WINDOM AREA HOSPITAL
Windom, Minnesota

COMBINED FINANCIAL STATEMENTS

YEARS ENDED APRIL 30, 2006 AND 2005

WINDOM AREA HOSPITAL
Windom, Minnesota
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Windom Area Hospital and Affiliate
Windom, Minnesota

We have audited the accompanying combined balance sheets of Windom Area Hospital and its discretely presented component unit as of April 30, 2006 and 2005, and the related combined statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These combined financial statements are the responsibility of the management of Windom Area Hospital. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards 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 combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Windom Area Hospital as of April 30, 2006 and 2005 and the results of its operations, changes in net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 22, 2006 on our consideration of Windom Area Hospital's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 2 through 6, is not a required part of the basic combined financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on management's discussion and analysis.

Larson Allen Weishair & Co., LLP

LARSON, ALLEN, WEISHAIR & CO., LLP

Minneapolis, Minnesota
June 22, 2006

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Introduction

The Windom Area Hospital (Hospital) offers readers of our financial statements this narrative overview and analysis of the financial activities of Windom Area Hospital for the fiscal years ended April 30, 2006 and 2005. We encourage readers to consider the information presented here in conjunction with the Hospital's combined financial statements, including the notes thereto.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to Windom Area Hospital's audited combined financial statements. The combined financial statements are composed of the balance sheet, combined statement of revenues, expenses, and changes in net assets, and the statement of cash flows. The combined financial statements also include notes to the combined financial statements that explain in more detail some of the information in the combined financial statements. The combined financial statements are designed to provide readers with a broad overview of the Hospital's finances.

The combined financial statements include the Hospital and Foundation finances. The mission of the Windom Area Foundation is to provide charitable support for medical and educational programs of Windom Area Hospital. Total Foundation funds equal $67,648 at year end.

Required Financial Statements

The Hospital's combined financial statements report information of Windom Area Hospital using accounting methods similar to those used by private sector healthcare organizations. These statements offer short and long-term information about its activities. The combined balance sheet includes all of the Hospital's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to Hospital creditors (liabilities). The combined balance sheet also provides the basis for evaluating the capital structure of the Hospital and assessing the liquidity and financial flexibility of the Hospital.

All of the current year's revenues and expenses are accounted for in the combined statement of revenues, expenses, and changes in net assets. This statement can be used to determine whether the Hospital has successfully recovered all of its costs through its patient service revenue and other revenue sources. Revenues and expenses are reported on an accrual basis, which means the related cash could be received or paid in a subsequent period.

The final required statement is the combined statement of cash flows. The statement reports cash receipts, cash payments and net changes in cash resulting from operations, investing and financing activities. It also provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

Financial Highlights

Hospital total assets increased by $1,283,261 to $14,623,363 in FY 06 and by $804,805 to $13,340,102 in FY 05. Net property, plant and equipment increased by $471,083 in fiscal year 2006 and by $1,303,462 in FY 2005. Total liabilities decreased by $71,653 in FY 2006 and by $312,291 in FY 2005. The total margin was 9.4%, 9.9% and 7.2% for the years ended April 30, 2006, 2005 and 2004, respectively.

Financial Analysis of the Hospital

The combined balance sheet and the combined statement of revenues, expenses, and changes in net assets report the net assets of the Hospital and the changes in them. The Hospital's net assets - the difference between assets and liabilities - is a way to measure financial health or financial position. Over time, sustained increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic condition, population growth and new or changed governmental legislation should also be considered.

Net Assets

A summary of the Hospital's balance sheets at April 30, 2006, 2005 and 2004 is presented below:

Table 1
Condensed Combined Balance Sheets (in Thousands)

	April 30,		
	2006	2005	2004
Current Assets	$ 3,680	$ 3,044	$ 3,026
Assets Limited as to Use	3,508	3,330	3,846
Capital Assets	7,424	6,953	5,650
Other Assets	12	13	13
Total Assets	$ 14,623	$ 13,340	$ 12,535
Current Liabilities	$ 1,203	$ 1,097	$ 1,293
Long-Term Debt Outstanding	2,187	2,364	2,480
Total Liabilities	3,390	3,461	3,773
Invested in Capital Assets, Net of Related Debt	$ 5,147	$ 4,049	$ 3,135
Restricted	1,329	3,491	3,959
Unrestricted	4,757	2,339	1,668
Total Net Assets	11,234	9,879	8,762
Total Liabilities and Net Assets	$ 14,623	$ 13,340	$ 12,535

As can be seen by Table 1, net assets increased by $1.3 million to $11.2 million in fiscal year 2006. In fiscal year 2005, net assets increased by $1.1 million to 9.9 million. The change in net assets results primarily from operating income.

Revenues, Expenses, and Changes in Net Assets

The following table presents a summary of the Hospital's historical revenues and expenses for the fiscal years ended April 30, 2006, 2005 and 2004.

Table 2
Condensed Combined Statements of Revenue, Expenses, and Changes in Net Assets (in Thousands)

	Year Ended April 30,		
	2006	2005	2004
Operating Revenues	$ 11,548	$ 11,002	$ 9,461
Operating Expenses	10,466	9,922	8,780
Operating Income	1,081	1,080	681
Non-Operating Income	99	29	41
Excess of Revenues over Expenses	1,180	1,109	722
Capital Grants and Contributions	175	8	21
Changes in Net Assets	1,355	1,117	743
Total Net Assets, Beginning of Year	9,879	8,762	8,019
Total Net Assets, End of Year	$ 11,234	$ 9,879	$ 8,762

Operating and Financial Performance

Volume: Inpatient admissions (excluding newborns) for fiscal year 2006 were 748 compared to 824 in fiscal year 2005 and 749 in fiscal year 2004. This is a decrease of 76 or 9% between 2006 and 2005 and an increase of 75 or 10% between 2005 and 2004. Patient days (excluding newborns) for fiscal year 2006 were 1,989 compared to 2,262 in fiscal year 2005 and 2,153 in fiscal year 2004. This is a decrease of 273 or 12% from 2005 and an increase of 109 or 5% between 2005 and 2004. The length of stay decreased from 2.9 days in 2004 to 2.8 days in 2005 to 2.6 days in 2006. Emergency department visits increased to 2,772 in fiscal year 2006 from 2,616 in fiscal year 2005. This is an increase of 156 visits or 6%. They increased from 2,589 in 2004, which is an increase of 27 or 1%. All other outpatient visits for 2006 were 17,917 compared to 17,996 17,964 in 2005 and 15,731 in 2004. This is a decrease of 47 visits from 2005 to 2006 and an increase of 2,265 visits or 14% from 2004 to 2005. Total surgeries decreased to 1,234 from 1,330 in the previous fiscal year. This is a decrease of 96 surgeries or 7%. In fiscal year 2005 surgeries increased from 1,072 which is an increase of 258 surgeries or 24%.

Net Patient Service Revenue: Effective May 1, 2005, an 8% rate increase was implemented. As a result of the rate increase, net patient service revenue increased $509,921 or 5% compared to fiscal year 2005. Revenue deductions, the amount of patient service revenue uncollectible due to contractual agreements, government reimbursement policies, and bad debts increased to $4,584,933 from $4,486,902, a 2% increase.

Other Operating Revenue: Other operating revenue increased $69,153 and decreased $17,495 in fiscal years 2006 and 2005, respectively, from the previous year. The increase is due to an increase in Wellness Center income because of the Blue Cross Blue Shield workout reimbursement program and the utilities refund from the City of Windom for switching to the generator during peak usage.

Nursing Services: Nursing service expenses decreased $10,509 and increased $175,585 in fiscal years 2006 and 2005, respectively, from the previous year. Nursing salaries increased in 2005 due to staffing changes for the addition. In 2006 staffing patterns were established for adequate coverage.

Other Professional Services: Other professional services increased $51,976 and $532,863 in fiscal years 2006 and 2005, respectively, from the previous year. Pharmacy drug costs continue to escalate. ER professional fees increased in 2005 due to a full year of expense due to a full year of expense for additional weekend coverage by emergency room contract physicians.

General Services: General services increased $37,493 and $87,665 in fiscal years 2006 and 2005, respectively, when compared to the previous year. Expenses relating to updates to the facility account for most of this increase.

Administrative and Fiscal Services: Expenses in this category increased by $271,216 and $257,642 in fiscal years 2006 and 2005, respectively, when compared to the previous year. Employee benefit costs, primarily health insurance continue to rise.

Interest and Amortization: Interest and amortization increased $43,500 and $61,900 in fiscal years 2006 and 2005, respectively, when compared to the previous year. This increase is attributed to interest expense for the 2003 gross revenue bonds.

Depreciation: Depreciation increased $150,105 and $27,104 in fiscal years 2006 and 2005, respectively, when compared to the previous year. This increase is due to the remodeling of laboratory and imaging areas in 2006 and the nursing addition in 2005.

Non-Operating Revenue and Expenses: The total in this category increased $69,153 and decreased $11,183 in fiscal years 2006 and 2005, respectively, when compared to the previous year. The increase is due to a rise in investment interest rates.

Capital Assets

At the end of fiscal years 2006, 2005 and 2004, the Hospital had invested $7,423,960, $6,952,877 and $5,649,415, respectively, in capital assets. The $471,083 increase in capital assets in fiscal year 2006 is primarily a result of remodeling the laboratory and imaging areas.

Capital Leases

At the end of fiscal years 2006, 2005 and 2004, the Hospital had a total of $0, $21,379 and $61,890, respectively, in capital lease obligations. Further detailed information is presented in the Notes to the Financial Statements.

Capital Grants and Contributions

For the years ended 2006, 2005 and 2004, the Hospital had a total of $174,690, $8,086 and $20,560, respectively, in capital grants and contributions. A majority of the grant balance in 2006 relates to a capital grant to partially fund the replacement of a generator at the Hospital.

Economic and Other Factors and Next Year's Budget

The Windom Area Hospital Board of Directors and management considered many factors when setting the fiscal year 2006 budget. Of primary importance in setting the 2006 budget is the status of the economy, which takes into account market forces and environmental factors such as:

- Medicare and Medicaid reimbursement rates continued decline
- Health Insurance Portability and Accountability Act (HIPAA)
- Increased expectations for quality at a lower price
- Workforce shortages
- Cost of supplies
- Surging drug costs

Contacting the Hospital's Finance Department

Windom Area Hospital's combined financial statements are designed to present users with a general overview of the Hospital's finances and to demonstrate the Windom Area Hospital's accountability. If you have questions about the report or need additional financial information, please contact Administration at Windom Area Hospital, 2150 Hospital Drive, PO Box 339, Windom, MN 56101.

LIABILITIES AND NET ASSETS	Primary Enterprise	Component Unit (Foundation)	Total Reporting Entity (Memorandum Only)
CURRENT LIABILITIES			
Current Maturities of Long-Term Debt	$ 90,000	$ -	$ 90,000
Accounts Payable	300,162	-	300,162
Due to Third-Party Payors	300,000	-	300,000
Accrued Expenses	512,792	-	512,792
Total Current Liabilities	1,202,954	-	1,202,954
LONG-TERM DEBT, Net of Current Maturities	2,186,580	-	2,186,580
NET ASSETS			
Invested in Capital Assets Net of Related Debt	5,147,380	-	5,147,380
Restricted:			
Expendable for Bond Indenture	1,183,280	-	1,183,280
Expendable for Specific Donor Restrictions	124,144	21,532	145,676
Unrestricted	4,711,377	46,116	4,757,493
Total Net Assets	11,166,181	67,648	11,233,829
Total Liabilities and Net Assets	$ 14,555,715	$ 67,648	$ 14,623,363

LIABILITIES AND FUND BALANCE	Primary Enterprise	Component Unit (Foundation)	Total Reporting Entity (Memorandum Only)
CURRENT LIABILITIES			
Current Maturities of Long-Term Debt	$ 111,379	$ -	$ 111,379
Accounts Payable	183,322	-	183,322
Construction Payable	220,086	-	220,086
Due to Third-Party Payors	75,000	-	75,000
Accrued Expenses	458,337	-	458,337
Accrued Interest Expense	48,929	-	48,929
Total Current Liabilities	1,097,053	-	1,097,053
LONG-TERM DEBT, Net of Current Maturities	2,364,134	-	2,364,134
NET ASSETS			
Invested in Capital Assets Net of Related Debt	4,049,390	-	4,049,390
Restricted:			
Expendable for Capital Improvements	427,974	-	427,974
Expendable for Bond Indenture	659,204	-	659,204
Expendable for Specific Donor Restrictions	918	18,727	19,645
Unrestricted	4,684,299	38,403	4,722,702
Total Fund Balance	9,821,785	57,130	9,878,915
Total Liabilities and Fund Balance	$ 13,282,972	$ 57,130	$ 13,340,102

WINDOM AREA HOSPITAL
Windom, Minnesota
COMBINED STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN NET ASSETS
YEAR ENDED APRIL 30, 2006

	Primary Enterprise	Component Unit (Foundation)	Total Reporting Entity (Memorandum Only)
REVENUE			
Net Patient Service Revenue	$ 11,429,033	$ -	$ 11,429,033
Other Revenue	93,259	25,387	118,646
Total Revenue	11,522,292	25,387	11,547,679
EXPENSES			
Nursing Services	2,892,295	-	2,892,295
Other Professional Services	3,492,346	-	3,492,346
General Services	913,189	-	913,189
Administrative and Fiscal Services	2,421,074	17,674	2,438,748
Interest and Amortization	119,838	-	119,838
Depreciation	609,790	-	609,790
Total Expenses	10,448,532	17,674	10,466,206
INCOME FROM OPERATIONS	1,073,760	7,713	1,081,473
NONOPERATING REVENUE AND EXPENSES			
Interest Income and Donations	122,035	-	122,035
Net Assets Released from Restriction	-	(20,625)	(20,625)
Loss on Disposal of Assets	(2,659)	-	(2,659)
Total Nonoperating Revenue and Expenses	119,376	(20,625)	98,751
EXCESS (DEFICIT) OF REVENUE OVER EXPENSES	1,193,136	(12,912)	1,180,224
Capital Grants and Contributions	151,260	23,430	174,690
INCREASE IN NET ASSETS	1,344,396	10,518	1,354,914
NET ASSETS			
Beginning of Year	9,821,785	57,130	9,878,915
End of Year	$ 11,166,181	$ 67,648	$ 11,233,829

See accompanying Notes to Combined Financial Statements.

WINDOM AREA HOSPITAL
Windom, Minnesota
COMBINED STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN NET ASSETS
YEAR ENDED APRIL 30, 2005

	Primary Enterprise	Component Unit (Foundation)	Total Reporting Entity (Memorandum Only)
REVENUE			
Net Patient Service Revenue	$ 10,919,112	$ -	$ 10,919,112
Other Revenue	71,305	11,420	82,725
Total Revenue	10,990,417	11,420	11,001,837
EXPENSES			
Nursing Services	2,904,441	-	2,904,441
Other Professional Services	3,438,733	-	3,438,733
General Services	875,696	-	875,696
Administrative and Fiscal Services	2,164,690	2,842	2,167,532
Interest and Amortization	76,338	-	76,338
Depreciation	459,685	-	459,685
Total Expenses	9,919,583	2,842	9,922,425
INCOME FROM OPERATIONS	1,070,834	8,578	1,079,412
NONOPERATING REVENUE AND EXPENSES			
Interest Income and Donations	57,178	547	57,725
Net Assets Released from Restriction	-	(3,000)	(3,000)
Loss on Disposal of Assets	(25,127)	-	(25,127)
Total Nonoperating Revenue and Expenses	32,051	(2,453)	29,598
EXCESS OF REVENUE OVER EXPENSES	1,102,885	6,125	1,109,010
Capital Grants and Contributions	7,100	986	8,086
INCREASE IN NET ASSETS	1,109,985	7,111	1,117,096
NET ASSETS			
Beginning of Year	8,711,800	50,019	8,761,819
End of Year	$ 9,821,785	$ 57,130	$ 9,878,915

See accompanying Notes to Combined Financial Statements.

WINDOM AREA HOSPITAL
Windom, Minnesota
COMBINED STATEMENT OF CASH FLOWS
YEAR ENDED APRIL 30, 2006

	Primary Enterprise	Component Unit (Foundation)	Total Reporting Entity (Memorandum Only)
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts from and on Behalf of Patients	$ 11,731,210	$ -	$ 11,731,210
Payments to Suppliers and Contractors	(6,458,451)	(17,674)	(6,476,125)
Payments to Employees	(3,505,737)	-	(3,505,737)
Other Receipts and Payments, Net	206,887	4,762	211,649
Net Cash Provided (Used) by Operating Activities	1,973,909	(12,912)	1,960,997
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Capital Grants and Contributions	151,260	23,430	174,690
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Capital Expenditures	(1,080,873)	-	(1,080,873)
Cash Payments for Interest	(116,287)	-	(116,287)
Principal Payments on Long-Term Debt	(198,933)	-	(198,933)
Net Cash Used by Capital and Related Financing Activities	(1,396,093)	-	(1,396,093)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of Investments	(1,125,508)	-	(1,125,508)
Sale of Investments	1,020,473	(2,805)	1,017,668
Decrease in Other Assets	(2,849)	-	(2,849)
Interest Income and Donations	122,035	-	122,035
Net Cash Provided (Used) by Investing Activities	14,151	(2,805)	11,346
INCREASE IN CASH AND CASH EQUIVALENTS	743,227	7,713	750,940
Cash and Cash Equivalents - Beginning	648,665	38,403	687,068
CASH AND CASH EQUIVALENTS - ENDING	$ 1,391,892	$ 46,116	$ 1,438,008

See accompanying Notes to Combined Financial Statements.

WINDOM AREA HOSPITAL
Windom, Minnesota
COMBINED STATEMENT OF CASH FLOWS (CONTINUED)
YEAR ENDED APRIL 30, 2006

	Primary Enterprise	Component Unit (Foundation)	Total Reporting Entity (Memorandum Only)
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES			
Income from Operations	$ 1,073,760	$ 7,713	$ 1,081,473
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:			
Depreciation Expense	609,790	-	609,790
Interest Expense Considered a Capital Financing Activity	116,287	-	116,287
Amortization	3,551	-	3,551
Loss on Disposal of Assets	(2,659)	-	(2,659)
Provision for Bad Debts	84,690	-	84,690
Net Assets Released from Restriction	-	(20,625)	(20,625)
(Increase) Decrease in:			
Patient Accounts Receivable	1,627	-	1,627
Accrued Interest Receivable	(9,140)	-	(9,140)
Supplies and Prepaid Expenses	(31,277)	-	(31,277)
Increase (Decrease) in:			
Accounts Payable	(103,246)	-	(103,246)
Due to Third-Party Payors	225,000	-	225,000
Accrued Expenses	5,526	-	5,526
Net Cash Provided (Used) by Operating Activities	$ 1,973,909	$ (12,912)	$ 1,960,997
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash Paid for Interest	$ 117,248	$ -	$ 117,248

See accompanying Notes to Combined Financial Statements.

WINDOM AREA HOSPITAL
Windom, Minnesota
COMBINED STATEMENT OF CASH FLOWS
YEAR ENDED APRIL 30, 2005

	Primary Enterprise	Component Unit (Foundation)	Total Reporting Entity (Memorandum Only)
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts from and on Behalf of Patients	$ 10,301,836	$ -	$ 10,301,836
Payments to Suppliers and Contractors	(6,261,735)	(2,842)	(6,264,577)
Payments to Employees	(3,345,471)	-	(3,345,471)
Other Receipts and Payments, Net	118,965	8,420	127,385
Net Cash Provided by Operating Activities	813,595	5,578	819,173
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Capital Grants and Contributions	7,100	986	8,086
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Capital Expenditures	(1,763,147)	-	(1,763,147)
Cash Payments for Interest	(72,787)	-	(72,787)
Principal Payments on Long-Term Debt	(38,262)	-	(38,262)
Net Cash Used by Capital and Related Financing Activities	(1,874,196)	-	(1,874,196)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of Investments	(418,788)	-	(418,788)
Sale of Investments	885,103	2,014	887,117
Decrease in Other Assets	(2,849)	-	(2,849)
Interest Income and Donations	57,178	547	57,725
Net Cash Provided by Investing Activities	520,644	2,561	523,205
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(532,857)	9,125	(523,732)
Cash and Cash Equivalents - Beginning	1,181,522	29,278	1,210,800
CASH AND CASH EQUIVALENTS - ENDING	$ 648,665	$ 38,403	$ 687,068

See accompanying Notes to Combined Financial Statements.

WINDOM AREA HOSPITAL
Windom, Minnesota
COMBINED STATEMENT OF CASH FLOWS (CONTINUED)
YEAR ENDED APRIL 30, 2005

	Primary Enterprise	Component Unit (Foundation)	Total Reporting Entity (Memorandum Only)
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES			
Income from Operations	$ 1,070,834	$ 8,578	$ 1,079,412
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:			
Depreciation Expense	459,685	-	459,685
Interest Expense Considered a Capital Financing Activity	72,787	-	72,787
Amortization	3,551	-	3,551
Loss on Disposal of Assets	(25,127)	-	(25,127)
Provision for Bad Debts	207,915	-	207,915
Net Assets Released from Restriction	-	(3,000)	(3,000)
Increase in:			
Patient Accounts Receivable	(612,254)	-	(612,254)
Accrued Interest Receivable	(13,213)	-	(13,213)
Supplies and Prepaid Expenses	(76,554)	-	(76,554)
Increase (Decrease) in:			
Accounts Payable	(136,687)	-	(136,687)
Due to Third-Party Payors	(199,724)	-	(199,724)
Accrued Expenses	62,382	-	62,382
Net Cash Provided by Operating Activities	$ 813,595	$ 5,578	$ 819,173
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash Paid for Interest	$ 121,240	$ -	$ 121,240
NONCASH ACTIVITIES			
Construction Payable	$ 220,086	$ -	$ 220,086

See accompanying Notes to Combined Financial Statements.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Organization

Windom Area Hospital (Hospital) is an enterprise fund of the City of Windom, Minnesota, is managed by a board of directors appointed by the City Council, and is licensed to provide hospital services. The Hospital is exempt from Federal and State income taxes.

For financial reporting purposes, the Hospital is divided into the "Primary Enterprise" and "Component Unit." The Primary Enterprise consists of the Hospital.

The Windom Area Hospital Foundation, Inc. (Foundation) is a 501(c)(3) Organization whose sole purpose is to support the Windom Area Hospital. The Foundation was established in fiscal year 2002 and conducts fundraising campaigns on behalf of the Windom Area Hospital. The Foundation's operations have been discretely presented as a component unit of the Hospital.

The memorandum-only totals aggregate the Primary Enterprise and its Component Unit. In accordance with governmental accounting standards, no consolidating or other eliminations were made in arriving at the totals; thus, they do not represent consolidated information.

Method of Accounting

The Hospital reports in accordance with the *Audit and Accounting Guide for Health Care Organizations* published by the American Institute of Certified Public Accountants which prescribes accounting and reporting policies, some of which are unique to providers of health care services.

Proprietary Fund Accounting

The Hospital utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis. Substantially all revenue and expenses are subject to accrual.

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, Windom Area Hospital has elected not to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989.

Use of Estimates

The preparation of combined financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Grants and Contributions

From time to time, the Hospital receives grants and contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as non-operating revenues. Amounts restricted to capital acquisitions are reported after non-operating revenues and expenses.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents are considered to be highly liquid investments with an original maturity of ninety days or less, and exclude assets limited as to use.

Accounts Receivable and Allowance for Uncollectible Accounts

The Hospital provides an allowance for uncollectible self-pay and miscellaneous commercial insurance accounts. Patients are not required to provide collateral for services rendered. Payment for services is required upon receipt of an invoice, after payment by insurance, if any. Self-pay accounts are analyzed for collectibility based on the months past due and payment history. An allowance is estimated for these accounts based on the historical experience of the Hospital. Accounts that are determined to be uncollectible are sent to a collection agency and written off at that time. At April 30, 2006 and 2005, the allowance for uncollectible accounts was approximately $246,000 and $271,000, respectively.

Supplies

Supplies are stated at cost (principally on the first-in, first-out basis) not in excess of market value. Market value is determined by comparison with recent purchases or realizable value.

Assets Limited as to Use

Assets limited as to use include assets set aside for debt service, for construction payments, and by the Board of Directors for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Investments

Investments are recorded at cost, if purchased, or at fair market value on the date received, if by gift or bequest. All investments are carried at market value.

Deferred Debt Acquisition Costs

Deferred debt acquisition costs are being amortized on the straight-line method over the life of the related debt.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital Assets

Capital assets are stated at cost, if purchased, or at fair market value on the date received, if donated, less accumulated depreciation. Depreciation is provided on a straight-line basis over the estimated useful lives of the property.

Policy for Care of the Underserved

The Hospital provides care to patients who meet certain criteria under their charity care policy without charge or at amounts less than their established rates. The Hospital believes the underserved are those persons who are unable through private resources, employer support, or public aid to provide payment for health care services or those unable to gain access to health related care because of limited resources, inadequate education, or discrimination. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Operating Revenues and Expenses

The Hospital's statement of revenues, expenses and changes in net assets distinguishes between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Hospital's principal activity. Non-exchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as non-operating revenues. Operating expenses are all expenses incurred to provide health care services.

Net Assets

Net assets of the Hospital are classified in three components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable net assets are non-capital net assets* that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital assets net of related debt or restricted.*

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses, and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters.

NOTE 2 NET PATIENT SERVICE REVENUE

The Hospital has agreements with third-party payors which provide for payments to the organization at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows.

Medicare

The Hospital has elected the Critical Access Hospital (CAH) designation. As a CAH, the Hospital is reimbursed for inpatient, outpatient and swing beds services for Medicare patients on a reasonable cost basis. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

Medicaid

Inpatient services rendered to Medicaid program beneficiaries are reimbursed under a reimbursement methodology similar to inpatient Medicare. Outpatient Medicaid services are reimbursed on reasonable cost.

Revenue from the Medicare program accounted for approximately 44 percent for the years ended 2006 and 2005 and revenue from the Medicaid program accounted for approximately 2 percent and 3 percent of the Hospital's net patient revenue for the years ended 2006 and 2005, respectively. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Other

The Hospital has also entered into payment agreements with certain commercial insurance carriers. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Following is a reconciliation of gross patient service revenue to net patient service revenue:

	2006	2005
Gross Patient Service Revenue	$ 16,013,966	$ 15,406,014
Adjustments and Discounts:		
Medicare	(2,890,415)	(3,019,153)
Medicaid	(314,749)	(345,498)
Other	(1,295,079)	(914,336)
Provision for Bad Debt	(84,690)	(207,915)
Total Adjustments and Discounts	(4,584,933)	(4,486,902)
Net Patient Service Revenue	$ 11,429,033	$ 10,919,112

NOTE 3 ACCOUNTS RECEIVABLE

Patient accounts receivable reported as current assets by Windom Area Hospital at April 30, 2006 and 2005 consist of these amounts:

	2006	2005
Receivable from Patients and Their Insurance Carriers	$ 1,428,863	$ 1,486,330
Receivable from Medicare	535,831	578,995
Receivable from Medicaid	41,505	52,191
Total Patient Accounts Receivable	2,006,199	2,117,516
Less: Allowance for Uncollectible Amounts	(246,000)	(271,000)
Net Patient Accounts Receivable	$ 1,760,199	$ 1,846,516

NOTE 4 DEPOSITS AND INVESTMENTS

Deposits

Minnesota Statutes require that all City Hospitals' deposits be protected by insurance, surety bonds, or collateral. The market value of collateral pledged must equal 110 percent of the deposits not covered by insurance or bonds (140 percent in the case of mortgage notes pledged). Minnesota Statutes also require that securities pledged as collateral be held in safekeeping by the Hospital or in a financial institution other than that furnishing the collateral.

The Hospital's deposits at year end were fully covered by federal depository insurance or by collateral held by the Hospital's custodial bank in the Hospital's name.

Investments

Credit Risk - Minnesota Statutes authorize City Hospitals to invest in obligations of the U.S. Government and its agencies and of the State of Minnesota and its agencies, bankers acceptances, commercial paper, and certain other types of securities.

Interest Rate Risk - The Hospital does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Concentration of Credit Risk - The Hospital places no limit on the amount it may invest in any one issuer or institution.

NOTE 4 DEPOSITS AND INVESTMENTS (CONTINUED)

At April 30, 2006 and 2005, the carrying amounts of deposits and investments are included in the Hospital's balance sheets as follows:

	2006	2005
Carrying Amount:		
Deposits	$ 5,035,793	$ 4,177,013
Included in the Following Balance Sheet Captions:		
Cash and Cash Equivalents	$ 1,438,008	$ 687,068
Construction Funds	-	427,974
Debt Service Account Under Bond Indenture	1,183,280	659,204
Board Designated for Capital Improvements	2,392,973	2,384,040
Restricted By Donor	21,532	18,727
	$ 5,035,793	$ 4,177,013

NOTE 5 ASSETS LIMITED AS TO USE

Those assets limited as to use consist of the following at April 30:

	2006	2005
Construction Funds:		
Cash	$ -	$ 427,974
Debt Service Account Under Bond Indenture Agreement:		
Cash	1,183,280	659,204
Board Designated Capital Improvements:		
Cash	2,392,973	2,384,040
Restricted by Donor:		
Certificates of Deposit	21,532	18,727
Total Assets Limited as to Use	3,597,785	3,489,945
Less: Current Portion Assets Limited as to Use	(90,000)	(160,336)
Noncurrent Assets Limited as to Use	$ 3,507,785	$ 3,329,609

The construction funds in the prior year were proceeds from the issuance of the General Obligation Hospital Bonds 2003 and were restricted and used for the payment of the construction project.

Debt service funds are designated for the servicing of the General Obligation Hospital Bonds of 2003 and are required by bond indenture agreements.

NOTE 5 ASSETS LIMITED AS TO USE (CONTINUED)

The Hospital's Board of Directors has designated certain assets for capital improvements. The Board of Directors retains control and may, at its discretion, subsequently use these assets for other purposes.

NOTE 6 CAPITAL ASSETS

Capital Assets (in thousands) for the years ended April 30, 2006 and 2005 consist of the following:

	Balance April 30, 2005	Additions and Transfers	Retirements	Balance April 30, 2006
Land	$ 24	$ -	$ -	$ 24
Land Improvements	233	-	-	233
Buildings	5,792	992	-	6,784
Fixed Equipment	1,857	604	(3)	2,458
Moveable Equipment	3,031	548	(343)	3,236
Construction in Progress	1,137	327	(1,386)	78
Total at Historical Cost	12,074	2,471	(1,732)	12,813
Less Accumulated Depreciation for:				
Land Improvements	(206)	(30)	-	(218)
Buildings	(1,240)	(229)	-	(1,499)
Fixed Equipment	(1,425)	(87)	3	(1,489)
Moveable Equipment	(2,250)	(319)	339	(2,183)
Total Accumulated Depreciation	(5,121)	(665)	342	(5,389)
Capital Assets, Net	$ 6,953	$ 1,806	$ (1,390)	$ 7,424

NOTE 6 CAPITAL ASSETS (CONTINUED)

	Balance April 30, 2004	Additions and Transfers	Retirements	Balance April 30, 2005
Land	$ 24	$ -	$ -	$ 24
Land Improvements	233	-	-	233
Buildings	3,470	2,322	-	5,792
Fixed Equipment	1,806	121	(70)	1,857
Moveable Equipment	2,774	287	(30)	3,031
Construction in Progress	2,075	1,375	(2,313)	1,137
Total at Historical Cost	10,382	4,105	(2,413)	12,074
Less Accumulated Depreciation for:				
Land Improvements	(195)	(11)	-	(206)
Buildings	(1,076)	(164)	-	(1,240)
Fixed Equipment	(1,419)	(55)	49	(1,425)
Moveable Equipment	(2,043)	(229)	22	(2,250)
Total Accumulated Depreciation	(4,733)	(459)	71	(5,121)
Capital Assets, Net	$ 5,649	$ 3,646	$ (2,342)	$ 6,953

Construction in progress at April 30, 2006 relates to a computer system upgrade. The project is expected to be completed in October 2006 with a total expected cost of approximately $250,000. The project is being funded through internal funds.

Construction in progress at April 30, 2005 related to the renovation of lab and imaging departments. The project was completed in July 2005 with a total cost of approximately $1.4 million. The project was funded through internal funds, therefore there was no capitalized interest.

NOTE 7 LONG-TERM DEBT

A summary of long-term debt at April 30, 2006 and 2005 consists of the following:

	Balance April 30, 2005	Additions	Reductions	Balance April 30, 2006
2003 Gross Revenue Hospital Bonds	$ 2,500,000	$ -	$ (180,000)	$ 2,320,000
Capital Leases	21,379	-	(21,379)	-
	$ 2,521,379	$ -	$ (201,379)	2,320,000
Less: Current Portion				(90,000)
Less: Unamortized Bond Discount				(43,420)
Total Long-Term Debt, Net of Current Maturities				$ 2,186,580

NOTE 7 LONG-TERM DEBT (CONTINUED)

	Balance April 30, 2004	Additions	Reductions	Balance April 30, 2005
2003 Gross Revenue Hospital Bonds	$ 2,500,000	$ -	$ -	$ 2,500,000
Capital Leases	62,087	-	(40,708)	21,379
	$ 2,562,087	$ -	$ (40,708)	2,521,379
Less: Current Portion				(111,379)
Less: Unamortized Bond Discount				(45,866)
Total Long-Term Debt, Net of Current Maturities				$ 2,364,134

2003 Gross Revenue Hospital Bonds: City of Windom, Minnesota, Gross Revenue Hospital Bonds, Series 2003, maturing in June 2023. Bonds bear interest rate from 1.75% to 5.50% with an average coupon rate of 5.09%. Bonds are secured by the revenues of the Hospital.

The aggregate maturities on long-term debt as of April 30, 2006 are as follows:

	Long-Term Debt	
Year Ending April 30,	Principal	Interest
2007	$ -	$ 114,843
2008	95,000	112,405
2009	95,000	109,317
2010	100,000	105,655
2011	105,000	101,424
2012-2016	600,000	428,134
2017-2021	765,000	257,516
2022-2024	560,000	46,796
Total	$ 2,320,000	$ 1,276,090

The provisions of the various debt agreements related to the above indebtedness contain various restrictive covenants and certain amounts to be deposited with the trustee. Such deposits are included with assets limited as to use. Capitalized leases at April 30, 2005 consisted of equipment with a cost of $224,087 and accumulated amortization of $201,211. The capital lease was paid off during fiscal year 2006 and the equipment is fully depreciated.

NOTE 8 DEFINED BENEFIT PENSION PLAN - STATEWIDE

Plan Description

Substantially all employees of the Hospital are required by State Law to belong to the pension plan administered by the Public Employees Retirement Association (PERA).

Disclosure relating to this plan follows:

Plan Description

The Hospital contributes to the Public Employees Retirement Fund (PERF), a cost-sharing multiple-employer defined benefit pension plan administered by PERA. PERF provides retirement, disability, and death benefits to plan members and beneficiaries. Benefits are established by State Statute and vest after three years of credited service. PERA issues a publicly available financial report that includes combined financial statements and required supplementary information for the plan. That report may be obtained by contacting PERA, 514 St. Peter Street #200, St. Paul, MN 55102 or by calling 651-296-7460 or 1-800-652-9026.

Funding Policy

Plan members are required to contribute 5.50% of the annual covered salary and the Hospital is required to contribute at an actuarially determined rate. The current rate is 6.00% of annual covered payroll. The contribution requirements of plan members and the Hospital are established and may be amended by State Statute. The Hospital's contributions, equal to the required contributions, to PERF for the years ended April 30, 2006 and 2005 was $203,772 and $187,211, respectively.

NOTE 9 CONCENTRATIONS OF CREDIT RISK

The Hospital is located in Windom, Minnesota. The Hospital grants credit, without collateral, to its patients, most of whom are local residents and are insured under third-party payor agreements. The Hospital also grants credit, without collateral, for other miscellaneous receivables.

NOTE 10 CONTINGENCIES

Malpractice Claims

The Hospital's malpractice insurance is a claims made policy. Should this policy lapse and not be replaced with equivalent coverage, claims based upon occurrence during its term, but reported subsequent thereto, will be uninsured.

NOTE 10 CONTINGENCIES (CONTINUED)

Other

In the normal course of business, there could be various outstanding contingent liabilities such as, but not limited to, the following:

- Lawsuits alleging negligence in care
- Environmental pollution
- Violation of regulatory body's rules and regulations
- Violation of federal and/or state laws

No contingent liabilities such as, but not limited to those described above, are reflected in the accompanying combined financial statements. No such liabilities have been asserted and, therefore, no estimate of loss, if any, is determinable.

NOTE 11 MANAGEMENT CONTRACT

The Hospital has a management agreement with Sioux Valley Health Services (Sioux Valley). This agreement gives Sioux Valley, through the Hospital's administrator full authority to implement and fulfill the policy decisions of the Hospital's Board of Directors. Either party may terminate this agreement with proper notice. Total management fees, including the administrator's salary and benefits, were $173,841 and $133,844 for the years ended April 30, 2006 and 2005, respectively.

INDEPENDENT AUDITORS' REPORT ON LEGAL COMPLIANCE

Board of Directors
Windom Area Hospital
Windom, Minnesota

We have audited the combined financial statements of Windom Area Hospital and its discretely presented component unit as of and for the year ended April 30, 2006, and have issued our report thereon dated June 22, 2006.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minnesota Statute Section 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* covers seven main categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, tax increment financing, and miscellaneous provisions. Our study included all of the listed categories, except we did not test for tax increment financing as the Hospital has no tax increment financing. The results of our tests indicate that for the items tested, the Hospital complied with the material terms and conditions of applicable legal provisions.

This report is intended solely for the information and use of the board of directors, management, and the Office of the State Auditor of Minnesota and is not intended to be and should not be used by anyone other than these specified parties.

Larson Allen Weishair & Co., LLP

LARSON, ALLEN, WEISHAIR & CO., LLP

Minneapolis, Minnesota
June 22, 2006

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*

Board of Directors
Windom Area Hospital
Windom, Minnesota

We have audited the combined financial statements of Windom Area Hospital and its discretely presented component unit as of and for the year ended April 30, 2006, and have issued our report thereon dated June 22, 2006. We conducted our audit in accordance with U.S. generally accepted auditing standards 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 Windom Area Hospital's internal control over financial reporting in order to determine our auditing procedures for the purposes of expressing our opinion on the combined financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Windom Area Hospital's ability to record, process, summarize, and report financial data consistent with the assertions of management in the combined financial statements.

Due to the limited number of staff in the accounting department and business office, certain functions within the accounting department and business office are not completely segregated which normally would promote adequate internal control. However, certain administrative controls are in place which mitigate the risk of incompatible duties due to employing a limited number of staff. We realize the Hospital is not large enough to employ additional personnel to eliminate this lack of segregation, but we are required by professional standards to make you aware of the situation.

A material weakness is a reportable condition in which the design or operation of one of more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the combined financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weakness. However, we believe the reportable condition described above is not a material weakness.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether Windom Area Hospital's combined 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 the combined 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 the board of directors and management and is not intended to be and should not be used by anyone other than these specified parties.

Larson Allen Weishair & Co., LLP

LARSON, ALLEN, WEISHAIR & CO., LLP

Minneapolis, Minnesota
June 22, 2006