\$ 595	\$ -	\$ 578
Externally limited funds				
Unexpended funds on research	119	-	138	-
Held by trustees under debt and other agreements	338	348	338	515
	<u>\$ 457</u>	<u>\$ 943</u>	<u>\$ 476</u>	<u>\$ 1,093</u>

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,	
	2008	2007
Unrestricted		
Dividends and interest income	<u>\$ 36</u>	<u>\$ 62</u>
Total unrestricted investment activity	<u>36</u>	<u>62</u>
Temporarily restricted		
Dividends and interest income	178	12
Endowment income distributions	(14)	(12)
Net realized gains (losses) on investments		
Trading gains	77	35
Other-than-temporary impairment	(30)	(5)
	<u>211</u>	<u>30</u>
Change in net unrealized appreciation on equity method investments	<u>(227)</u>	<u>69</u>
Total temporarily restricted investment activity	<u>(16)</u>	<u>99</u>
	<u>\$ 20</u>	<u>\$ 161</u>

The Spaulding Rehabilitation Hospital Corporation
Notes to Financial Statements
September 30, 2008 and 2007

(dollars in thousands)

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

	Years Ended September 30,	
	2008	2007
Investment income included in operations and reported in		
Other revenue	\$ 13	\$ 23
Investment income included in nonoperating gains (expenses) and reported in		
Income from investments	<u>23</u>	<u>39</u>
Total investment activity included in deficit of revenues over expenses	<u>\$ 36</u>	<u>\$ 62</u>

5. 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 \$1,047 and \$2,109 as of September 30, 2008 and 2007, 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 2.2% and 4.1% for 2008 and 2007, respectively. Pledges are expected to be collected as follows:

	September 30,	
	2008	2007
Amounts due		
Within one year	\$ 2,829	\$ 2,368
In one to five years	<u>2,211</u>	<u>2,784</u>
Total pledges receivable	5,040	5,152
Less: Unamortized discount	<u>95</u>	<u>282</u>
	4,945	4,870
Less: Allowance for uncollectibles	<u>2,332</u>	<u>409</u>
Net pledges receivable	2,613	4,461
Contributions receivable from trusts	<u>121</u>	<u>-</u>
	<u>\$ 2,734</u>	<u>\$ 4,461</u>

The Spaulding Rehabilitation Hospital Corporation
Notes to Financial Statements
September 30, 2008 and 2007

(dollars in thousands)

6. Property and Equipment

Property and equipment consists of the following:

	September 30,	
	2008	2007
Land and land improvements	\$ 5,760	\$ 5,829
Buildings and building improvements	42,743	41,907
Equipment	15,441	15,510
Construction in progress	<u>7,387</u>	<u>6,883</u>
	71,331	70,129
Accumulated depreciation	<u>(40,638)</u>	<u>(38,600)</u>
Property and equipment, net	<u>\$ 30,693</u>	<u>\$ 31,529</u>

Depreciation expense for the years ended September 30, 2008 and 2007 was \$3,181 and \$4,383, respectively.

For the years ended September 30, 2008 and 2007, fully depreciated assets with an original cost of \$1,144 and \$6,936, respectively, were written off.

The Spaulding Rehabilitation Hospital Corporation
Notes to Financial Statements
September 30, 2008 and 2007

(dollars in thousands)

7. Long-Term Obligations

Long-term obligations consist of the following:

	September 30,	
	2008	2007
Notes payable to PHS		
Partners HealthCare Capital Framework Loan, variable interest rate of 4.88% and 5.10% at September 30, 2008 and 2007, respectively, final maturity in 2038	\$ 29,400	\$ 31,537
Loan from PHS, fixed interest rate of 5.38%, final maturity in 2011	1,900	2,500
Notes payable to PCC		
Fixed interest rate of 6.10% at September 30, 2007, maturity in December 2007	-	2,500
Fixed interest rate of 8.25% at September 30, 2007, maturity in December 2007	-	5,120
Massachusetts Health and Educational Facilities Authority Revenue Bonds		
Massachusetts General Hospital Series F, average interest rate of 6.25%, final maturity in 2012	4,614	5,604
Capital lease obligations	-	37
	<u>35,914</u>	<u>47,298</u>
Less current portion	5,089	12,350
	<u>\$ 30,825</u>	<u>\$ 34,948</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.

The MGH Series F Revenue Bonds are collateralized by a lien on the unrestricted gross receipts of The General Hospital Corporation (General) and MGH. The General is jointly and severally liable with MGH for the total amount of the Series F Revenue Bonds, a portion of which has been recorded directly by Spaulding. The gross receipts of Spaulding are not pledged for the payment of the Series F Bonds.

Aggregate maturities and payments of long-term obligations, including obligations under capital leases (Note 8), during the next five years are as follows: 2009 - \$5,089; 2010 - \$5,411; 2011 - \$5,260; 2012 - \$4,669 and 2013 - \$2,063.

The fair value of long-term obligations was approximately \$36,249 and \$47,973 as of September 30, 2008 and 2007, respectively.

Interest expense approximates interest paid during the years ended September 30, 2008 and 2007.

The Spaulding Rehabilitation Hospital Corporation
Notes to Financial Statements
September 30, 2008 and 2007

(dollars in thousands)

8. Leases

Spaulding has noncancelable operating leases for certain buildings and equipment. Rental expense under these and other contracts approximated \$1,579 and \$1,622 in 2008 and 2007, respectively. Minimum future lease commitments under noncancelable leases for the next five years and thereafter are as follows:

	Operating Leases
2009	\$ 1,200
2010	1,017
2011	1,031
2012	885
2013	542
Thereafter	<u>1,023</u>
Total lease payments	<u>\$ 5,698</u>

9. Pension and Postretirement Healthcare Plans

Pension Plans

Substantially all employees of MGH and its affiliates (including Spaulding, as MGH was formerly its sole corporate member) 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 participant's employer, 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 totaled \$62,106 and \$67,026 in 2008 and 2007, respectively. The amount of pension expense allocated to Spaulding was \$2,786 in 2008 and \$2,701 in 2007.

Certain professional staff employed by MGH and its affiliates who hold appointments at the Harvard Medical School participate in the MGH Academic Annuity Plan which is a defined contribution plan. MGH and its affiliates contribute to the plan a percentage, as defined by the plan agreement, of each participant's annual compensation. The amount of expense incurred under this plan by Spaulding for 2008 and 2007 was \$14 and \$74, respectively.

Postretirement Healthcare Benefits

Spaulding also provides subsidized health 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. The accrued postretirement benefit obligation at September 30, 2008 and 2007 was \$500 and \$562, respectively. The amount of expense incurred under this plan by Spaulding for 2008 and 2007 was \$67 and \$70, respectively. Actuarial net losses of \$220 in 2008 and \$254 in 2007 are recognized in unrestricted net assets. The actuarial loss that will be amortized from unrestricted net assets into expense in 2009 is \$36.

The Spaulding Rehabilitation Hospital Corporation
Notes to Financial Statements
September 30, 2008 and 2007

(dollars in thousands)

10. Professional Liability Insurance

Spaulding 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, 2008. 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.

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

11. Transactions with Affiliated Corporations

Spaulding received investment management, legal, financial, administrative, operating and professional support services from PHS, the General, and the Massachusetts General Physicians Organization, Inc. (MGPO) of \$10,661 and \$12,640 in 2008 and 2007, respectively. Spaulding provided certain teaching and administrative services to PHS affiliates which totaled \$11,650 and \$10,180 in 2008 and 2007, respectively. For the years ended September 30, 2008 and 2007, Spaulding received payments from the General of \$982 and \$1,300, respectively, as additional reimbursement for patients transferred from the General and cared for at Spaulding and other PCC entities. PCC accrued \$925 in severance on behalf of Spaulding in 2008. All services among these affiliated corporations were reimbursed on an estimated cost basis.

During 2008 and 2007, Spaulding received funds from, and transferred funds to, certain affiliated corporations. These equity transfers are reported separately as changes in net assets and are excluded from deficit of revenues over expenses. Amounts transferred were as follows:

	Years Ended September 30,	
	2008	2007
Transfers from (to)		
PHS	\$ 2,037	\$ 3,336
PCC	1,340	(3,314)
	<u>3,377</u>	<u>22</u>
Liability transfer to PCC	7,770	-
Investment transfer to PCC (Note 3)	-	(4,193)
	<u>\$ 11,147</u>	<u>\$ (4,171)</u>

The Spaulding Rehabilitation Hospital Corporation
Notes to Financial Statements
September 30, 2008 and 2007

(dollars in thousands)

12. Joint Venture

Spaulding and Youville Lifecare, Inc. participate in a joint venture (Spaulding/Youville Rehabilitation Services, LLC) which was formed to enhance the availability and quality of rehabilitation services and provide improved coordination of these services. Spaulding's share of losses from the joint venture, as defined in the joint venture agreement, amounted to \$1,531 and \$279 for the years ended September 30, 2008 and 2007, respectively.

Summarized financial data for Youville Lifecare, Inc. as of and for the years ended September 30, 2008 and 2007 is as follows:

	Years Ended	
	September 30,	
	2008	2007
	<i>(unaudited)</i>	<i>(audited)</i>
Total operating revenue	\$ 59,218	\$ 58,238
Total operating expenses	62,042	58,608
Loss from operations	(2,824)	(370)
Excess (deficit) of revenues over expenses	(4,670)	3,132

	September 30,	
	2008	2007
	<i>(unaudited)</i>	<i>(audited)</i>
Current assets	\$ 22,364	\$ 21,460
Total assets	65,813	70,895
Current liabilities	7,414	6,880
Total liabilities	39,361	38,734
Unrestricted net assets	22,644	27,315

13. Concentration of Credit Risk

Financial instruments that potentially subject Spaulding to concentration of credit risk consist of patient accounts receivable, research grants receivable, pledges receivable and certain investments. Spaulding 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. Spaulding 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.

The Spaulding Rehabilitation Hospital Corporation
Notes to Financial Statements
September 30, 2008 and 2007

(dollars in thousands)

14. Restricted Net Assets

Restricted net assets are available for the following purposes:

	September 30,	
	2008	2007
Temporarily restricted		
Buildings and equipment	\$ 7,021	\$ 7,839
Clinical care, research and academic	130	251
	<u>\$ 7,151</u>	<u>\$ 8,090</u>
Permanently restricted		
Clinical care, research and academic	<u>\$ 313</u>	<u>\$ 308</u>

15. Functional Expenses

Total operating expenses by function are as follows:

	Years Ended	
	September 30,	
	2008	2007
Healthcare services	\$ 83,278	\$ 82,069
Research and academic	2,829	3,337
General and administrative	11,297	11,868
	<u>\$ 97,404</u>	<u>\$ 97,274</u>

16. New Building

In October 2005, PHS paid \$4,750 in exchange for the development rights to certain parcels of land in Charlestown, Massachusetts (Yards End), the planned site of the new hospital. Spaulding's share of the purchase price was \$2,048. In November 2008, Spaulding received approval from the Partners HealthCare Finance Committee to proceed with final design and permitting for a 134-bed hospital at Yards End.

17. Contingencies

Spaulding is subject to complaints, claims and litigation which have risen in the normal course of business. In addition, Spaulding 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 Spaulding, has increased.

The Spaulding Rehabilitation Hospital Corporation
Schedule of Expenditures of Federal Awards
Year Ended September 30, 2008

	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			
Heart and Vascular Diseases Research	93.837		\$ 133,327
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853		314,370
Child Health and Human Development Extramural Research	93.865		25,739
Aging Research	93.866		555,534
Center for Medical and Rehabilitation Research	93.929		15,755
Subtotal - Department of Health and Human Services			<u>1,044,725</u>
Department of Education			
National Institute on Disability and Rehabilitation Research	84.133		30,715
Total Research and Development Direct Programs			<u>1,075,440</u>
Research and Development Passed Through Other Organizations			
Department of Health and Human Services			
National Institutes of Health			
Beth Israel Deaconess Medical Center	93.838	5 R01 HL072648-05	(12,127)
Beth Israel Deaconess Medical Center	93.847	5 R01 DK63296-05	16,820
Beth Israel Deaconess Medical Center	93.233	1 R01 HL074972-01A2	14,749
Boston University	93.361	1 R01 NR010815-01A2	2,424
Harvard Medical School	93.213	1 R21 AT003503-01	3,507
Massachusetts General Hospital	93.847	5 U01 NS049640-02	6,414
Simbex, LLC	93.865	5 R44 HD055715-02	7,247
Tufts University School of Medicine	93.866	5 R01 AG018844-09	155,119
University of Pittsburgh	93.853	5 R01 NS048178-03	4,155
University of Pittsburgh	93.865	5 R01 HD046700-04	5,828
Subtotal - Department of Health and Human Services			<u>204,136</u>
Department of Defense			
U.S. Army Medical Command			
Center for Integration of Medicine and Innovative Technology	12.420	W81XWH-07-2-0011	35,952
Massachusetts Institute of Technology	12.420	W81XWH-07-1-0343	83,543
Subtotal - Department of Defense			<u>119,495</u>
Department of Education			
University of Akron	84.133	H133 A030810	(64)
Total Research and Development Pass-Through Programs			<u>323,567</u>
Total Research and Development			<u>1,399,007</u>
Research Training Direct Programs			
Department of Health and Human Services			
Aging Research	93.866		812
Total Research Training Direct Programs			<u>812</u>
Research Training Passed Through Other Organizations			
Department of Health and Human Services			
National Institutes of Health			
Albert Einstein Healthcare Network	93.865	5 K12 HD001097-12	178,148
Total Research Training Pass-Through Programs			<u>178,148</u>
Total Research Training			<u>178,960</u>
Total Research and Development and Research Training Cluster			<u>1,577,967</u>
Total Federal Expenditures			<u>\$ 1,577,967</u>

The accompanying notes are an integral part of the schedule of expenditures of federal awards.

The Spaulding Rehabilitation Hospital Corporation
Notes to Schedule of Expenditures of Federal Awards
September 30, 2008

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant transactions of The Spaulding Rehabilitation 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 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 for the period October 1, 2007 through September 30, 2011 of 65% for research. Fringe benefit rates for the period October 1, 2007 through September 30, 2008 range from 10% to 35%.

3. Subrecipients

During fiscal 2008, the Hospital provided to subrecipients in the Research and Development and Research Training Cluster \$122,549 as follows. These amounts are included in the accompanying Schedule of Expenditures of Federal Awards:

Arizona State University	\$ 29,051
Harvard University	13,255
Hebrew Rehabilitation Center for Aged	3,530
Massachusetts General Hospital	24,310
Massachusetts Institute Technology	17,440
University of Puerto Rico	34,963
	<u>\$ 122,549</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 Spaulding Rehabilitation Hospital Corporation

We have audited the financial statements of The Spaulding Rehabilitation Hospital Corporation as of and for the year ended September 30, 2008 and have issued our report thereon dated December 19, 2008. 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 Spaulding Rehabilitation 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 Spaulding Rehabilitation Hospital Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of The Spaulding Rehabilitation 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 Spaulding Rehabilitation 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 Spaulding Rehabilitation Hospital Corporation in a separate letter dated December 17, 2008.

This report is intended solely for the information and use of The Spaulding Rehabilitation 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 19, 2008

**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 Spaulding Rehabilitation Hospital Corporation

Compliance

We have audited the compliance of The Spaulding Rehabilitation 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, 2008. The Spaulding Rehabilitation 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 Spaulding Rehabilitation Hospital Corporation's management. Our responsibility is to express an opinion on The Spaulding Rehabilitation 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 Spaulding Rehabilitation 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 Spaulding Rehabilitation Hospital Corporation's compliance with those requirements.

In our opinion, The Spaulding Rehabilitation 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, 2008.

Internal Control over Compliance

The management of The Spaulding Rehabilitation 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 Spaulding Rehabilitation 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 Spaulding Rehabilitation 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 Spaulding Rehabilitation 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 cursive script that reads "PricewaterhouseCoopers LLP".

December 19, 2008

Part III
Findings

The Spaulding Rehabilitation Hospital Corporation
Schedule of Findings and Questioned Costs
Year Ended September 30, 2008

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 \$300,000

Auditee qualified as low-risk auditee? X 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 Spaulding Rehabilitation Hospital Corporation
Summary Schedule of the Status of Prior Audit Findings

There were no findings from prior years to update.