

**SHENANDOAH VALLEY MEDICAL SYSTEM, INC.**

**CONSOLIDATED FINANCIAL REPORT**

**MARCH 31, 2011**

DHHR - Finance

JUL -1 2011

Date Received

## 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 <i>Governmental Auditing Standards</i>	17
Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with <i>OMB Circular A-133</i>	19
Schedule of Findings and Questioned Costs	21



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 sheets of Shenandoah Valley Medical System, Inc (a not-for-profit Organization) as of March 31, 2011 and 2010, and the related consolidated statements of operations and changes in net assets, and cash flows for the years 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 audits

We conducted our audits 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 audits 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 audits provide 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, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 24, 2011, 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 of our audits.

Our audits were 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. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The accompanying schedule of non-federal awards for the year ended March 31, 2011 is presented for purposes of additional information and is not a required part of the basic consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, this information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

DHHR - Finance

Smith Elliott Kearns & Company, LLC

Hagerstown, Maryland  
June 24, 2011

JUL - 1 2011

Date Received

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

CONSOLIDATED BALANCE SHEETS  
MARCH 31, 2011 AND 2010

<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
<b><u>CURRENT ASSETS</u></b>		
Cash and cash equivalents	\$ 2,074,643	\$ 2,278,639
Cash equivalents designated for debt service	429,227	427,467
Cash equivalents designated for capital acquisitions	566,013	556,345
Patient receivables, less allowance for doubtful accounts of \$588,774 and \$581,256 in 2011 and 2010, respectively	1,355,746	997,731
Grants receivable	327,456	532,541
Medicare/medicaid settlement receivable	331,422	560,396
Other current assets	226,290	270,792
<b>TOTAL CURRENT ASSETS</b>	<b>\$ 5,310,797</b>	<b>\$ 5,623,911</b>
<b><u>PROPERTY AND EQUIPMENT</u></b>		
Land and land improvements	\$ 903,515	\$ 763,639
Buildings and building improvements	8,073,793	8,034,898
Equipment	3,607,279	3,855,125
Vehicles	307,670	307,670
Leasehold improvements	559,350	535,471
	<u>\$ 13,451,607</u>	<u>\$ 13,496,803</u>
Less accumulated depreciation	4,493,287	4,439,750
	<u>\$ 8,958,320</u>	<u>\$ 9,057,053</u>
Construction in progress	-	72,685
<b>PROPERTY AND EQUIPMENT, NET</b>	<b>\$ 8,958,320</b>	<b>\$ 9,129,738</b>
<b>TOTAL ASSETS</b>	<b>\$ 14,269,117</b>	<b>\$ 14,753,649</b>

<b><u>LIABILITIES AND NET ASSETS</u></b>	<b><u>2011</u></b>	<b><u>2010</u></b>
<b><u>CURRENT LIABILITIES</u></b>		
Accounts payable	\$ 322,253	\$ 274,472
Accrued payroll and related items	821,725	1,083,963
Current maturities of capital lease obligations	6,272	6,710
Current maturities of notes payable	204,860	190,725
Deferred revenue	236,139	533,918
<b>TOTAL CURRENT LIABILITIES</b>	<b><u>\$ 1,591,249</u></b>	<b><u>\$ 2,089,788</u></b>
<b><u>LONG-TERM LIABILITIES</u></b>		
Capital lease obligations, less current portion	\$ -	\$ 6,272
Notes payable, less current portion	7,635,706	7,840,422
<b>TOTAL LONG-TERM LIABILITIES</b>	<b><u>\$ 7,635,706</u></b>	<b><u>\$ 7,846,694</u></b>
<b>TOTAL LIABILITIES</b>	<b><u>\$ 9,226,955</u></b>	<b><u>\$ 9,936,482</u></b>
<b><u>NET ASSETS</u></b>		
Unrestricted	\$ 5,042,162	\$ 4,817,167
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b><u>\$ 14,269,117</u></b>	<b><u>\$ 14,753,649</u></b>

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, 2011 AND 2010

	<b>2011</b>	<b>2010</b>
<b><u>UNRESTRICTED REVENUE AND SUPPORT</u></b>		
Net patient service revenue	\$ 13,483,753	\$ 11,804,598
Federal grants	3,754,219	3,887,708
State grants	336,775	281,474
Interest income	12,480	14,985
Other income	436,857	473,301
Contributions	133,569	75,050
	<b>\$ 18,157,653</b>	<b>\$ 16,537,116</b>
<b><u>EXPENSES</u></b>		
Salaries and wages	\$ 11,348,720	\$ 9,967,332
Employee benefits	1,629,524	1,363,871
Pension expense	232,160	167,386
Employee-related expenses	268,584	256,781
Contracted services	101,223	83,871
Consulting services	71,490	117,058
Medical supplies	702,524	588,986
Office supplies	110,616	105,078
Lab contracted services	219,748	162,852
Equipment-related expenses	384,737	474,861
Insurance	44,949	41,016
Facility operations	544,806	463,588
Office management	567,407	343,457
Depreciation	608,990	602,619
Legal and accounting	98,650	98,686
Provider tax	6,327	23,150
Provision for bad debts	554,279	368,575
Interest expense	396,596	422,126
Other expenses	161,114	136,608
	<b>\$ 18,052,444</b>	<b>\$ 15,787,901</b>
<b>INCOME FROM OPERATIONS</b>	<b>\$ 105,209</b>	<b>\$ 749,215</b>
<b><u>OTHER GAINS (LOSSES)</u></b>		
(Loss) on sale of property and equipment	-	(7,935)
<b><u>EXCESS REVENUES OVER EXPENSES</u></b>	<b>\$ 105,209</b>	<b>\$ 741,280</b>
Grant funds used to purchase property and equipment	119,786	1,038,404
<b>CHANGE IN NET ASSETS</b>	<b>\$ 224,995</b>	<b>\$ 1,779,684</b>
<b><u>NET ASSETS - BEGINNING OF YEAR</u></b>	<b>4,817,167</b>	<b>3,037,483</b>
<b><u>NET ASSETS - END OF YEAR</u></b>	<b>\$ 5,042,162</b>	<b>\$ 4,817,167</b>

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, 2011 AND 2010

	2011	2010
<b><u>CASH FLOWS FROM OPERATING ACTIVITIES</u></b>		
Change in net assets	\$ 224,995	\$ 1,779,684
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	608,990	602,619
Loss on sale of property and equipment	-	7,935
Provision for bad debts	554,279	368,575
(Increase) in patient receivables, net	(912,294)	(456,124)
(Increase) decrease in grants receivable	205,085	(414,677)
(Increase) decrease in due from third-party payers	228,974	(137,519)
(Increase) decrease in other current assets	44,502	(74,976)
Increase in accounts payable	47,781	68,694
(Decrease) in accrued payroll and related items	(262,238)	(25,636)
Increase (decrease) in deferred revenue	(297,779)	444,485
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ 442,295</b>	<b>\$ 2,163,060</b>
<b><u>CASH FLOWS FROM INVESTING ACTIVITIES</u></b>		
Acquisition of property and equipment	\$ (437,572)	\$ (1,203,047)
<b>NET CASH (USED) BY INVESTING ACTIVITIES</b>	<b>\$ (437,572)</b>	<b>\$ (1,203,047)</b>
<b><u>CASH FLOWS FROM FINANCING ACTIVITIES</u></b>		
Principal payments on long-term debt	\$ (197,291)	\$ (195,955)
<b>NET CASH (USED) BY FINANCING ACTIVITIES</b>	<b>\$ (197,291)</b>	<b>\$ (195,955)</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>\$ (192,568)</b>	<b>\$ 764,058</b>
<b><u>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</u></b>	<b>3,262,451</b>	<b>2,498,393</b>
<b><u>CASH AND CASH EQUIVALENTS, END OF YEAR</u></b>	<b>\$ 3,069,883</b>	<b>\$ 3,262,451</b>
<b><u>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</u></b>		
Cash paid during the year for interest	\$ 396,596	\$ 422,126

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

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL 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.



SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. Donor-restricted contributions whose restrictions are met within the same year as received are classified as unrestricted contributions in the accompanying financial statements.

The Organization had no temporarily or permanently restricted net assets at March 31, 2011 and 2010.

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

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**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 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.

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, 2011, the Organization had no uncertain tax positions that qualify for either recognition or disclosure in the financial statements. The Organization's policy is to recognize interest and penalties on unrecognized tax benefits in income tax expense in the financial statements. For the years ended March 31, 2011 and 2010, respectively, there were no interest or penalties recorded or included in the financial statements. Generally, the tax years beginning before March 31, 2007 are no longer subject to examination by federal, state or local taxing authorities.

**Interest:**

The Organization incurred \$396,596 and \$422,126 of interest costs during the years ended March 31, 2011 and 2010, respectively. No interest costs have been capitalized for the years ended March 31, 2011 and 2010.

**SHENANDOAH VALLEY MEDICAL SYSTEM, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**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 \$47,027 and \$51,170 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, 2011 and 2010, 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 2010 amounts to be consistent with the 2011 presentation. These reclassifications had no effect on the change in net assets previously reported for the year ended March 31, 2010.

**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 \$588,774 and \$581,256 at March 31, 2011 and 2010, 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, 2011 and 2010 was as follows:

	2011	2010
Medicare	11%	9%
Medicaid	35%	29%
Other third-party payers	38%	41%
Self-pay	16%	21%
	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, 2011 and 2010, outstanding estimated settlements are as follows:

	Medicare Program	Medicaid Program	Total
Year ended March 31, 2011	\$ 49,911	\$ 281,511	\$ 331,422
Year ended March 31, 2010	\$ 42,974	\$ 517,422	\$ 560,396

**SHENANDOAH VALLEY MEDICAL SYSTEM, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**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. These settlements are subject to review and approval by the Third-Party Payers. Any change to the anticipated settlement is recognized in the financial statements at the time of settlement.

**Note 4. 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, 2011). The line of credit is secured by patient receivables. There was no outstanding balance at March 31, 2011 and 2010.

**Note 5. Notes Payable**

The notes payable at March 31 consist of the following:

	<b>2011</b>	<b>2010</b>
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	\$ 2,714,390	\$ 2,772,746
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	4,696,754	4,801,824
Note payable to Hill-Dale Corporation, payable in monthly installments of \$228, with final payment in April 2010, unsecured	-	227

**SHENANDOAH VALLEY MEDICAL SYSTEM, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Note 5. 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, 2011), with final payment in October 2016, secured by a certificate of deposit	33,993	40,208
Note payable to Branch Banking and Trust (BB&T), payable in monthly installments of \$1,992, including interest at the bank's prime rate (3.25% at March 31, 2011), with final payment in April 2022, secured by a certificate of deposit	229,852	245,896
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	165,577	170,246
	\$ 7,840,566	\$ 8,031,147
Less current portion	204,860	190,725
	\$ 7,635,706	\$ 7,840,422

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

2012	\$ 204,860
2013	216,027
2014	227,278
2015	239,170
2016	250,280
Thereafter	6,702,951
	\$ 7,840,566

**Debt Covenants**

The Organization is subject to certain covenants as part of the aforementioned debt obligations, one of which is a requirement to maintain cash balances for debt service and future capital improvements. These cash balances have been designated by the Board of Directors and total \$995,240 and \$983,812 at March 31, 2011 and 2010, respectively. The Organization was in compliance with all debt covenants as of and for the year ended March 31, 2011.

**SHENANDOAH VALLEY MEDICAL SYSTEM, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Note 6. Capital Lease Obligations**

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

	2011	2010
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 \$22,075.	\$ 6,272	\$ 12,982
Less current portion	6,272	6,710
	\$ -	\$ 6,272

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

Total future payments	\$ 6,959
Less amount representing interest	687
Total capital lease obligations	\$ 6,272

**Note 7. 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, 2011 and 2010 is as follows:

	2011	2010
Gross patient service revenue	\$ 17,556,468	\$ 13,525,411
Sliding fee adjustments (charity)	(2,788,711)	(1,586,854)
Contractual adjustments	(1,284,004)	(133,959)
Net patient service revenue	\$ 13,483,753	\$ 11,804,598

**Note 8. 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 \$232,160 and \$167,386 for the years ended March 31, 2011 and 2010, respectively.

**SHENANDOAH VALLEY MEDICAL SYSTEM, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Note 9. 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 Eastern Panhandle of West Virginia and the surrounding area, 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, West Virginia and the surrounding area under operating leases. Office equipment is also leased under terms of operating leases. These leases expire between 2011 and 2019. Total rental payments for office space and equipment under operating leases for the years ended March 31, 2011 and 2010 were \$168,611 and \$114,368, respectively.

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

2012	\$ 156,033
2013	\$ 148,926
2014	\$ 143,714
2015	\$ 126,061
2016	\$ 71,600

**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.

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Note 10. Functional Expenses**

The following reflects the Organization's expenses reported by functional classification for the years ended March 31, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Patient care	\$ 15,344,577	\$ 13,419,716
Management and general	2,707,867	2,368,185
	<u>\$ 18,052,444</u>	<u>\$ 15,787,901</u>

**Note 11. Subsequent Events**

The Organization has evaluated events and transactions subsequent to March 31, 2011 through June 24, 2011, 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, 2011 through June 24, 2011 that require recognition or disclosure in the financial statements.



SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED MARCH 31, 2011

Federal Grantor/ Pass-Through Grantor/ Program Title	Federal CFDA Number	Pass-Through Entity Number	Federal Expenditures
<b><u>U.S. Department of Health and Human Services</u></b>			
<b>Direct Awards:</b>			
* Community Health Centers (4/1/10 - 3/31/11)	93.224	N/A	\$ 2,772,939
ARRA:			
* Increase Services to Health Centers	93.703	N/A	253,715
* Capital Improvement Program	93.703	N/A	62,712
<b>Pass-Through Awards:</b>			
Passed through West Virginia Department of Health and Human Resources:			
Family Resource Network (7/1/09 - 6/30/10)	93.590	G100326	1,057
(7/1/10 - 6/30/11)	93.590	G110230	5,943
HIV Counseling and Testing			
(10/1/10-12/31/10)	93.940	G110584	1,916
(1/1/11-12/31/11)	93.940	G110873	873
Passed through West Virginia University Research Corporation:			
Developing a Center of Excellence for Outpatient HIV Early Intervention Services	93.918	5H76HA017419	48,643
Passed through Washington D C Department of Health:			
HIV-Related Core Medical Services, Support Services for Metropolitan Areas	93.914	Unknown	191,209
<b>Total U.S. Department of Health and Human Services</b>			<b>\$ 3,339,007</b>
<b><u>U.S. Department of Agriculture</u></b>			
<b>Pass-Through Awards:</b>			
Passed through West Virginia Department of Health and Human Resources:			
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)			
* (10/1/09 - 9/30/10)	10.557	G100530	\$ 461,814
* (10/1/10 - 9/30/11)	10.557	G110554	406,799
<b>Total U.S. Department of Agriculture</b>			<b>\$ 868,613</b>
<b>Total Expenditures of Federal Awards</b>			<b>\$ 4,207,620</b>

\* 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 94% 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, 2011.

**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, 2011	\$ 4,207,620
Less: Amount recorded in property and equipment in the consolidated statement of financial position as of March 31, 2011 related to the ARRA - Capital Improvement Program	<u>55,124</u>
Total expenditures of federal awards recorded in the consolidated statement of activities as of March 31, 2011	<u>\$ 4,152,496</u>

SHENANDOAH VALLEY MEDICAL SYSTEM, INC.

SCHEDULE OF NON-FEDERAL AWARDS  
YEAR ENDED MARCH 31, 2011

Grantor Name/ Program Title	Grant Number	Award Amount	Receivable (Deferred Revenue) 3/31/2010	Receipts 4/1/2010 - 3/31/2011	Expenditures 4/1/2010 - 3/31/2011	Receivable (Deferred Revenue) 3/31/2011
<b>West Virginia Department of Health and Human Resources</b>						
Family Planning Services (7/1/09 - 6/30/10)	MOU# FP10-2078	\$ 86,411	\$ -	\$ 19,138	\$ 19,138	\$ -
(7/1/10 - 6/30/11)	MOU# FP11-2078	\$ 90,705	\$ -	\$ 78,283	\$ 78,283	\$ -
Breast and Cervical Cancer Screening (7/1/09 - 6/30/10)	MOU# BC10-1049	\$ 14,738	\$ -	\$ 1,442	\$ 1,442	\$ -
(7/1/10 - 6/30/11)	MOU# BC11-1048	\$ 15,500	\$ -	\$ 11,397	\$ 11,397	\$ -
Uncompensated Care (7/1/09 - 6/30/10)	G100097	\$ 126,793	\$ -	\$ 55,270	\$ 55,270	\$ -
(7/1/10 - 6/30/11)	G110329	\$ 97,800	\$ -	\$ 32,026	\$ 32,026	\$ -
Mortgage Finance (7/1/09 - 6/30/10)	G100129	\$ 54,000	\$ -	\$ 17,820	\$ 17,820	\$ -
(7/1/10 - 6/30/11)	G110361	\$ 51,300	\$ -	\$ 34,371	\$ 34,371	\$ -
Family Resource Center (7/1/09 - 6/30/10)	G100326	\$ 43,942	\$ -	\$ -	\$ -	\$ -
(7/1/10 - 6/30/11)	G110230	\$ 43,942	\$ -	\$ 39,057	\$ 39,057	\$ -
<b>West Virginia Development Office and City of Martinsburg</b>						
Governor's Community Partnership Grant Program - Healthy Smiles Dental Center	10-1096	\$ 90,000	\$ -	\$ 74,761	\$ 74,761	\$ -
Governor's Community Partnership Grant Program - Healthy Smiles Dental Center	11-793	\$ 30,000	\$ -	\$ -	\$ -	\$ -
<b>Team For West Virginia Children, Inc.</b>						
Partners in Prevention Mini-Grant (7/1/09-6/30/10)		\$ 7,500	\$ 293	\$ 4,043	\$ 3,750	\$ -
(7/1/10-6/30/11)		\$ 7,500	\$ -	\$ 3,457	\$ 4,112	\$ 655
				<u>\$ 371,065</u>	<u>\$ 371,427</u>	

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.



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**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, 2011, and have issued our report thereon dated June 24, 2011. 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 consolidated 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 11-1). 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.



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To the Board of Directors  
Shenandoah Valley Medical System, Inc  
Page #2

***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*.

We noted certain other matters that we reported to management of the Organization in a separate letter dated June 24, 2011

The Organization's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Organization's response and, accordingly, we express no opinion on it

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 24, 2011



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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 Shenandoah Valley Medical System, Inc.'s (Organization) compliance with the types of compliance requirements described in the *U S Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Organization's major federal programs for the year ended March 31, 2011. 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 compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended March 31, 2011. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with *OMB Circular A-133* and which is described in the accompanying schedule of findings and questioned costs as Finding 11-2.

***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 the 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

To the Board of Directors  
Shenandoah Valley Medical System, Inc  
Page #2

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.

The Organization's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Organization's responses and, accordingly, we express no opinion on the responses.

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 24, 2011

**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?   X   Yes        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?   X   Yes        No

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
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 11-1: (SIGNIFICANT DEFICIENCY)

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.

**SHENANDOAH VALLEY MEDICAL SYSTEM, INC.**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**SECTION III. - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**CFDA No. 93.224 - Community Health Centers**

**FINDING 11-2:**

**CRITERIA:** An Organization should have procedures and controls in place to review and approve each reduced fee application submitted by patients.

**CONDITION:** Two reduced fee applications that were tested did not have the proper approval by an Organization employee.

**CAUSE:** During the fiscal year, reduced fee applications were being reviewed by various employees in the Organization and not by a centralized person, making it easier for some applications not to be properly approved.

**QUESTIONED COSTS:** None

**EFFECT:** Additional reduced fee applications could have been processed into the system without the proper approvals and patients that are ineligible could be receiving the reduced fee benefits.

**RECOMMENDATION:** We recommend that the Organization enhance their application procedure to have a centralized approval process managed by personnel (a person or persons) trained on the process for all reduced fee applications to ensure that the applications are completed properly and that the patients that are approved for the reduced fee meet all the requirements.

**MANAGEMENT'S RESPONSE:** SVMS has designated an employee as the Sliding Fee Application Coordinator. This individual is located in the Shenandoah Community Health Center Primary Care office space and is responsible for sliding fee application review and approval for document completion, sliding fee percent calculation and application filing for all patients applying for Sliding Fee in all SVMS departments.

**SECTION IV. - SCHEDULE OF PRIOR YEAR FINDINGS**

**FINDING 10-1: Financial Statement Preparation**

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 was considered to be a significant deficiency.

**Status:** 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