The Spaulding Rehabilitation Hospital Corporation

Report on Federal Awards in Accordance with OMB Circular A-133
September 30, 2006
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Part I

Financial Statements

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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, 2006 and 2005, 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.

As described in Notes 2 and 5 to the financial statements in 2006, The Spaulding Rehabilitation Hospital Corporation adopted Financial Accounting Standards Board Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, and Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. In accordance with the transition provisions of these pronouncements, the 2006 financial statements include the cumulative effect of adopting these new pronouncements.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 8, 2006 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, 2006. 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.

The accompanying Schedule of Expenditures of Federal Awards 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 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.

PricewaterhouseCoopers LLP

December 8, 2006

The Spaulding Rehabilitation Hospital Corporation
Balance Sheets
September 30, 2006 and 2005

(in thousands)	2006	2005
Assets		
Current assets		
Cash and equivalents	$ 1,147	$ 4,955
Investments	313	28
Current portion of investments limited as to use	498	369
Patient accounts receivable, net of allowance for bad debts: 2006 - $1,648; 2005 - $1,476	18,481	18,850
Due from affiliates	605	-
Research grants receivable	169	241
Other current assets	2,954	3,086
Total current assets	24,167	27,529
Investments limited as to use, less current portion	2,132	6,187
Long-term investments	1,809	534
Pledges receivable, net, less current portion	3,257	1,078
Property and equipment, net	29,297	27,227
Other assets	107	117
Total assets	$ 60,769	$ 62,672
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term obligations	$ 6,444	$ 3,710
Accounts payable and accrued expenses	1,948	1,321
Accrued compensation and benefits	7,273	7,041
Current portion of accrual for settlements with third-party payers	153	508
Unexpended funds on research grants	160	291
Due to affiliates	-	2,519
Total current liabilities	15,978	15,390
Other liabilities		
Accrual for settlements with third-party payers, less current portion	-	843
Accrued professional liability	121	115
Accrued employee benefits	2,292	2,124
Accrued other	360	5,000
	2,773	8,082
Long-term obligations, less current portion	30,353	28,302
Total liabilities	49,104	51,774
Commitments and contingencies		
Net assets		
Unrestricted	5,115	8,747
Temporarily restricted	6,287	1,944
Permanently restricted	263	207
Total net assets	11,665	10,898
Total liabilities and net assets	$ 60,769	$ 62,672

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

The Spaulding Rehabilitation Hospital Corporation
Statements of Operations
Years Ended September 30, 2006 and 2005

(in thousands)	2006	2005
Operating revenue		
Net patient service revenue	$ 92,175	$ 101,958
Direct academic and research revenue	3,295	2,732
Indirect academic and research revenue	837	747
Other revenue	4,251	5,892
Total operating revenue	100,558	111,329
Operating expenses		
Employee compensation and benefits	64,820	68,807
Supplies and other expenses	30,492	31,553
Direct academic and research expenses	3,295	2,732
Depreciation and amortization	4,125	4,185
Provision for bad debts	1,572	1,209
Interest	1,459	1,506
Nonrecurring charges	799	165
Total operating expenses	106,562	110,157
Income (loss) from operations	(6,004)	1,172
Nonoperating gains (expenses)		
Income from investments	58	119
Change in net unrealized gains (losses) on equity method investments	(20)	50
Gifts and other	(558)	(1,093)
Academic and research gifts, net of expenses	(254)	362
System development funding	(2,329)	(2,423)
Total nonoperating expenses, net	(3,103)	(2,985)
Deficit of revenues over expenses	(9,107)	(1,813)
Other changes in net assets		
Funds utilized for property and equipment	3	32
Transfers from affiliates, net	5,041	1,193
Cumulative effect of accounting changes	431	-
Decrease in unrestricted net assets	$ (3,632)	$ (588)

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, 2006 and 2005

(in thousands)	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets at October 1, 2004	$ 9,335	$ 674	$ 284	$ 10,293
Increases (decreases)				
Income from operations	1,172	-	-	1,172
Income (loss) from investments	119	(179)	-	(60)
Change in net unrealized gains (losses) on equity method investments	50	(51)	-	(1)
Gifts and other	(1,093)	1,500	(77)	330
Academic and research gifts, net of expenses	362	-	-	362
System development funding	(2,423)	-	-	(2,423)
Funds utilized for property and equipment	32	-	-	32
Transfers from affiliates, net	1,193	-	-	1,193
Change in net assets	(588)	1,270	(77)	605
Net assets at September 30, 2005	8,747	1,944	207	10,898
Increases (decreases)				
Loss from operations	(6,004)	-	-	(6,004)
Income from investments	58	13	-	71
Change in net unrealized gains (losses) on equity method investments	(20)	(6)		(26)
Gifts and other	(558)	4,336	56	3,834
Academic and research gifts, net of expenses	(254)	-	-	(254)
System development funding	(2,329)	-	-	(2,329)
Funds utilized for property and equipment	3	-	-	3
Transfers from affiliates, net	5,041	-	-	5,041
Cumulative effect of accounting changes	431	-	-	431
Change in net assets	(3,632)	4,343	56	767
Net assets at September 30, 2006	$ 5,115	$ 6,287	$ 263	$ 11,665

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

The Spaulding Rehabilitation Hospital Corporation
Statements of Cash Flows
Years Ended September 30, 2006 and 2005

(in thousands)	2006	2005
Cash flows from operating activities		
Change in net assets	$ 767	$ 605
Adjustments to reconcile change in net assets to net cash provided by (used for) operating activities		
Cumulative effect of accounting changes	(431)	-
Depreciation and amortization	4,125	4,185
Provision for bad debts	1,572	1,209
Gain on sale of property	(517)	-
Net realized and change in unrealized (gains) losses on investments	(147)	(155)
Change in interest in the net assets of The Massachusetts General Hospital	-	532
Transfers from affiliates, net	(5,041)	(1,193)
Restricted contributions	(1,994)	45
Increase (decrease) in cash resulting from a change in		
Patient accounts receivable	(1,203)	(155)
Other current assets	1,010	577
Pledges receivable	(2,985)	(1,660)
Accounts payable and accrued expenses	767	(1,686)
Accrued compensation and benefits	144	(1,128)
Accrual for settlements with third-party payers	(254)	(306)
Unexpended funds on research grants	(131)	58
Accrued employee benefits and other	(26)	(99)
Due to affiliates	(3,124)	106
Net cash provided by (used for) operating activities	(7,468)	935
Cash flows from investing activities		
Purchase of property and equipment	(6,308)	(1,846)
Proceeds from sale of property	635	-
Purchase of investments	(2,588)	(4,341)
Proceeds from sales of investments	5,101	2,826
Net cash used for investing activities	(3,160)	(3,361)
Cash flows from financing activities		
Payments on long-term obligations	(3,973)	(18,006)
Proceeds from long-term obligations	8,758	23,551
Transfers from affiliates, net	41	1,193
Restricted contributions	1,994	(45)
Net cash provided by financing activities	6,820	6,693
Net increase (decrease) in cash and equivalents	(3,808)	4,267
Cash and equivalents at beginning of year	4,955	688
Cash and equivalents at end of year	$ 1,147	$ 4,955

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

(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. The Massachusetts General Hospital (MGH) was the sole corporate member of Spaulding through September 30, 2001. Effective October 1, 2001, Partners Continuing Care, Inc. (PCC), established to serve as the sole corporate member of all nonacute facilities and services within Partners HealthCare System, Inc. (PHS), became the sole corporate member of Spaulding.

As of October 1, 2006, Spaulding changed Medicare certification from a long-term acute care hospital to an inpatient rehabilitation facility. Expenses to manage the transition are reflected as nonrecurring charges.

PHS is the sole member of MGH, The Brigham and Women's/Faulkner Hospitals, Inc., The North Shore Medical Center, Inc., Newton-Wellesley Hospital and PCC. 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."

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

Due to the significance of the transactions between PHS and other members of PHS, 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' 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, investments, 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, patient accounts receivable, pledges receivable and accounts payable, except for long-term obligations which is disclosed in Note 6.

(in thousands)

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.

Investments
Spaulding 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 gains and losses included in deficit of revenues over expenses. Separately invested investments (marketable investments) are measured at fair value, generally based on quoted market prices, with the change in net unrealized gains and losses excluded from deficit of revenues over expenses.

Investment income or loss (including realized gains and losses, interest and dividends) is included in deficit of revenues over expenses unless the income or loss is restricted by donor or law. Investment income or loss 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 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, with no adjustment in the cost basis for subsequent recoveries in fair value.

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

(in thousands)

Derivative Instruments
Derivatives are recognized as either assets or liabilities in the balance sheet at fair value regardless of the purpose or intent for holding them. Changes in the fair value of derivatives are either recognized in excess of revenues over expenses or net assets, depending on certain factors, including whether the derivative is speculative or being used to hedge changes in fair value or cash flows.

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 market 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. Subsequent to initial recognition, 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 $3,722 and $3,927 were recorded as of September 30, 2006 and 2005, 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.

(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 and unrealized net gains on permanently restricted gifts are classified as temporarily restricted until appropriated for spending by Spaulding in accordance with policies established by Partners 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 market value exceeds book value. Unrestricted net assets include all the remaining net assets of Spaulding. See Note 13 for further information on the composition of restricted net assets.

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 are recognized as unrestricted revenues as the related expenditures are incurred. Spaulding recognizes indirect cost recoveries at 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, change in net unrealized gains and losses on equity method investments, substantially all investment income (including realized gains and losses) 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 the System. Academic and research gifts largely consist of donor contributions to the entity (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.

(in thousands)

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 changes in unrealized gains and losses on marketable investments, transfers of assets to and from affiliates, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for acquisition of such assets).

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 is directly applicable to public companies, Spaulding has elected to follow the prescribed guidance.

Traditionally, there have been two accepted methods for quantifying and assessing the materiality of the effects of financial statement misstatements: the "rollover" method and the "iron curtain" method. The rollover method focuses primarily on the impact of a misstatement on the statement of operations—including the reversing effect of prior year misstatements—but its use can lead to the accumulation of misstatements in the balance sheet. The iron curtain method, on the other hand, focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year misstatements on the statement of operations. Prior to the application of SAB 108, Spaulding used the rollover method for quantifying and assessing the materiality of financial statement misstatements.

SAB 108 establishes an approach that requires quantification and assessment of the materiality of financial statement misstatements based on the effects of the misstatements on each of the company's financial statements and the related financial statement disclosures. This model is commonly referred to as a "dual approach" because it requires quantification and assessment of the materiality of misstatements under both the iron curtain and the rollover methods. SAB 108 permits companies to initially apply its provisions either by (i) restating prior financial statements as if the dual approach had always been applied or (ii) recording the cumulative effect of initially applying the dual approach as adjustments to the carrying values of assets and liabilities with an offsetting adjustment recorded to the opening balance of unrestricted net assets. Spaulding elected to record the effects of applying SAB 108 using the cumulative effect transition method.

Prior to fiscal 2006, Spaulding 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 net impact of the amortization policy was to increase net patient service revenue by $118 in 2005. The impact of the change in other liabilities was to decrease operating expenses by $34 in 2005. The adoption of SAB 108 as of October 1, 2005 resulted in a decrease in accruals for settlements with third-party payers of $944 and a decrease in accounts payable and accrued expenses of $140. Adjustment of other differences resulted in a decrease in property and equipment of $5. The impact of these adjustments resulted in a net increase of $1,079 in unrestricted net assets. For the year ended September 30, 2006, adjustments to prior year estimates resulted in a decrease to income from operations of $573.

(in thousands)

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 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 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. A portion of the accrual for settlements with third-party payers has been classified as long-term because such amounts, by their nature or by virtue of regulation or legislation, will not be paid within one year.

Charity Care
Spaulding provides care to patients who meet certain criteria under its charity care policy. 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 11).

Reclassifications
Certain amounts in the 2005 financial statements have been reclassified to conform with the 2006 presentation. Research grants receivable is reflected separately from the other current assets and is reported net of a reserve against uncollectible balances. The reserve was previously classified as a component of accounts payable and accrued expenses. Certain long-term liabilities have been reclassified from accrual for settlements with third-party payers to accrued other.

(in thousands)

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 market value method whereby each partner is assigned a number of units based on the market value of the assets of a pool at the time of entry of the funds into the pool. Current market 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 PHS. Cash or investments received as collateral on the securities lending transaction are also reported as assets on the consolidated balance sheet. Because the collateral must be returned in the future, a corresponding liability is reported in the consolidated financial statements.

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

	September 30, 2006			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Pooled investments				
Invested cash equivalents	$ 268	$ -	$ -	$ 268
Equities	643	87	(9)	721
U.S. Government, domestic and foreign fixed income securities	905	100	(86)	919
Private partnerships and other	768	198	-	966
Accrued interest and dividends	10	-	-	10
	2,594	385	(95)	2,884
Separately invested				
Invested cash equivalents	816	-	-	816
U.S. Government and domestic fixed income securities	1,052	-	-	1,052
	1,868	-	-	1,868
	$ 4,462	$ 385	$ (95)	$ 4,752

(in thousands)

	September 30, 2005			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Pooled investments				
Invested cash equivalents	$ 2,929	$ -	$ -	$ 2,929
Equities	608	165	(8)	765
U.S. Government, domestic and foreign fixed income securities	270	5	(3)	272
Private partnerships and other	618	157	(1)	774
Accrued interest and dividends	10	-	-	10
	4,435	327	(12)	4,750
Separately invested				
Invested cash equivalents	223	-	-	223
Equities	1,443	-	-	1,443
U.S. Government and domestic fixed income securities	702	-	-	702
	2,368	-	-	2,368
	$ 6,803	$ 327	$ (12)	$ 7,118

The fair value and gross unrealized losses of investments and investments limited as to use, with fair value less than cost, that are not deemed to be other-than-temporarily impaired at September 30, 2006 are as follows:

	Less than 12 Months		12 Months or Greater	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Pooled investments				
Equities	$ 89	$ (8)	$ 10	$ (1)
U.S. Government, domestic and foreign fixed income securities	128	(27)	139	(59)
Private partnerships and other	36	-	-	-
	$ 253	$ (35)	$ 149	$ (60)

Securities with unrealized losses 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. For specific securities, these factors include evidence of continuing debt service payments and prospects for principal repayment (fixed income), the age of investment relative to historical valuation patterns (private equity), and historical market volatility, prospects and price trends of individual securities relative to industry peers (equity). Based on management's evaluation of investments with a fair value less than cost at September 30, 2006, no other-than-temporary impairment was determined to have occurred.

(in thousands)

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

	September 30, 2006	September 30, 2005
Current assets		
Investments	$ 313	$ 28
Current portion of investments limited as to use	498	369
	811	397
Investments limited as to use, less current portion	2,132	6,187
Long-term investments	1,809	534
	$ 4,752	$ 7,118

Investments limited as to use consist of the following:

	September 30, 2006		September 30, 2005	
	Current Portion	Long-Term Portion	Current Portion	Long-Term Portion
Internally designated funds				
Unexpended academic and research gifts	$ -	$ 111	$ -	$ 4,362
Other		1,561	-	1,156
	-	1,672	-	5,518
Externally limited funds				
Unexpended funds on research	160	-	291	-
Held by trustees under debt and other agreements	338	460	78	669
	$ 498	$ 2,132	$ 369	$ 6,187

(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, 2006	2005
Unrestricted		
Dividends and interest income	$ 171	$ 169
Endowment income distributions, net of reinvested gains	9	4
Net realized gains (losses) on investments		
Trading gains	154	194
Other than temporary impairment	(1)	(3)
Change in net unrealized gains (losses) on equity method investments	(20)	50
Total unrestricted investment activity	313	414
Temporarily restricted		
Dividends and interest income	2	(139)
Endowment income distributions	(9)	(5)
Net realized gains (losses) on investments		
Trading (losses) gains	20	(35)
	13	(179)
Change in net unrealized gains (losses) on investments		
Equity method investments	(6)	(51)
Total temporarily restricted investment activity	7	(230)
	$ 320	$ 184

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

	Years Ended September 30, 2006	2005
Investment income included in operations and reported in		
Other revenue	$ 3	$ 1
Investment income included in nonoperating gains (expenses) and reported in		
Income from investments	58	119
Change in net unrealized gains (losses) on equity method investments	(20)	50
Academic and research gifts, net of expenses	272	244
Total investment activity included in deficit of revenues over expenses	$ 313	$ 414

(in thousands)

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 $1,483 and $677 as of September 30, 2006 and 2005, 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 4.6% and 4.2% for 2006 and 2005, respectively. Pledges are expected to be collected as follows:

	September 30, 2006	September 30, 2005
Amounts due		
Within one year	$ 1,507	$ 693
In one to five years	3,795	1,241
Total pledges receivable	5,302	1,934
Less: Unamortized discount	480	137
	4,822	1,797
Less: Allowance for uncollectibles	82	42
Net pledges receivable	$ 4,740	$ 1,755

5. Property and Equipment

Property and equipment consists of the following:

	September 30, 2006	September 30, 2005
Land and land improvements	$ 5,829	$ 3,800
Buildings and building improvements	43,164	45,177
Equipment	19,403	18,728
Construction in progress	2,054	437
	70,450	68,142
Accumulated depreciation	(41,153)	(40,915)
Property and equipment, net	$ 29,297	$ 27,227

Depreciation expense for the years ended September 30, 2006 and 2005 was $4,115 and $4,174, respectively.

For the years ended September 30, 2006 and 2005, fully depreciated assets with an original cost of $3,671 and $2,730, respectively, were written off.

(in thousands)

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation ("FIN") No. 47, *Accounting for Conditional Asset Retirement Obligations*. FIN 47 clarifies that the term "conditional asset retirement obligation" as used in Statement of Financial Accounting Standards (SFAS) No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing or method of settlement are conditional on a future event. An entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair vale 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.

Spaulding implemented FIN 47 at September 30, 2006 and recorded conditional asset retirement obligations of approximately $360. These conditional asset retirement obligations relate to certain materials requiring specific remediation efforts. Upon implementation of FIN 47, Spaulding recorded a $360 reduction in unrestricted net assets which is recorded as a cumulative effect of a change in accounting principle.

6. Long-Term Obligations

Long-term obligations consist of the following:

	September 30, 2006	September 30, 2005
Notes payable to Partners HealthCare System, Inc.		
Partners Capital Framework Loan, variable interest rate of 5.11% and 4.50% at September 30, 2006 and 2005, respectively, final maturity in 2036	$ 24,297	$ 19,968
Loan from PHS, fixed interest rate of 5.38%, final maturity in 2011	3,100	3,700
Note payable to PCC, variable interest rate of 6.10% at September 30, 2006, final maturity in 2007	2,500	-
Massachusetts Health and Educational Facilities Authority Revenue Bonds		
Massachusetts General Hospital Series F, average interest rate of 6.25%, final maturity in 2012	6,537	7,415
Capital lease obligations	363	929
	36,797	32,012
Less current portion	6,444	3,710
	$ 30,353	$ 28,302

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

(in thousands)

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 7), during the next five years are as follows: 2007 - $6,444; 2008 - $3,813; 2009 - $4,040; 2010 - $4,308 and 2011 - $4,099.

The fair value of long-term obligations was approximately $37,683 and $33,207 as of September 30, 2006 and 2005, respectively.

Interest expense approximates interest paid during the years ended September 30, 2006 and 2005.

7. Leases

Spaulding has capital and noncancelable operating leases for certain buildings and equipment. Rental expense under these and other contracts approximated $1,803 and $2,068 in 2006 and 2005, respectively. Minimum future lease commitments under noncancelable leases for the next five years and thereafter are as follows:

	Capital Leases	Operating Leases
2007	$ 336	$ 1,525
2008	37	878
2009	-	789
2010	-	447
2011	-	453
Thereafter	-	1,580
Total lease payments	373	$ 5,672
Less amounts representing interest	10	
Capital lease obligations at September 30, 2006	$ 363	

8. 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 age, years of service and salary. Interest is credited to participants' accounts annually at market rates.

(in thousands)

Pension expense under the MGH Plan for all affiliates totaled $46,371 and $38,455 in 2006 and 2005, respectively. The amount of pension expense allocated to Spaulding was $3,510 in 2006 and $3,404 in 2005.

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 2006 and 2005 was $214 and $261, 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, 2006 and 2005 was $614 and $336, respectively.

9. 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, 2006. 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.

PHS and its affiliates follow 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, 2006 and 2005. Spaulding has assumed the obligation for any unasserted malpractice claims not covered by CRICO.

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.

10. 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 $15,361 and $15,587 in 2006 and 2005, respectively. Spaulding provided certain teaching and administrative services to PHS affiliates which totaled $7,961 and $4,601 in 2006 and 2005, respectively. For the years ended September 30, 2006 and 2005, Spaulding received payments from the General of $1,300 as additional reimbursement for patients transferred from the General and cared for at Spaulding. All services among these affiliated corporations were reimbursed on an estimated cost basis. In 2005, the Rehabilitation Hospital of the Cape and Islands (RHCI) transferred $1,600 to Spaulding for management services provided during the start-up of RHCI.

(in thousands)

During 2006 and 2005, 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, 2006	Years Ended September 30, 2005
Transfers from (to)		
PHS	$ 41	$ (407)
RHCI	-	1,600
	41	1,193
Liability transfer to PHS	5,000	-
	$ 5,041	$ 1,193

11. 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 transferred oncology services to the joint venture to allow for increased capacity for complex medical and orthopedic patients. Spaulding's share of gains (losses) from the joint venture, as defined in the joint venture agreement, amounted to $(388) and $921 for the years ended September 30, 2006 and 2005, respectively.

Summarized financial data for Youville Lifecare, Inc. as of and for the years ended September 30, 2006 and 2005 is as follows:

	Years Ended September 30, 2006 *(unaudited)*	Years Ended September 30, 2005
Total operating revenue	$ 54,066	$ 50,110
Total operating expenses	54,061	49,424
Income from operations	5	686
Excess of revenues over expenses	2,064	2,456

	September 30, 2006 *(unaudited)*	September 30, 2005
Current assets	$ 20,266	$ 19,839
Total assets	66,654	65,359
Current liabilities	8,975	9,749
Total liabilities	39,854	40,771
Unrestricted net assets	22,400	20,336

(in thousands)

12. Concentration of Credit Risk

Financial instruments that potentially subject Spaulding to concentration of credit risk consist of patient accounts 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. Pledges receivable are due from multiple donors. 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. Spaulding has not historically incurred any significant credit losses outside the normal course of business.

13. Restricted Net Assets

Restricted net assets are available for the following purposes:

	September 30, 2006	September 30, 2005
Temporarily restricted		
Buildings and equipment	$ 6,078	$ 1,625
Clinical care, research and academic	209	319
	$ 6,287	$ 1,944
Permanently restricted		
Investments to be held in perpetuity	$ 263	$ 207

14. Functional Expenses

Total operating expenses by function are as follows:

	Years Ended September 30, 2006	Years Ended September 30, 2005
Healthcare services	$ 87,251	$ 92,011
Research and academic	4,132	3,479
General and administrative	15,179	14,667
	$ 106,562	$ 110,157

(in thousands)

15. New Building

In April 2005, Spaulding's Board of Trustees voted to authorize and approve a capital expenditure not to exceed $156,000 for the site costs, development and construction of a 150-bed replacement hospital. In October 2005, PHS paid $4,750 in exchange for the development rights to certain parcels of land in Charlestown, Massachusetts, the planned future site of the new hospital. Spaulding's share of the purchase price was $2,048 and has been recorded in construction in progress.

16. Investment Transfer

Effective October 1, 2006, the Board of Trustees of Spaulding approved the permanent transfer of substantially all unrestricted investments to its parent, PCC. In addition, in conjunction with the board resolution, all system development funding will become the responsibility of PCC. Temporarily and permanently restricted investments, as well as externally limited investments, will continue to be included in the financial statements of Spaulding. Spaulding will account for this transaction as a net asset transfer in fiscal 2007. The impact of this transfer will be to reduce investments and unrestricted net assets by $897.

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, 2006

	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			
Heart and Vascular Diseases Research	93.837		$ 117,021
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853		371,621
Child Health and Human Development Extramural Research	93.865		83,462
Aging Research	93.866		613,596
Subtotal - Department of Health and Human Services			1,185,700
Department of Education			
National Institute on Disability and Rehabilitation Research	84.133		432,710
Total Research and Development Direct Programs			1,618,410
Research and Development Passed Through from Other Organizations			
Department of Health and Human Services			
Afferent Corporation	93.929	2 R44 HD040035-02	62
Beth Israel Deaconess Medical Center	93.838	5 R01 HL072648-04	36,030
Beth Israel Deaconess Medical Center	93.847	5 R01 DK63296-04	92,875
Boston University	93.929	R01 HD043568	(6,266)
Innersea Technologies, Inc.	93.865	1 R43 HD050003-01	5,905
Kennedy Krieger Institute	93.242	5 R01 MH59630-05	103,526
Massachusetts General Hospital	93.847	5 R01 DK49302-09	257
Talking Lights	93.929	5 R44 HD040781-03	30,891
Tufts University School of Medicine	93.866	2 R01 AG018844-05	116,830
Subtotal Department of Health and Human Services			380,110
Department of Education			
University of Akron	84.133	H133 A030810	116,440
Total Research and Development Pass-Through Programs			496,550
Total Research and Development			2,114,960
Research Training Direct Programs			
Department of Health and Human Services			
Aging Research	93.866		163,125
Total Research Training Direct Programs			163,125
Research Training Passed Through from Other Organizations			
Department of Health and Human Services			
National Institutes of Health			
Albert Einstein Healthcare Network	93.929	5 K12 HD001097-10	108,133
Total Research Training Pass-Through Programs			108,133
Total Research Training			271,258
Total Research and Development and Research Training Cluster			2,386,218
Total Federal Expenditures			$ 2,386,218

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

The Spaulding Rehabilitation Hospital Corporation
Notes to Schedule of Expenditures of Federal Awards
September 30, 2006

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 or credits to amounts reported as expenditures in prior years.

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, 2003 through September 30, 2007 of 65% for research. Fringe benefit rates for the period October 1, 2005 through September 30, 2006 range from 29.5% to 32.5%.

3. Subrecipients

During fiscal 2006, the Hospital provided to subrecipients in the Research and Development and Research Training Program $223,205 as follows. These amounts are included in the accompanying Schedule of Expenditures of Federal Awards:

Arizona State University	$ 53,658
Boston University	34,067
Dartmouth College	5,106
Harvard University	1,226
Hebrew Rehabilitation Center	2,137
HRCA Research & Training Institute	433
Massachusetts General Hospital	126,578
	$ 223,205

Part II

Reports on Compliance and Internal Controls

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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, 2006 and have issued our report thereon dated December 8, 2006, which includes an explanatory paragraph regarding the adoption of Financial Accounting Standards Board Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, and Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. 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 in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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 8, 2006.

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 those specified parties.

PricewaterhouseCoopers LLP

December 8, 2006

PRICEWATERHOUSECOOPERS

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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, 2006. 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, 2006.

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 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 and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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 those specified parties.

PricewaterhouseCoopers LLP

December 8, 2006

Part III

Findings

The Spaulding Rehabilitation Hospital Corporation
Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

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
Reportable condition(s) identified not considered to be material weaknesses?	___ yes	_X_ none reported
Noncompliance material to financial statements noted?	___ yes	_X_ no

Federal Awards

Internal control over financial reporting		
Material weakness(es) identified?	___ yes	_X_ no
Reportable condition(s) identified 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 Circular A-133, Section .510(a)?	___ yes	_X_ no

Identification of Major Programs

Research and Development and Research Training	Various CFDA numbers
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. Findings and Questioned Costs for Federal Awards

There were no findings 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.