SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

CONSOLIDATED FINANCIAL REPORT

MARCH 31, 2010

CONTENTS

Independent Auditors' Report	1
Consolidated Financial Statements:	
Consolidated Balance Sheets	2
Consolidated Statements of Operations and Changes in Net Assets	3
Consolidated Statements of Cash Flows	4
Notes to Consolidated Financial Statements	5-13
Schedule of Expenditures of Federal Awards	14
Notes to Schedule of Expenditures of Federal Awards	15
Schedule of Non-Federal Awards	16
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Governmental Auditing Standards*	17
Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with *OMB Circular A-133*	19
Schedule of Findings and Questioned Costs	21

SEK&Co

Smith Elliott Kearns & Company, LLC
Certified Public Accountants & Consultants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Shenandoah Valley Medical System, Inc
Martinsburg, West Virginia

We have audited the accompanying consolidated balance sheet of Shenandoah Valley Medical System, Inc. (a not-for-profit Organization) as of March 31, 2010, and the related consolidated statements of operations and changes in net assets, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Organization's management Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The consolidated financial statements of the Organization as of March 31, 2009, were audited by other auditors whose report dated November 23, 2009, expressed an unqualified opinion on those 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of March 31, 2010, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 14, 2010, on our consideration of the Organization'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 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 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 or our audit.

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements of the Organization taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the 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 consolidated financial statements. The accompanying schedule of non-federal awards for the year ended March 31, 2010 is presented for purposes of additional information and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated, in all material respects in relation to the basic 2010 consolidated financial statements taken as a whole

Hagerstown, Maryland
June 14, 2010

Smith Elliott Kearns & Company, LLC

DHHR - Finance

AUG 13 2010

Date Received

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

CONSOLIDATED BALANCE SHEETS
MARCH 31, 2010 AND 2009

ASSETS	2010	2009
CURRENT ASSETS		
Cash and cash equivalents	$ 2,278,639	$ 1,529,052
Cash equivalents designated for debt service	427,467	425,603
Patient receivables, less allowance for doubtful accounts of $581,256 and $865,005 in 2010 and 2009, respectively	1,071,641	984,092
Grants receivable	479,332	64,655
Medicare/medicaid settlement receivable	560,396	422,877
Other current assets	250,091	175,115
TOTAL CURRENT ASSETS	$ 5,067,566	$ 3,601,394
ASSETS LIMITED AS TO USE		
Cash equivalents designated for capital acquisitions	$ 556,345	$ 543,738
PROPERTY AND EQUIPMENT		
Land and land improvements	$ 763,639	$ 763,639
Buildings and building improvements	8,016,933	8,034,898
Equipment	3,855,125	3,268,090
Vehicles	307,670	307,670
Leasehold improvements	533,215	43,222
	$ 13,476,582	$ 12,417,519
Less accumulated depreciation	4,419,529	3,884,574
	$ 9,057,053	$ 8,532,945
Construction in progress	72,685	4,300
PROPERTY AND EQUIPMENT, NET	$ 9,129,738	$ 8,537,245
TOTAL ASSETS	$ 14,753,649	$ 12,682,377

LIABILITIES AND NET ASSETS	2010	2009
CURRENT LIABILITIES		
Accounts payable	$ 274,472	$ 205,778
Accrued payroll and related items	1,083,963	1,109,599
Current maturities of capital lease obligations	6,710	7,621
Current maturities of notes payable	190,725	179,159
Deferred revenue	533,918	89,433
TOTAL CURRENT LIABILITIES	$ 2,089,788	$ 1,591,590
LONG-TERM LIABILITIES		
Capital lease obligations, less current portion	6,272	12,982
Notes payable, less current portion	7,840,422	8,040,322
TOTAL LONG-TERM LIABILITIES	$ 7,846,694	$ 8,053,304
TOTAL LIABILITIES	$ 9,936,482	$ 9,644,894
NET ASSETS		
Unrestricted	$ 4,817,167	$ 3,037,483
TOTAL LIABILITIES AND NET ASSETS	$ 14,753,649	$ 12,682,377

The Notes to the Consolidated Financial Statements are an integral part of these statements.

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED MARCH 31, 2010 AND 2009

	2010	2009
UNRESTRICTED REVENUE AND SUPPORT		
Net patient service revenue	$ 11,804,598	$ 11,356,906
Federal grants	3,887,708	3,400,561
State grants	281,474	251,134
Interest income	14,985	28,662
Other income	473,301	389,676
Contributions	75,050	39,519
TOTAL UNRESTRICTED REVENUE AND SUPPORT	$ 16,537,116	$ 15,466,458
EXPENSES		
Salaries and wages	$ 9,967,332	$ 9,501,463
Employee benefits	1,363,871	1,282,124
Pension expense	167,386	177,048
Employee-related expenses	256,781	255,222
Contracted services	83,871	34,784
Consulting services	117,058	75,604
Medical supplies	588,986	501,742
Office supplies	105,078	103,258
Lab contracted services	162,852	138,911
Equipment-related expenses	474,861	288,558
Insurance	41,016	36,527
Facility operations	463,588	409,612
Office management	343,457	304,570
Depreciation	602,619	610,462
Legal and accounting	98,686	70,933
Provider tax	23,150	42,912
Provision for bad debts	368,575	653,405
Interest expense	422,126	439,908
Other expenses	136,608	166,015
TOTAL EXPENSES	$ 15,787,901	$ 15,093,058
INCOME FROM OPERATIONS	$ 749,215	$ 373,400
OTHER GAINS (LOSSES)		
(Loss) on sale of property and equipment	(7,935)	(45,250)
EXCESS REVENUES OVER EXPENSES	$ 741,280	$ 328,150
Grant funds used to purchase property and equipment	1,038,404	16,373
CHANGE IN NET ASSETS	$ 1,779,684	$ 344,523
NET ASSETS - BEGINNING OF YEAR	3,037,483	2,692,960
NET ASSETS - END OF YEAR	$ 4,817,167	$ 3,037,483

The Notes to the Consolidated Financial Statements are an integral part of these statements.

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED MARCH 31, 2010 AND 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	$ 1,779,684	$ 344,523
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	602,619	610,462
Loss on sale of property and equipment	7,935	45,250
Provision for bad debts	368,575	653,405
(Increase) in patient receivables, net	(456,124)	(414,693)
(Increase) decrease in grants receivable	(414,677)	46,545
(Increase) decrease in due from third-party payers	(137,519)	(363,374)
(Increase) decrease in other current assets	(74,976)	7,631
Increase in accounts payable	68,694	260
Increase (decrease) in accrued payroll and related items	(25,636)	88,270
Increase (decrease) in deferred revenue	444,485	(1,057)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 2,163,060	$ 1,017,222
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of property and equipment	$ (1,203,047)	$ (140,141)
NET CASH (USED) BY INVESTING ACTIVITIES	$ (1,203,047)	$ (140,141)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on long-term debt	$ (195,955)	$ (192,060)
NET CASH (USED) BY FINANCING ACTIVITIES	$ (195,955)	$ (192,060)
NET INCREASE IN CASH AND CASH EQUIVALENTS	$ 764,058	$ 685,021
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	2,498,393	1,813,372
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 3,262,451	$ 2,498,393
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest	$ 422,126	$ 439,908

The Notes to the Consolidated Financial Statements are an integral part of these statements.

Note 1. Nature of Activities and Significant Accounting Policies

Nature of Activities:

Shenandoah Valley Medical System, Inc. (Organization) was incorporated in 1976 in West Virginia as a not-for-profit corporation. The Organization provides ambulatory care services primarily to patients residing in the Eastern Panhandle of West Virginia and the Winchester, Virginia areas Programs include general primary care, family practice, obstetrics and gynecology, internal medicine, pediatric medicine, behavioral health services, and Woman, Infants, and Children (WIC) services

During fiscal year 2005, the Organization established the Shenandoah Community Health Foundation (Foundation) to solicit, collect, and otherwise raise money and to expend and dispose of money exclusively for the benefit of the Organization. The Foundation is a non-stock, not-for-profit corporation with one sole voting member, the Organization

Principles of Consolidation:

The accompanying consolidated financial statements include the accounts of Shenandoah Valley Medical System, Inc. and its subsidiary Shenandoah Community Health Foundation. All significant intercompany transactions have been eliminated in consolidation

Use of Estimates:

The preparation of consolidated financial statements in conformity with generally accepted accounting principles, require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as of the date of financial statements, and revenues and expenses during the reporting period. Actual results could differ from these estimates

Cash and Cash Equivalents:

Cash and cash equivalents includes investments in highly liquid debt instruments with original maturities of three months or less when purchased, which are not limited as to use.

Net Patient Receivables:

Patient receivables are reported at estimated net realizable amounts from patients and responsible third-party payers. Amounts owed to the Organization are reported net of allowances for bad debts and contractual adjustments. Specific patient balances are written off at the time they are determined to be uncollectible. The process for estimating the ultimate collection of receivables involves significant assumptions and judgments.

In this regard, the Organization has implemented a standardized approach to estimate and review the collectability of its receivables based on accounts receivable aging trends. Historical collection and payer reimbursement experience is an integral part of the estimation process related to determining the allowance for contractual adjustments and doubtful accounts. In addition, the Organization assesses the current state of its billing functions in order to identify any known collection or reimbursement issues to determine the impact, if any, on its reserve estimates, which involve judgment Revisions in reserve estimates are recorded as an adjustment to net patient service revenue for contractual adjustments and bad debt expenses for doubtful accounts. The Organization believes that its collection and reserve processes, along with the monitoring of its billing processes, help to reduce the risk associated with material revisions to reserve estimates resulting from adverse changes in collection, reimbursement experience and billing functions

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Property and Equipment:

Property and equipment is reported at cost for purchased items and at fair value for contributed items Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Construction in progress represents capital projects underway but not completed as of year end. Construction in progress is not depreciated until the asset is complete and placed into service. The Organization's policy is to capitalize assets whose expected useful life is in excess of one year and cost (or fair value) is greater than $1,000. Depreciation is computed on the straight-line method based on estimated service lives of the assets as follows:

Buildings and building improvements	5-39 years
Equipment	8-50 years
Vehicles	3-10 years
Leasehold improvements	7-20 years

Net Assets:

Net assets of the Organization and changes therein are classified and reported as follows:

Unrestricted net assets - net assets that are not subject to donor/grantor-imposed stipulations

Temporarily restricted net assets - net assets subject to donor/grantor-imposed stipulations that will be met either by actions of the Organization and/or the passage of time

Permanently restricted net assets - net assets subject to donor/grantor-imposed stipulations that they be maintained permanently by the Organization.

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

The Organization had no temporarily or permanently restricted net assets at March 31, 2010 and 2009

Contributions, Grants and Awards:

All contributions, grants and awards are considered to be available for unrestricted use unless specifically restricted by the donor/grantor. Amounts received that are designated for future periods or restricted by the donor/grantor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. However, if a restriction is fulfilled in the same time period in which the contribution, grant or award is received, the Organization reports the support as unrestricted

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Net Patient Service Revenue:
The Organization has agreements with third-party payers that provide for payments to the organization at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, and discounted charges Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlement is made

Excess Revenues Over (Under) Expenses:
The consolidated statements of operations and changes in net assets include income from operations Changes in unrestricted net assets which are excluded from income from operations are grant funds used to purchase property and equipment. Other changes in unrestricted net assets that would be excluded from income from operations, consistent with industry practice, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Charity Care:
The Organization provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Organization does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue.

Income Taxes:
The Organization has been recognized by the Internal Revenue Service as a not-for-profit-corporation and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code on income from operations related to its tax-exempt purpose.

The Organization is subject to the Health Care Provider Tax imposed by the State of West Virginia. These taxes are imposed based on healthcare related services provided in the State of West Virginia and are reported on the consolidated statements of operations and changes in net assets

The Organization follows the FASB Accounting Standards Codification, which provides guidance on accounting for uncertainty in income taxes recognized in an enterprise's financial statements. As of March 31, 2010, the Organization had no uncertain tax positions that qualify for either recognition or disclosure in the financial statements. Generally, the tax years beginning before March 31, 2006 are no longer subject to examination by federal, state or local taxing authorities.

Interest:
The Organization incurred $422,126 and $439,908 of interest costs during the years ended March 31, 2010 and 2009, respectively. No interest costs have been capitalized for the years ended March 31, 2010 and 2009

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Marketing and Advertising Costs:

The Organization expenses marketing and advertising costs in the period in which they have been incurred. A total of $51,170 and $34,546 in such costs are included in other expenses on the consolidated statements of operations and changes in net assets for the years ended March 31, 2010 and 2009, respectively.

Grant Revenue:

Federal, state and other grant revenue resulting from exchange transactions are recognized by the Organization as related grant program expenses are incurred. Grant funds are recorded as deferred revenue or grants receivable if related program expenditures are less than, or greater than, receipts for the period, respectively.

Reclassifications:

There were certain reclassifications made to 2009 amounts to be consistent with the 2010 presentation. These reclassifications had no effect on the change in net assets previously reported for the year ended March 31, 2009.

Note 2. Patient Receivables

Patient receivables, amounts due from patient and responsible parties, are reported net of estimated contractual adjustments and bad debt allowances of $581,256 and $865,005 at March 31, 2010 and 2009, respectively. The Organization grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers at March 31, 2010 and 2009 was as follows:

	2010	2009
Medicare	9%	8%
Medicaid	29%	22%
Other third-party payers	41%	40%
Self-pay	21%	30%
	100%	100%

Note 3. Due From Third-Party Payers

The Organization's estimated reimbursement for services rendered to Medicare and Medicaid program beneficiaries is determined by the submission and settlement of cost report submissions to the Medicare and Medicaid programs. At March 31, 2010 and 2009, outstanding estimated settlements are as follows:

	Medicare Program	Medicaid Program	Total
Year ended March 31, 2010	$ 42,974	$ 517,422	$ 560,396
Year ended March 31, 2009	$ 70,332	$ 352,545	$ 422,877

Note 3. Due From Third-Party Payers (Continued)

The Organization provides services to Medicare and Medicaid patients under cost-based reimbursement contracts. Settlements due to/from the Medicare and Medicaid programs are reported as net patient service revenue in the year the services are provided.

Note 4. Assets Limited as to Use

Assets limited as to use totaled $983,812 and $969,341 at March 31, 2010 and 2009, respectively, and consist of certificates of deposit and money market funds held at various financial institutions with varying interest rates and maturity dates. These assets have been designated by the Board of Directors for future capital improvements and to meet debt service requirements as required by the loan agreement for the new health care facility.

Note 5. Line of Credit

The Organization has an available line of credit with Branch Banking and Trust (BB&T) with a maximum commitment amount of $200,000 and a variable interest rate at the bank's prime lending rate (3.25% at March 31, 2010). The line of credit is secured by patient receivables. There was no outstanding balance at March 31, 2010 and 2009.

Note 6. Notes Payable

The notes payable at March 31 consist of the following:

	2010	2009
Note payable to United NCB Development Corporation (NCB), payable in monthly installments of $20,713, including interest of 6.65% with final balloon payment in January 2031, jointly secured with the USDA note by substantially all of the Organization's assets	$ 2,772,746	$ 2,832,437
Note payable to United States Department of Agriculture (USDA), payable in monthly installments of $25,593, including interest of 4.25% with final payment in January 2036, jointly secured by substantially all the Organization's assets with the NCB note above	4,801,824	4,902,231
Note payable to Hill-Dale Corporation, payable in monthly installments of $228, with final payment in April 2010, unsecured	227	2,963

Note 6. Notes Payable (Continued)

Note Payable to Branch Banking and Trust (BB&T), payable in monthly installments of $636, including interest at the bank's prime rate plus 0.5% (3.75% at March 31, 2010), with final payment in October 2016, secured by a certificate of deposit	40,208	46,192
Note payable to Branch Banking and Trust (BB&T), payable in monthly installments of $2,310, including interest at the bank's prime rate (3 25% at March 31, 2010), with final payment in April 2022, secured by a certificate of deposit	245,896	261,419
Note payable to Branch Banking and Trust (BB&T), payable in monthly installments of $1,490, including interest at 7 75%, with final balloon payment in November 2012, secured by the assignment of leases and rents	170,246	174,239
	$ 8,031,147	$ 8,219,481
Less current portion	190,725	179,159
	$ 7,840,422	$ 8,040,322

Aggregate maturities of the above notes payable are as follows for years ending March 31:

2011	$ 190,725
2012	204,880
2013	216,027
2014	227,278
2015	239,170
Thereafter	6,953,067
	$ 8,031,147

Debt Covenants

The Organization is subject to certain covenants as part of the aforementioned debt obligations. The Organization was in compliance with all debt covenants as of March 31, 2010.

Note 7. Capital Lease Obligations

Obligations under capital lease existing at March 31 are as follows:

	2010	2009
Beckman Coulter, payable in monthly installments of $773, including interest of 25.58%, maturing December 2011, collateralized by lab equipment with a cost of $25,970 and accumulated depreciation of $11,687.	$ 12,982	$ 18,191
All-Lines Leasing, payable in monthly installments of $895, including interest of 23.10%, maturing June 2009, collateralized by janitorial equipment with a cost of $17,193 and accumulated depreciation of $6,018.	-	2,412
	$ 12,982	$ 20,603
Less current portion	6,710	7,621
	$ 6,272	$ 12,982

The future minimum lease payments on the above lease are as follows for years ending March 31:

2011	$ 9,280
2012	6,960
Total future payments	$ 16,240
Less amount representing interest	3,258
Total capital lease obligations	$ 12,982

Note 8. Net Patient Service Revenue

Reconciliation of gross patient service revenue, computed at standard service charges, to net patient service revenue for the years ended March 31, 2010 and 2009 is as follows:

	2010	2009
Gross patient service revenue	$ 13,525,411	$ 13,277,701
Sliding fee adjustments (charity)	(1,586,854)	(1,492,863)
Contractual adjustments	(133,959)	(427,932)
Net patient service revenue	$ 11,804,598	$ 11,356,906

Note 9. Retirement Plan

The Organization has a defined contribution plan that covers substantially all regular full-time and regular part-time employees with specified service levels. The Organization's contribution is based on a percentage of each employee's salary. Employees may also make voluntary contributions. Funded retirement benefits are held in various investment vehicles designated by the employees. Contributions to the plan by the Organization amounted to $167,386 and $177,048 for the years ended March 31, 2010 and 2009, respectively

Note 10. Commitments and Contingencies

Cash Balances in Excess of FDIC Insurance:

The Organization maintains cash in demand deposit accounts with federally insured banks. At times the balances in these accounts may be in excess of federally insured limits In management's opinion, the amounts in excess of FDIC limits do not pose a significant risk to the Organization

Revenue and Support Dependency:

The Organization is significantly dependent on reimbursement from the Medicaid program. Changes in program requirements or funding mechanisms could significantly impact future operating results and financial position. Additionally, a substantial portion of the Organization's revenues are generated through grants received from the U.S Department of Health and Human Services and the West Virginia Department of Health and Human Resources. Curtailment of grant funding by the grantor agencies could have a significant effect on the operations of the Organization

The Organization serves the areas surrounding the Eastern Panhandle of West Virginia and, accordingly, the amount of charity care provided and dependence on the Medicaid program is determined by the local economy.

Operating Leases:

The Organization leases office space at various locations in Martinsburg and the surrounding area under operating leases Medical equipment is also leased under terms of operating leases These leases expire between 2010 and 2019 Total rental payments for office space and equipment under operating leases for the years ended March 31, 2010 and 2009 were $114,368 and $148,396, respectively

Future minimum lease payments on all operating leases are as follows for years ending March 31:

2011	$ 157,090
2012	$ 154,066
2013	$ 159,052
2014	$ 164,227
2015	$ 146,921

Medical Malpractice:

The Organization's health care professionals are covered by the Federal Tort Claims Act, and, therefore, no professional liability insurance is necessary. Pursuant to Section 224 of the Public Health Service (PHS) Act, 42 USC 233, the Federal Tort Claims Act covers alleged negligent medical care during the performance of official duties for Community Health Centers funded under Section 330 of the PHS Act. Under the Federal Tort Claims Act, the U S. Government consents to be sued for any damage to property or for personal injury or death caused by the negligence or wrongful act or omission of Federal employees who were acting within the scope of their employment

Note 11. Functional Expenses

The following reflects the Organization's expenses reported by functional classification for the years ended March 31, 2010 and 2009:

	2010	2009
Patient care	$ 13,419,716	$ 12,829,099
Management and general	2,368,185	2,263,959
	$ 15,787,901	$ 15,093,058

Note 12. Subsequent Events

The Organization has evaluated events and transactions subsequent to March 31, 2010 through June 14, 2010, the date these financial statements were available to be issued. Based on the definitions and requirements of generally accepted accounting principles, management has not identified any events that have occurred subsequent to March 31, 2010 through June 14, 2010 that require recognition or disclosure in the financial statements.

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED MARCH 31, 2010

Federal Grantor/ Pass-Through Grantor/ Program Title	Federal CFDA Number	Pass-Through Entity Number	Federal Expenditures
U.S. Department of Health and Human Services			
Direct Awards:			
* Community Health Centers			
(4/1/09 - 3/31/10)	93.224	N/A	$ 2,772,939
ARRA:			
* Increase Services to Health Centers	93.703	N/A	83,864
* Capital Improvement Program	93.703	N/A	871,448
Pass-Through Awards:			
Passed through West Virginia Department of Health and Human Resources:			
Family Planning Services			
(7/1/08 - 6/30/09)	93.217	FP09-2078	31,546
(7/1/09 - 6/30/10)	93.217	FP10-2078	86,298
Breast and Cervical Cancer Screening			
(7/1/08 - 6/30/09)	93.283	BC09-1055	7,334
(7/1/09 - 6/30/10)	93.283	BC10-1049	38,420
Family Resource Network			
(7/1/08 - 6/30/09)	93.590	G090244	2,972
(7/1/09 - 6/30/10)	93.590	G100326	2,972
Passed through Vanderbilt University:			
Southern Community Cohort Study	93.393	5R01CA092447	70,566
Passed through West Virginia University Research Corporation:			
Developing a Center of Excellence for Outpatient HIV Early Intervention Services	93.918	5H76HA01719	48,643
Passed through Washington D.C. Department of Health:			
HIV-Related Core Medical Services Support Services for Metropolitan Areas	93.914	Unknown	25,446
Pass-through E.A. Hawse Health Center:			
Oral Health Earmark Grant	93.887	C76HF16460	187,842
Total U.S. Department of Health and Human Services			$ 4,230,290
U.S. Department of Agriculture			
Pass-Through Awards:			
Passed through West Virginia Department of Health and Human Resources:			
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)			
* (10/1/08 - 9/30/09)	10.557	G090548	$ 455,518
* (10/1/09 - 9/30/10)	10.557	G100530	365,563
Total U.S. Department of Agriculture			$ 821,081
Total Expenditures of Federal Awards			$ 5,051,371

* These programs are considered to be major federal financial assistance programs as defined by the Single Audit Act Amendments of 1997

The accompanying notes are an integral part of this schedule

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note 1. Single Audit Overview

The Single Audit is the performance of a uniform audit of all Shenandoah Valley Medical System, Inc.'s federal grants in conjunction with the annual audit of the consolidated basic financial statements The adoption of such a procedure was formalized by the Federal Office of Management and Budget (OMB) in Circular A-133 The Single Audit fulfills all the Federal agencies' audit requirements, which include financial, compliance and the adequacy of internal control. The programs tested as major programs are indicated on the Schedule of Expenditures of Federal Awards and on the Schedule of Findings and Questioned Costs and amounted to 92% of total federal award expenditures.

Note 2. Fiscal Period Audited

Single Audit testing procedures were performed for transactions occurring during the fiscal year ended March 31, 2010.

Note 3. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Shenandoah Valley Medical System, Inc. and is presented 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.

Total expenditures of federal awards as of March 31, 2010	$ 5,051,371
Less: Amount recorded in property and equipment in the consolidated statement of financial position as of March 31, 2010 related to the ARRA - Capital Improvement Program	841,971
Total expenditures of federal awards recorded in the consolidated statement of activities as of March 31, 2010	$ 4,209,400

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

SCHEDULE OF NON-FEDERAL AWARDS
YEAR ENDED MARCH 31, 2010

Grantor Name/ Program Title	Grant Number	Award Amount	Receivable (Deferred Revenue) 3/31/2009	Receipts 4/1/09 - 3/31/2010	Expenditures 4/1/09 - 3/31/2010	Receivable (Deferred Revenue) 3/31/2010
West Virginia Department of Health and Human Resources						
Family Planning Services						
(7/1/09 - 6/30/10)	MOU# FP10-2078	$ 37,193	$ -	$ 37,193	$ 37,193	$ -
(7/1/08 - 6/30/09)	MOU# FP09-2078	$ 12,498	$ -	$ 12,498	$ 12,498	$ -
Breast and Cervical Cancer Screening	MOU# BC09-1055	$ 36,344	$ -	$ 36,344	$ 36,344	$ -
Uncompensated Care						
(7/1/08 - 6/30/09)	G090062	$ 142,036	$ -	$ 62,892	$ 62,892	$ -
(7/1/09 - 6/30/10)	G100097	$ 126,793	$ -	$ 71,523	$ 71,523	$ -
Mortage Finance						
(7/1/08 - 6/30/09)	G090085	$ 54,000	$ -	$ 17,820	$ 17,820	$ -
(7/1/09 - 6/30/10)	G100129	$ 54,000	$ -	$ 17,820	$ 17,820	$ -
Family Resource Center						
(7/1/08 - 6/30/09)	G090244	$ 39,056	$ -	$ 39,056	$ 39,056	$ -
(7/1/09 - 6/30/10)	G100326	$ 43,942	$ -	$ 43,942	$ 43,942	$ -

Note: This schedule of expenditures of non-federal awards includes the primary West Virginia grant activity of Shenandoah Valley Medical System, Inc. and is presented on the accrual basis of accounting. Some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

See Independent Auditor's Report.

Smith Elliott Kearns & Company, LLC
Certified Public Accountants & Consultants

REPORT 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 Directors
Shenandoah Valley Medical System, Inc
Martinsburg, West Virginia

We have audited the consolidated financial statements of Shenandoah Valley Medical System, Inc. (Organization) as of and for the year ended March 31, 2010, and have issued our report thereon dated June 14, 2010. 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 Organization'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 Organization's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's consolidated financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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. However, we identified a certain deficiency in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be a significant deficiency in internal control over financial reporting (Finding 10-1). A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Smith Elliott Kearns & Company, LLC
Certified Public Accountants & Consultants

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's consolidated 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*.

This report is intended solely for the information and use of management, the Board of Directors, others within the Organization, 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.

Smith Elliott Kearns & Company, LLC

Hagerstown, Maryland
June 14, 2010

Smith Elliott Kearns & Company LLC
Certified Public Accountants & Consultants

REPORT 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 Directors
Shenandoah Valley Medical System, Inc.
Martinsburg, West Virginia

Compliance

We have audited the compliance of Shenandoah Valley Medical System, Inc. (Organization) 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 March 31, 2010. The Organization'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 Organization's management. Our responsibility is to express an opinion on the Organization'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 Organization'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 Organization's compliance with those requirements.

In our opinion, the Organization 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 March 31, 2010.

Internal Control Over Compliance

Management of the Organization 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 Organization'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*, 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 Organization's internal control over compliance.

Smith Elliott Kearns & Company, LLC
Certified Public Accountants & Consultants

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, 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 management, the Board of Directors, others within the Organization, 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.

Smith Elliott Kearns & Company, LLC

Hagerstown, Maryland
June 14, 2010

DHHR - Finance

AUG 13 2010

Date Received

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

SECTION 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?	_X_ Yes ___ 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
Noncompliance material to federal awards?	___ Yes _X_ No
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 501(a) of OMB Circular A-133?	___ Yes _X_ No

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
93.224	Community Health Centers
93.703	ARRA - Increase Services to Health Centers
93.703	ARRA - Capital Improvement Program
10.557	Special Supplemental Nutrition Program for Woman, Infants, and Children (WIC)

Dollar threshold used to distinguish between type A and type B programs:	$300,000
Auditee qualified as low-risk auditee?	___ Yes _X_ No

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

SECTION II. - FINANCIAL STATEMENT FINDINGS

FINDING 10-1:

CRITERIA:	If an Organization does not have procedures and controls over financial reporting, including the necessary level of current, specialized knowledge to prevent, detect, or correct a potential misstatement in the financial statements or notes, this constitutes a deficiency in internal control.
CONDITION:	The financial statements for the Organization are currently prepared by its auditors as part of the audit process with a review of the statements by Management and accounting personnel of the Organization. This occurred because the Organization chose to outsource the preparation of its external financial statements and accompanying footnotes as part of the annual audit process. This condition is considered to be a significant deficiency.
CAUSE:	The Organization chose to outsource the preparation of its financial statements and related disclosures because it is the most efficient and cost effective manner to accomplish this part of the financial reporting process.
QUESTIONED COSTS:	None
EFFECT:	The financial statements could have been misstated or incomplete and the Organization's internal control system alone may not have identified this.
RECOMMENDATION:	Many nonprofit entities have determined that it is cost beneficial to rely on the auditor to prepare the entity's financial statements and help guide management through complex accounting standards, which is perfectly acceptable and a cost effective way of dealing with this issue. Therefore, there is not a recommendation related to this finding.
MANAGEMENT'S RESPONSE:	Although we are aware of the standards concerning the preparation of financial statements, we chose to have our auditors prepare them. We believe this is very cost effective. Internal financial statements without full disclosures are prepared on a monthly basis and reviewed by the Board of Directors

SECTION III. - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

There are no findings or questioned costs reported.

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

SECTION IV. - SCHEDULE OF PRIOR YEAR FINDINGS

FINDING 09-1: Accounts Receivable Reconciliation

During prior audits, it was determined that the accounts receivable reconciliation control process included design and implementation system flaws. That reconciliation process was not corrected in prior years and a material difference existed between the detailed accounts receivable and the general ledger balances. This condition was considered to be a material weakness in relation to the audit objective of fairly presenting financial statement information that is materially accurate.

Status: Corrected during September and October 2009

FINDING 09-2: Cash Reconciliation

During last year's audit, it was determined that the cash reconcilation control process included design and implementation system flaws. An unreconciled difference existed between the bank statement for the operating checking account and the general ledger balances. This condition was considered to be a material weakness in relation to the audit objective of fairly presenting financial statement information that is materially accurate when considered in combination with Finding 09-1.

Status: Corrected during September and October 2009