

**MORGAN HILL UNIFIED
SCHOOL DISTRICT**

ANNUAL FINANCIAL REPORT

**FOR THE YEAR ENDED
JUNE 30, 2016**

MORGAN HILL UNIFIED SCHOOL DISTRICT

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FINANCIAL SECTION

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Vavrinek, Trine, Day & Co., LLP

Certified Public Accountants

VALUE THE DIFFERENCE

INDEPENDENT AUDITOR'S REPORT

Governing Board
Morgan Hill Unified School District
Morgan Hill, California

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Morgan Hill Unified School District (District) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. 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; and the *2015-2016 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting*, issued by the California Education Audit Appeals Panel as regulations. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Morgan Hill Unified School District, as of June 30, 2016, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter - Change in Accounting Principles

As discussed in Note 1 to the financial statements, in 2016, the District adopted new accounting guidance, GASB Statement No. 72, *Fair Value Measurement and Application*; GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statement 67 and 68*; GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*; and GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, budgetary comparison schedule, schedule of other postemployment benefits funding progress, schedule of the district's proportionate share of net pension liability, and the schedule of district's pension contributions, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Morgan Hill Unified School District's basic financial statements. The accompanying supplementary information such as the combining and individual non-major fund financial statements and Schedule of Expenditures of Federal Awards, as required by Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* and the other supplementary information as listed on the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The accompanying supplementary information as listed in the table of contents is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 8, 2016, on our consideration of the Morgan Hill Unified School District'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* in considering Morgan Hill Unified School District's internal control over financial reporting and compliance.



Palo Alto, California
December 8, 2016

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Morgan Hill Unified School District
15600 Concord Circle
Morgan Hill, CA 95037

MANAGEMENT'S DISCUSSION AND ANALYSIS

The discussion and analysis of Morgan Hill Unified School District's financial performance provides an overall review of the District's financial activities for the fiscal year ended June 30, 2016. The intent of this discussion and analysis is to look at the District's financial performance as a whole. To provide a complete understanding of the District's financial performance, please read it in conjunction with the Independent Auditor's Report, Notes to the Basic Financial Statements and the District's Financial Statements.

The Management's Discussion and Analysis (MD&A) is an element of the reporting model adopted by the Governmental Accounting Standards Board (GASB) in their Statement No. 34 Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments issued June 1999. Certain comparative information is required to be presented in the MD&A.

FINANCIAL HIGHLIGHTS

- The Governing Board continues to recognize their fiduciary responsibility to maintain the District's fiscal solvency, continuing the Board's commitment to ensure the District maintains sufficient reserves well above those required by the State.
- With the implementation of the Local Control Funding Formula, the District continues to receive increases in State funding. The new resources were directed to support school site programs and to partially reinstate some of the budget reductions made during the prior years.
- The District continued to have positive, collaborative relationships with all bargaining units which resulted in negotiations being settled by June 2015 for 2015-16.
- Using bond funds, the District completed a comprehensive technology infrastructure and continue implement one-to-one devices at secondary sites. The District is in the planning phase of building three new multi-purpose rooms and the reconstruction of the Britton Middle School campus.
- The District received the Educator Effectiveness one-time grant, which is to provide professional development and to promote educator quality and effectiveness. The funding provided the District opportunities to offer professional development to all teachers and administrators to support classroom instruction in common core.
- The District received the One Time Discretionary Funds for 2015-16. This funding satisfied any outstanding mandate claims filed in prior years. The intent of the funding is to support implementation of Common Core State Standards (CCSS), English Language Development (ESD) Standards, and Next Generation Science Standards (NGSS).

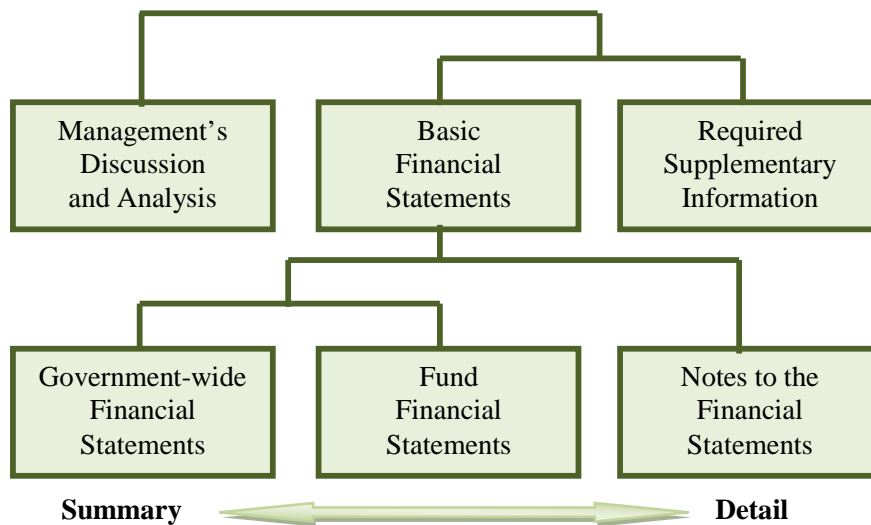
MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT’S DISCUSSION AND ANALYSIS JUNE 30, 2016

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of three parts – Management’s Discussion and Analysis (this section), the Basic Financial Statements, and Required Supplementary Information. These statements are organized so the reader can understand the Morgan Hill Unified School District as a financial whole, an entire operating entity. These statements then proceed to provide an increasingly detailed look at specific financial activities.

Components of the Financial Section



The first two statements are Government-wide Financial Statements, the Statement of Net Position and Statement of Activities. These statements provide information about the activities of the whole School District, presenting both an aggregate view of the District’s finances and a longer-term view of these finances. Fund financial statements provide the next level of detail. For governmental funds, these statements tell how services were financed in the short-term as well as what remains for future spending. The fund financial statements also look at the School District’s more significant funds with all other non-major funds presented in total in one column.

The financial statements also include notes that explain some of the information in the statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the financial statements.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2016

REPORTING THE DISTRICT AS A WHOLE

The Statement of Net Position and the Statement of Activities

These two statements provide information about the District as a whole using accounting methods similar to those used by private-sector companies. The Statement of Net Position includes all the District's assets and liabilities using the accrual basis of accounting. This basis of accounting takes into account all of the current year's revenues and expenses regardless of when cash is received or paid. These statements report information on the District as a whole and its activities in a way that helps answer the question, "How did we do financially during 2015-2016?"

These two statements report the School District's net position and changes in it. This change in net position is important because it tells the reader that, for the School District as a whole, the financial position of the School District has improved or diminished. The causes of this change may be the result of many factors, some financial, some not. Over time, the increases or decreases in the District's net position, as reported in the Statement of Activities, are one indicator of whether its financial health is improving or deteriorating. The relationship between revenues and expenses indicates the District's operating results. However, the District's goal is to provide services to our students, not to generate profits as commercial entities. One must consider many other non-financial factors, such as the quality of education provided and the safety of the schools, the condition of school buildings and other facilities, and changes to the property tax base of the District need to assess the overall health of the District.

Reporting the School District's Most Significant Funds

Fund Financial Statements

The fund financial statements provide more detailed information about the District's most significant funds – not the District as a whole. Funds are accounting devices the District uses to keep track of specific sources of funding and spending on particular programs. Some funds are required to be established by State law. However, the District establishes other funds to control and manage money for specific purposes.

- **Governmental Funds**
Most of the School District's activities are reported in governmental funds. The major governmental funds of the District are the General Fund, Building Fund, Capital Facilities Fund and Bond Interest and Redemption Fund. Governmental funds focus on how money flows into and out of the funds and the balances that remain at the end of the year. They are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the District's operations and services that help determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs.
- **Fiduciary Funds**
The District is the trustee, or fiduciary, for student activity funds and scholarship funds. All of the District's fiduciary activities are reported in separate Statements of Fiduciary Net Position. We exclude these activities from the District's other financial statements because the District cannot use these assets to finance its operations. The District is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2016

FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS

The School District as a Whole

For the period ending June 30, 2016, the District's net position increased \$10.86 million to \$127 million, or a 9.35% increase. The increase was the result of \$4.5 million increase in general purposes property taxes and \$4.9 million increase in Federal and State aid not restricted to specific purposes. District participates in both CalPERS and CalSTRS and therefore the aggregate net pension liability as of year-end was reflected on the financial statements (see Note 13 in the Annual Financial Report). The unrestricted net position would have been \$27.50 million before the GASB 68 adjustment. However, after the adjustment of \$59.39 million, the unrestricted net position is negative \$31.87 million (see Table 1).

(Table 1)
Comparative Condensed Statement of Net Position

	Governmental Activities	
	2016	2015
Assets		
Deposits and investments	\$ 77,352,124	\$ 79,231,490
Receivables	3,699,823	3,977,626
Prepaid expenses	23,170	15,807
Stores inventory	1,826	1,826
Capital assets	227,864,366	222,311,047
Total Assets	308,941,309	305,537,796
Deferred Outflows of Resources	8,244,606	5,746,362
Liabilities		
Accounts payable and other current liabilities	6,794,031	5,926,883
Unearned revenue	911,168	681,531
Long-term liabilities other than pensions	115,221,990	125,242,841
Aggregate net pension liability	61,255,737	49,767,876
Total Liabilities	184,182,926	181,619,131
Deferred Inflows of Resources	5,980,940	13,507,601
Net position		
Net investment in capital assets	134,894,488	128,008,293
Restricted	23,997,142	23,384,178
Unrestricted	(31,869,581)	(35,235,045)
Total Net Position	\$ 127,022,049	\$ 116,157,426

MORGAN HILL UNIFIED SCHOOL DISTRICT

**MANAGEMENT’S DISCUSSION AND ANALYSIS
JUNE 30, 2016**

The District’s net position increased by \$10,649,407 for this fiscal year (see Table 2). The District’s expenses for instruction, instruction related services and pupil services represented 74% of total expenses. The purely administrative activities of the District account for just 6% of total costs. The remaining 20% was spent in the areas of plant services and other expenses, including interest on long-term obligations, depreciation of capital assets and other outgo (see Figure 2).

**(Table 2)
Comparative Condensed Statement of Changes in Net Position**

	Governmental Activities	
	2016	2015
Revenues		
Program revenues	\$ 17,627,897	\$ 15,524,648
General revenues:		
Taxes levied for general purposes	53,625,978	49,118,548
Taxes levied for debt service	11,991,945	15,660,162
Taxes levied for other specific purposes	1,732,154	1,392,107
Federal and State aid not restricted to specific purposes	18,524,209	13,660,034
Interest and investment earnings	389,063	265,562
Miscellaneous	4,015,289	5,396,781
Total Revenues	107,906,535	101,017,842
Expenses		
Instruction	51,660,090	49,527,617
Instruction related services	10,387,335	9,423,428
Pupil support services	10,013,649	9,490,907
General administration	6,201,370	4,888,448
Plant services	9,987,226	7,527,247
Other	8,792,242	11,225,077
Total Expenses	97,041,912	92,082,724
Increase In Net Position	\$ 10,864,623	\$ 8,935,118

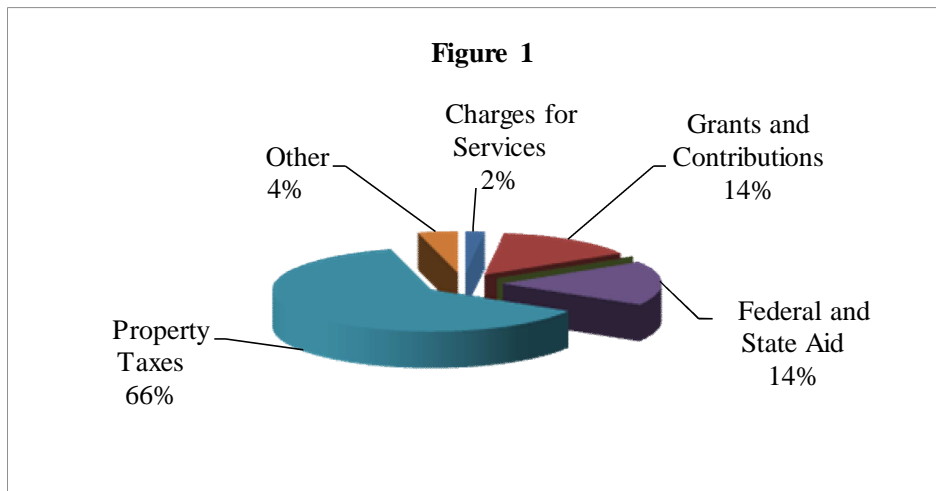
MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2016

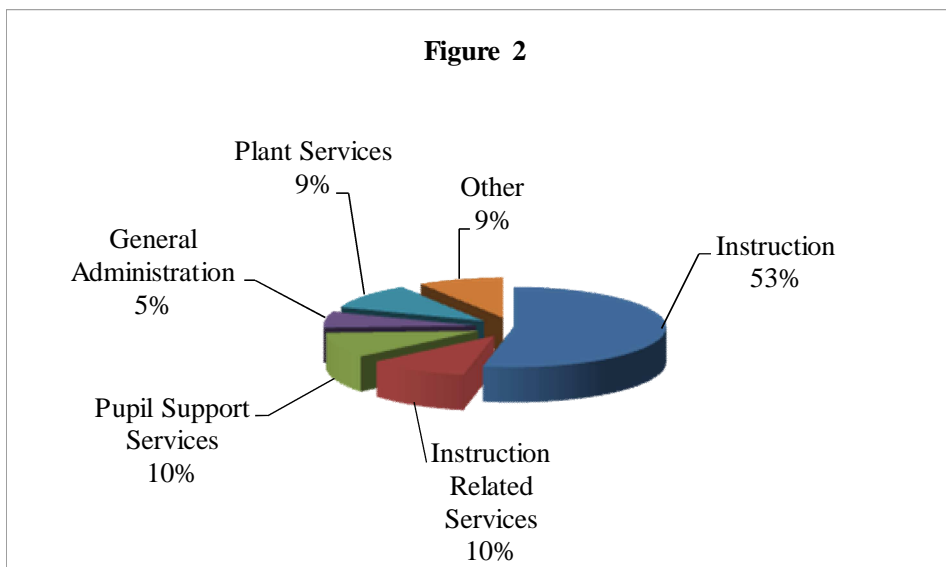
Governmental Activities

As reported in the Statement of Activities, the cost of all the District's governmental activities this year was \$97.3 million. The amount that our local taxpayers financed for these activities through property taxes was \$67.4 million or 62.4% of all revenues. Federal and State aid not restricted to specific purposes totaled \$18.5 million. (See Figure 1).

Revenues for the 2015-2016 Fiscal Year



Expenses for the 2015-2016 Fiscal Year



MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2016

FINANCIAL ANALYSIS OF THE FUND STATEMENTS

The fund financial statements focus on individual parts of the District's operations in more detail than the government-wide statements. The District's individual fund statements provide information on inflows and outflows and balances of spendable resources. The District's Governmental Funds reported a combined fund balance of \$74.6 million, a decrease of \$3.2 million from the previous fiscal year. This decrease is primarily the result of significant bond expenditures and decrease in the Bond Interest and Redemption Fund.

General Fund Budgetary Highlights

Over the course of the year, the District revised the annual operating budget during each interim period. The significant budget adjustments fell into the following categories:

- Budget revisions to the adopted budget required after approval of the State budget.
- Budget revisions to update revenues to actual enrollment information and to update expenditures for staffing adjustments related to actual enrollment.
- Budget revisions to update revenues and expenses in compliance with current education code requirements.
- Other budget revisions are routine in nature, including adjustments to categorical revenues and expenditures based on final awards, and adjustments between expenditure categories for school and department budgets.

The District ended the year with a General Fund ending balance of \$29.3 million excluding the Special Reserve Fund for Non Capital and the Retiree Benefit Special Reserve Fund. The State recommends a minimum ending reserve for economic uncertainties of 3% of General Fund expenditures. The District's ending reserve was \$18.18 million or 22.41%.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**MANAGEMENT’S DISCUSSION AND ANALYSIS
JUNE 30, 2016**

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

By the end of the 2015-2016 fiscal year, the District had investments of \$302.7 million in a broad range of capital assets, including school buildings, athletic facilities, administrative buildings, site improvements, vehicles, and equipment. The capital assets net of depreciation were valued at \$227.9 million at June 30, 2016 which is an increase of \$5.6 million from the previous year.

**(Table 3)
Comparative Schedule of Capital Assets
(net of depreciation)
June 30, 2016 and 2015**

	2016	2015	Difference	Percentage Change
Land	\$ 7,467,149	\$ 7,467,149	\$ -	0.0%
Buildings and improvements	186,137,331	175,604,508	10,532,823	6.0%
Machinery and equipment	1,657,575	1,993,823	(336,248)	-16.9%
Work in progress	32,602,311	37,245,567	(4,643,256)	-12.5%
Totals	\$ 227,864,366	\$ 222,311,047	\$ 5,553,319	2.5%

Long Term Obligation

As of June 30, 2016, the District had \$176.7 million in long-term obligations outstanding. The increase was the result of the District implementing the provisions of GASB 68, which required the District to recognize its proportionate share of the unfunded pension liability. The District participates in both CalPERS and CalSTRS and therefore the aggregate net pension liability as of year-end was reflected on the financial statements (see Note 13 in the Annual Financial Report).

**(Table 4)
Comparative Schedule of Outstanding Obligation
June 30, 2016 and 2015**

	2016	2015	Difference	Percentage Change
General obligation bonds (Including premiums and accretions)	\$ 92,293,451	\$ 104,698,318	\$ (12,404,867)	-11.8%
Certificates of participation	13,352,767	13,338,927	13,840	0.1%
Compensated absences	307,586	279,982	27,604	9.9%
Net OPEB obligation	9,268,186	6,925,614	2,342,572	33.8%
Net pension liability	61,255,737	49,767,876	11,487,861	100.0%
Totals	\$ 176,477,727	\$ 175,010,717	\$ 1,467,010	0.8%

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2016

COMPARATIVE AVERAGE DAILY ATTENDANCE SCHEDULE

This schedule provides a comparison of average daily attendance for the current and prior year.

Enrollment and average daily attendance (ADA) has experienced a decrease for the seventh year in a row. The schedule below depicts actual second period ADA from 2009-2010 to 2015-2016.

<u>ADA P-2</u>	<u>2009-2010</u>	<u>2010-2011</u>	<u>2011-2012</u>	<u>2012-2013</u>	<u>2013-2014</u>	<u>2014-2015</u>	<u>2015-2016</u>
Elementary	5,858.56	5,809.00	5,688.00	5,670.00	5,655.00	5,566.53	5,517.28
High School	2,821.06	2,733.00	2,686.00	2,651.00	2,516.00	2,552.50	2,531.87
Total ADA	8,679.62	8,542.00	8,374.00	8,321.00	8,208.00	8,119.03	8,049.15
ADA Change	(72.43)	(137.62)	(168.00)	(53.00)	(113.00)	(88.97)	(69.88)
% Change	-0.83%	-1.59%	-1.97%	-0.63%	-1.36%	-1.08%	-0.86%

FACTORS BEARING ON THE DISTRICT'S FUTURE

Under the leadership of Superintendent Steve Betando, Morgan Hill Unified School District continues to focus on improving our students' test scores and enhancing our ability to identify those students to meet their individual needs. As part of the Local Control Accountability Plan, the Morgan Hill Unified School District adopted three robust goals:

- **COLLEGE AND CAREER READINESS:** With an equity lens, Morgan Hill Unified School District will implement the Common Core State Standards (CCSS), Next Generation Science Standards (NGSS), and English Language Development (ELD) Standards to provide a strong grounding in core subject areas for all students.
- **PARENT ENGAGEMENT:** All parents are valued as partners in their child's education and are empowered to support their child's preparation for college or career readiness.
- **STUDENT ENGAGEMENT AND SCHOOL CLIMATE:** Increase student engagement, connectedness to school and community, and inspire productive persistence in all students to graduate college and career ready.

The Morgan Hill Unified School District has five schools in Program Improvement. In 2012-13, Jackson became the District's first math and music academy. Due to the success of the academy program and to expand choices for families, the District opened three academies since 2014-15: Walsh Elementary as a Science, Technology, Engineering, Arts, and Mathematics (STEAM Academy) and San Martin-Gwinn as an Environmental Science Academy, and Paradise Valley opened as the district's Engineering Academy. The District continues to focus on assisting the students, parents and staff to ensure appropriate support to close this achievement gap.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2016

The District provides post-employment health care benefits in accordance with the District's employment contracts. Administrative, Classified, and Certificated retirees who retire from the District on or after attaining age 55 receive post-employment health care benefits until the age of 65. In July 2009 the District implemented GASB 45 (Governmental Accounting Standards Board 45) and established a Special Reserve Fund for Post-Employment Benefits in compliance with GASB 45. The District selected the Frozen Entry Age funding method and made a one-time contribution from the General Fund of \$537,000 in 2008-09.

Stabilization of the State's economic health and the new Local Control Funding Formula are both beneficial to the District's finances; however there continues to be concern about the ability of the State to continually fund school districts through Proposition 98. Even if full funding is achieved within the eight year implementation period through the Local Control Funding Formula, California's funding per student still ranks among the lowest in the United States.

The Morgan Hill Board of Education and management will continue to provide the resources to ensure the support of our students' education within a balanced and managed budget.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, parents, investors, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact Victoria Knutson, Director of Fiscal Services, Morgan Hill Unified School District, 15600 Concord Circle, Morgan Hill, CA 95037.

MORGAN HILL UNIFIED SCHOOL DISTRICT

STATEMENT OF NET POSITION JUNE 30, 2016

	Governmental Activities
ASSETS	
Deposits and investments	\$ 77,352,124
Receivables	3,699,823
Internal balances (Due from other funds)	
Prepaid expenses	23,170
Stores inventories	1,826
Capital assets:	
Capital assets not depreciated	\$ 40,069,460
Capital assets being depreciated	262,635,800
Accumulated depreciation	<u>(74,840,894)</u>
Total Capital Assets	<u>227,864,366</u>
Total Assets	<u>308,941,309</u>
DEFERRED OUTFLOWS OF RESOURCES	
Deferred amount on refunding	397,929
Deferred outflows of resources related to pensions	7,846,677
Total Deferred Outflows of Resources	<u>8,244,606</u>
LIABILITIES	
Accounts payable	5,615,004
Interest payable	1,179,027
Internal balances (Due to other funds)	
Unearned revenue	911,168
Long-term obligations other than pensions:	
Current portion	9,538,003
Noncurrent portion	<u>105,683,987</u>
Total Long-Term Obligations Other Than Pensions	115,221,990
Aggregate net pension liability	<u>61,255,737</u>
Total Liabilities	<u>184,182,926</u>
DEFERRED INFLOWS OF RESOURCES	
Deferred inflows of resources related to pensions	<u>5,980,940</u>
Total Deferred Inflows of Resources	<u>5,980,940</u>
NET POSITION	
Net investment in capital assets	134,894,488
Restricted for:	
Educational programs	3,583,135
Child nutrition program	847,107
Debt service	10,141,701
Capital projects	9,425,199
Unrestricted	<u>(31,869,581)</u>
Total Net Position	<u>\$ 127,022,049</u>

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2016**

Functions/Programs	Expenses	Program Revenues		Net (Expenses)
		Charges for Services and Sales	Operating Grants and Contributions	Revenues and Changes in Net Position
				Governmental Activities
Governmental Activities:				
Instruction	\$ 51,660,090	\$ 9,251	\$ 8,575,104	\$ (43,075,735)
Instruction-related activities:				
Supervision of instruction	3,076,060	6	1,005,937	-207011700.0%
Instructional library and technology	280,473	-	28,601	(251,872)
School site administration	7,030,802	736	538,378	(6,491,688)
Pupil services:				
Home-to-school transportation	2,972,453	19,268	30,335	(2,922,850)
Food services	2,673,370	456,484	1,920,593	(296,293)
All other pupil services	4,367,826	-	1,266,048	(3,101,778)
General administration:				
Data processing	1,564,304	-	30,561	(1,533,743)
All other general administration	4,637,066	23,326	667,400	(3,946,340)
Plant services	9,987,226	3,890	13,521	(9,969,815)
Ancillary services	547,274	-	10,002	(537,272)
Community services	9,409	-	-	(9,409)
Interest on long-term obligations	4,508,866	-	-	(4,508,866)
Other outgo	3,726,693	1,600,882	1,427,574	(698,237)
Total Governmental-Type Activities	\$ 97,041,912	\$ 2,113,843	\$ 15,514,054	(79,414,015)
General revenues and subventions:				
Property taxes, levied for general purposes				53,625,978
Property taxes, levied for debt service				11,991,945
Taxes levied for other specific purposes				1,732,154
Federal and State aid not restricted to specific purposes				18,524,209
Interest and investment earnings				389,063
Intergovernmental revenues				1,605,115
Miscellaneous				2,410,174
Subtotal, General Revenues				90,278,638
Change in Net Position				10,864,623
Net Position - Beginning				116,157,426
Net Position - Ending				\$ 127,022,049

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

GOVERNMENTAL FUNDS

BALANCE SHEET

JUNE 30, 2016

	General Fund	Building Fund	Capital Facilities Fund
ASSETS			
Deposits and investments	\$ 33,479,469	\$ 20,106,662	\$ 8,612,485
Receivables	3,212,843	32,906	17,344
Due from other funds	173,421	-	-
Prepaid expenditures	23,170	-	-
Stores inventories	-	-	-
Total Assets	\$ 36,888,903	\$ 20,139,568	\$ 8,629,829
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 3,552,673	\$ 913,508	\$ 588,406
Due to other funds	2,814	-	-
Unearned revenue	911,168	-	-
Total Liabilities	4,466,655	913,508	588,406
Fund Balances:			
Nonspendable	37,670	-	-
Restricted	3,501,840	12,278,411	8,041,423
Committed	-	-	-
Assigned	10,698,000	6,947,649	-
Unassigned	18,184,738	-	-
Total Fund Balances	32,422,248	19,226,060	8,041,423
Total Liabilities and Fund Balances	\$ 36,888,903	\$ 20,139,568	\$ 8,629,829

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

Bond Interest and Redemption Fund	Non-Major Governmental Funds	Total Governmental Funds
\$ 11,307,582	\$ 3,845,926	\$ 77,352,124
13,146	423,584	3,699,823
-	2,814	176,235
-	-	23,170
-	1,826	1,826
<u>\$ 11,320,728</u>	<u>\$ 4,274,150</u>	<u>\$ 81,253,178</u>

\$ -	\$ 560,417	\$ 5,615,004
-	173,421	176,235
-	-	911,168
<u>-</u>	<u>733,838</u>	<u>6,702,407</u>

-	7,826	45,496
11,320,728	2,309,352	37,451,754
-	1,223,134	1,223,134
-	-	17,645,649
-	-	18,184,738
<u>11,320,728</u>	<u>3,540,312</u>	<u>74,550,771</u>
<u>\$ 11,320,728</u>	<u>\$ 4,274,150</u>	<u>\$ 81,253,178</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET POSITION
JUNE 30, 2016**

Amounts Reported for Governmental Activities in the Statement of Net Position are Different Because:

Total Fund Balance - Governmental Funds		\$ 74,550,771
Capital assets used in governmental activities are not financial resources and, therefore, are not reported as assets in governmental funds.		
The cost of capital assets is	\$ 302,705,260	
Accumulated depreciation is	(74,840,894)	
Net Capital Assets	<u>227,864,366</u>	227,864,366
Deferred charges on refunding related to the loss on refunding of debt which is classified as a deferred outflow of resources and expensed over the life of the debt on the government-wide financial statements, but was recorded as an expenditure in the governmental fund statements when the debt was issued.		
		397,929
In governmental funds, unmatured interest on long-term obligations is recognized in the period when it is due. On the government-wide statements, unmatured interest on long-term obligations is recognized when it is incurred.		
		(1,179,027)
Long-term obligations, including bonds payable, are not due and payable in the current period and, therefore, are not reported as liabilities in the funds. Long-term liabilities at year end consist of:		
Bonds payable and premiums	(92,293,451)	
COP payable and discounts	(13,352,767)	
Compensated absences (vacations)	(307,586)	
Net OPEB obligation	(9,268,186)	
Net pension liability, net of related deferred inflows and outflows of resources	<u>(59,390,000)</u>	
Total Long-Term Obligations		<u>(174,611,990)</u>
Total Net Position - Governmental Activities		<u><u>\$ 127,022,049</u></u>

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

**GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2016**

	General Fund	Building Fund	Capital Facilities Fund
REVENUES			
Local control funding formula	\$ 65,516,588	\$ -	\$ -
Federal sources	4,120,851	694,784	-
Other state sources	10,188,821	-	-
Other local sources	7,393,318	1,004,502	2,815,586
Total Revenues	87,219,578	1,699,286	2,815,586
EXPENDITURES			
Current			
Instruction	46,315,336	-	-
Instruction-related activities:			
Supervision of instruction	2,793,525	-	-
Instructional library, media and technology	255,217	-	-
School site administration	6,094,045	-	-
Pupil services:			
Home-to-school transportation	2,822,183	-	-
Food services	347	-	-
All other pupil services	3,926,822	-	-
General administration:			
Data processing	1,404,977	-	-
All other general administration	3,979,915	-	-
Plant services	7,297,659	35,102	488
Facility acquisition and construction	1,260,115	8,379,070	1,996,419
Ancillary services	509,704	-	-
Community services	8,763	-	-
Other outgo	3,726,693	-	-
Debt service			
Principal	-	-	-
Interest and other	-	958,855	-
Total Expenditures	80,395,301	9,373,027	1,996,907
Excess (Deficiency) of Revenues Over Expenditures	6,824,277	(7,673,741)	818,679
Other Financing Sources (Uses):			
Transfers in	82,681	416,000	-
Transfers out	(736,000)	-	(82,681)
Net Financing Sources (Uses)	(653,319)	416,000	(82,681)
NET CHANGE IN FUND BALANCES	6,170,958	(7,257,741)	735,998
Fund Balance - Beginning	26,251,290	26,483,801	7,305,425
Fund Balance - Ending	\$ 32,422,248	\$ 19,226,060	\$ 8,041,423

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

Bond Interest and Redemption Fund	Non-Major Governmental Funds	Total Governmental Funds
\$ -	\$ -	\$ 65,516,588
-	1,976,163	6,791,798
69,593	868,796	11,127,210
11,953,290	1,066,487	24,233,183
<u>12,022,883</u>	<u>3,911,446</u>	<u>107,668,779</u>
-	520,655	46,835,991
-	-	2,793,525
-	-	255,217
-	268,834	6,362,879
-	-	2,822,183
-	2,411,878	2,412,225
-	-	3,926,822
-	-	1,404,977
-	161,690	4,141,605
-	52,779	7,386,028
-	1,016,019	12,651,623
-	-	509,704
-	-	8,763
-	-	3,726,693
7,063,802	-	7,063,802
7,654,478	-	8,613,333
<u>14,718,280</u>	<u>4,431,855</u>	<u>110,915,370</u>
<u>(2,695,397)</u>	<u>(520,409)</u>	<u>(3,246,591)</u>
-	320,000	818,681
-	-	(818,681)
-	320,000	-
<u>(2,695,397)</u>	<u>(200,409)</u>	<u>(3,246,591)</u>
14,016,125	3,740,721	77,797,362
<u>\$ 11,320,728</u>	<u>\$ 3,540,312</u>	<u>\$ 74,550,771</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2016

Amounts Reported for Governmental Activities in the Statement of Activities are Different Because:

Total Net Change in Fund Balances - Governmental Funds **\$ (3,246,591)**

Capital outlays to purchase or build capital assets are reported in governmental funds as expenditures; however, for governmental activities, those costs are shown in the Statement of Net Position and allocated over their estimated useful lives as annual depreciation expenses in the Statement of Activities. This is the amount by which capital outlays exceed depreciation in the period.

Capital outlays	\$ 10,989,859	
Depreciation expense	<u>(5,334,807)</u>	
Net Expense Adjustment		5,655,052

Loss on disposal of capital assets is reported in the government-wide statement of net assets, but is not recorded in the governmental funds. (101,733)

In the Statement of Activities, certain operating expenses, such as compensated absences (vacations) are measured by the amounts earned during the year. In the governmental funds, however, expenditures for these items are measured by the amount of financial resources used (essentially, the amounts actually paid). Vacation amounts earned were more than the amounts used. (27,604)

In the governmental funds, pension costs are based on employer contributions made to pension plans during the year. However, in the Statement of Activities, pension expense is the net effect of all changes in the deferred outflows, deferred inflows and net pension liability during the year. (240,198)

Proceeds received from sale of bonds is a revenue source in the governmental funds, but it increases long-term liabilities in the Statement of Net Position and does not affect the Statement of Activities. (36,183,000)

Accreted interest on capital appreciation bonds does not require the use of current financial resources, and thus is not recorded in the governmental funds. In the Statement of Activities, however, accreted interest expense is recognized in the government-wide statements as an addition to long-term liabilities. (916,451)

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES (Continued) FOR THE YEAR ENDED JUNE 30, 2016

Amortization of premium, discount and defeasance cost of long-term liabilities is not recognized in the governmental funds, but they impact the Statement of Activities. The net amortization amount during the year is as follows:

Amortization of defeasance cost of general obligation bonds	(1,620,687)	
Amortization of premium of general obligation bonds	3,299,318	
Amortization of discount of certificates of participation	<u>(13,840)</u>	
Net amortization		1,664,791

Payment of principal on long-term liabilities is an expenditure in the governmental funds, but it reduces long-term liabilities in the Statement of Net Position and does not affect the Statement of Activities.

46,205,000

Payments of the retiree benefits are recorded as an expenditure in the governmental funds. However, the difference between the excess of the annual required contributions and the actual benefit payments made, is recorded as an additional expense in the Statement of Activities. The actual amount of the contribution was less than the annual required contributions.

(2,342,572)

Bond defeasance cost is recorded as an expenditure in the governmental funds but is recorded as a deferred charge on the Statement of Net Position and does not affect the Statement of Activities.

397,929

Change in Net Position of Governmental Activities \$ 10,864,623

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FIDUCIARY FUND
STATEMENT OF NET POSITION
JUNE 30, 2016**

	<u>Agency Fund</u>
ASSETS	
Deposits and investments	\$ 930,463
Total Assets	<u>\$ 930,463</u>
 LIABILITIES	
Due to student groups	\$ 930,463
Total Liabilities	<u>\$ 930,463</u>

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity

The Morgan Hill Unified School District was unified on July 1, 1966 under the laws of the State of California. The District operates under a locally elected seven member Board form of government and provides educational services to grades K-12 as mandated by the State and/or Federal agencies. The District operates eight elementary, two middle, two high schools, a continuation high school and a community adult school as well as a home-schooling program.

A reporting entity is comprised of the primary government, component units, and other organizations that are included to ensure the financial statements are not misleading. The primary government of the District consists of all funds, departments, boards, and agencies that are not legally separate from the District. For Morgan Hill Unified School District, this includes general operations, food service, and student related activities of the District.

Component Units

Component units are legally separate organizations for which the District is financially accountable. Component units may also include organizations that are fiscally dependent on the District, in that the District approves their budget, the issuance of their debt or the levying of their taxes. In addition, component units are other legally separate organizations for which the District is not financially accountable but the nature and significance of the organization's relationship with the District is such that exclusion would cause the District's financial statements to be misleading or incomplete. The component unit, although a legally separate entity is reported in the financial statements using the blended presentation method as if it was part of the District's operations because the governing board of the component unit is essentially the same as the governing board of the District and because its purpose is to finance the construction of facilities to be used for the direct benefit of the District. The financial activity for this component unit is presented in the financial statements as the Capital Projects Fund.

Basis of Presentation - Fund Accounting

The accounting system is organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. The District's funds are grouped into two broad fund categories: governmental and fiduciary.

Governmental Funds

Governmental funds are those through which most governmental functions typically are financed. Governmental fund reporting focuses on the sources, uses, and balances of current financial resources. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used. Current liabilities are assigned to the fund from which they will be paid. The difference between governmental fund assets and liabilities is reported as fund balance. The following are the District's major and non-major governmental funds:

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Major Governmental Funds

General Fund The General Fund is the chief operating fund for all districts. It is used to account for the ordinary operations of the District. All transactions except those amounts for another fund are accounted for in this fund.

Two funds currently defined as special revenue funds in the California State Accounting Manual (CSAM) do not meet the GASB Statement No. 54 special revenue fund definition. Specifically, Fund 17, Special Reserve Fund for Other Than Capital Outlay Projects, and Fund 20, Special Reserve Fund for Post-employment Benefits, are not substantially composed of restricted or committed revenue sources. While these funds are authorized by statute and will remain open for internal reporting purposes, these funds function effectively as extensions of the General Fund, and accordingly have been combined with the General Fund for presentation in these audited financial statements.

Building Fund The Building Fund exists primarily to account separately for proceeds from the sale of bonds (*Education Code* Section 15146) and may not be used for any purposes other than those for which the bonds were issued.

Capital Facilities Fund The Capital Facilities Fund is used primarily to account separately for monies received from fees levied on developers or other agencies as a condition of approving a development (*Education Code* Sections 17620-17626). Expenditures are restricted to the purposes specified in *Government Code* Sections 65970-65981 or to the items specified in agreements with the developer (*Government Code* Section 66006).

Bond Interest and Redemption Fund The Bond Interest and Redemption Fund is used for the repayment of bonds issued for a District (*Education Code* Sections 15125-15262).

Non-Major Governmental Funds

Special Revenue Funds The Special Revenue funds are used to account for the proceeds from specific revenue sources (other than trusts, major capital projects, or debt service) that are restricted or committed to expenditures for specified purposes and that compose a substantial portion of the inflows of the fund. Additional resources that are restricted, committed, or assigned to the purpose of the fund may also be reported in the fund.

Adult Education Fund The Adult Education Fund is used to account separately for Federal, State, and local revenues for adult education programs and is to be expended for adult education purposes only.

Child Development Fund The Child Development Fund is used to account separately for Federal, State, and local revenues to operate child development programs and is to be used only for expenditures for the operation of child development programs.

Cafeteria Fund The Cafeteria Fund is used to account separately for Federal, State, and local resources to operate the food service program (*Education Code* Sections 38090-38093) and is used only for those expenditures authorized by the governing board as necessary for the operation of the District's food service program (*Education Code* Sections 38091 and 38100).

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Deferred Maintenance Fund The Deferred Maintenance Fund is used to account separately for State apportionments and the District's contributions for deferred maintenance purposes (*Education Code* Sections 17582-17587) and for items of maintenance approved by the State Allocation Board.

Capital Project Funds The Capital Project funds are used to account for financial resources that are restricted, committed, or assigned to the acquisition or construction of major capital facilities and other capital assets (other than those financed by proprietary funds and trust funds).

Capital Project Fund for Blended Component Units This fund is used to account for capital projects financed by parcel taxes, upon approval of the voters during 2006-07.

Fiduciary Funds Fiduciary funds are used to account for assets held in trustee or agent capacity for others that cannot be used to support the District's own programs. The fiduciary fund category is split into four classifications: pension trust funds, investment trust funds, private-purpose trust funds, and agency funds. The key distinction between trust and agency funds is that trust funds are subject to a trust agreement that affects the degree of management involvement and the length of time that the resources are held.

Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. Such funds have no equity accounts since all assets are due to individuals or entities at some future time. The District's agency fund accounts for student body activities (ASB) and scholarship activities.

Basis of Accounting - Measurement Focus

Government-Wide Financial Statements The government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. This is the same approach used in the preparation of the proprietary fund financial statements, but differs from the manner in which governmental fund financial statements are prepared.

The government-wide statement of activities presents a comparison between expenses, both direct and indirect, for each governmental function, and excludes fiduciary activity. Direct expenses are those that are specifically associated with a service, program, or department and are therefore, clearly identifiable to a particular function. The District does not allocate indirect expenses to functions in the Statement of Activities, except for depreciation. Program revenues include charges paid by the recipients of the goods or services offered by the programs and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues. The comparison of program revenues and expenses identifies the extent to which each program is self-financing or draws from the general revenues of the District. Eliminations have been made to minimize the double counting of internal activities.

Net position should be reported as restricted when constraints placed on net position are either externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. The net position restricted for other activities result from special revenue funds and the restrictions on their use.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Fund Financial Statements Fund financial statements report detailed information about the District. The focus of governmental and proprietary fund financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Non-major funds are aggregated and presented in a single column. The internal service fund is presented in a single column on the face of the proprietary fund statement.

Governmental Funds All governmental funds are accounted for using the flow of current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. The statement of revenues, expenditures, and changes in fund balance reports on the sources (revenues and other financing sources) and uses (expenditures and other financing uses) of current financial resources. This approach differs from the manner in which the governmental activities of the government-wide financial statements are prepared. Governmental fund financial statements, therefore, include reconciliations with brief explanations to better identify the relationship between the government-wide financial statements, prepared using the economic resources measurement focus and the accrual basis of accounting, and the governmental fund financial statements, prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting.

Fiduciary Fund Fiduciary fund is accounted for using the flow of economic resources measurement focus and the accrual basis of accounting. Fiduciary fund is excluded from the government-wide financial statements because they do not represent resources of the District.

Revenues – Exchange and Non-Exchange Transactions Revenue resulting from exchange transactions, in which each party gives and receives essentially equal value, is recorded on the accrual basis when the exchange takes place. On a modified accrual basis, revenue is recorded in the fiscal year in which the resources are measurable and become available. Available means that the resources will be collected within the current fiscal year or are expected to be collected soon enough thereafter, to be used to pay liabilities of the current fiscal year. For the District, available means expected to be received within 45 to 60 days of fiscal year-end. The following revenue sources are considered to be both measurable and available at fiscal year-end: State apportionments, interest, certain grants and other local sources.

Non-exchange transactions, in which the District receives value without directly giving equal value in return, include property taxes, certain grants, entitlements, and donations. Revenue from property taxes is recognized in the fiscal year in which the taxes are received. Revenue from certain grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include time and purpose restrictions. On a modified accrual basis, revenue from non-exchange transactions must also be available before it can be recognized.

Unearned Revenue Unearned revenue arises when potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period or when resources are received by the District prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the District has a legal claim to the resources, the liability for unearned revenue is removed from the balance sheet and revenue is recognized.

Certain grants received before the eligibility requirements are met are recorded as unearned revenue. On the governmental fund financial statements, receivables that will not be collected within the available period are also recorded as unearned revenue.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Expenses/Expenditures On the accrual basis of accounting, expenses are recognized at the time they are incurred. The measurement focus of governmental fund accounting is on decreases in net financial resources (expenditures) rather than expenses. Expenditures are generally recognized in the accounting period in which the related fund liability is incurred, if measurable, and typically paid within 90 days. Principal and interest on long-term obligations, which have not matured, are recognized when paid in the governmental funds as expenditures. Allocations of costs, such as depreciation and amortization, are not recognized in the governmental funds but are recognized in the government-wide statements.

Cash and Cash Equivalents

The District's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. Cash equivalents also include cash with county treasury balances.

Investments

Investments held at June 30, 2016 with original maturities greater than one year are stated at fair value. Fair value is estimated based on quoted market prices at year-end. All investments not required to be reported at fair value are stated at cost or amortized cost. Fair values of investments in county and state investment pools are determined by the program sponsor.

Stores Inventories

Inventories consist of expendable food and supplies held for consumption. Inventories are stated at cost, on the weighted average basis. The costs of inventory items are recorded as expenditures in the governmental type funds when used.

Capital Assets and Depreciation

The accounting and reporting treatment applied to the capital assets associated with a fund are determined by its measurement focus. Capital assets are long-lived assets of the District. The District maintains a capitalization threshold of \$20,000. The District does not possess any infrastructure. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized, but are expensed as incurred. When purchased, such assets are recorded as expenditures in the governmental funds and capitalized in the government-wide statement of net position. The valuation basis for capital assets is historical cost, or where historical cost is not available, estimated historical cost based on replacement cost. Depreciation is computed using the straight-line method. Estimated useful lives of the various classes of depreciable capital assets are as follows: buildings, 20 to 50 years; improvements, 5 to 50 years; equipment, 2 to 15 years. Donated capital assets are capitalized at estimated fair market value on the date donated.

Interfund Balances

On fund financial statements, receivables and payables resulting from short-term interfund loans are classified as "interfund receivables/payables". These amounts are eliminated in the governmental columns of the statement of net position.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Compensated Absences

Compensated absences are accrued as a liability as the benefits are earned. The entire compensated absence liability is reported on the government-wide statement of net position. For governmental funds, the current portion of unpaid compensated absences is recognized upon the occurrence of relevant events such as employee resignations and retirements that occur prior to year-end that have not yet been paid with expendable available financial resources. These amounts are reported in the fund from which the employees who have accumulated leave are paid.

Sick leave is accumulated without limit for each employee at the rate of one day for each month worked. Leave with pay is provided when employees are absent for health reasons; however, the employees do not gain a vested right to accumulated sick leave. Employees are never paid for any sick leave balance at termination of employment or any other time. Therefore, the value of accumulated sick leave is not recognized as a liability in the District's financial statements. However, credit for unused sick leave is applicable to all classified school members who retire after January 1, 1999. At retirement, each member will receive .004 year of service credit for each day of unused sick leave.

Accrued Liabilities and Long-Term Obligations

All payables, accrued liabilities, and long-term obligations are reported in the government-wide and proprietary fund financial statements. In general, governmental fund payables and accrued liabilities that, once incurred, are paid in a timely manner and in full from current financial resources are reported as obligations of the governmental funds.

However, claims and judgments, compensated absences, special termination benefits, and contractually required pension contributions that will be paid from governmental funds are reported as a liability in the governmental fund financial statements only to the extent that they are due for payment during the current year. Bonds, capital leases, and other long-term obligations are recognized as liabilities in the governmental fund financial statements when due.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position also reports deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an expense or expenditure until then. The District reports deferred outflows of resources for the unamortized loss on the refunding of general obligation bonds, current year pension contributions, and net differences of net pension liability in proportionate share, in expected and actual experience, in assumption and in projected and actual earnings.

In addition to liabilities, the statement of financial position reports a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as revenue until then. The District reports deferred inflows of resources for net differences of net pension liability in proportionate share, in expected and actual experience, in assumption and in projected and actual earnings.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Pensions

For purposes of measuring the net pension liability and deferred outflows/inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the California State Teachers Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS) plan for schools (Plans) and additions to/deductions from the Plans' fiduciary net position have been determined on the same basis as they are reported by CalSTRS and CalPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Member contributions are recognized in the period in which they are earned. Investments are reported at fair value.

Debt Premiums and Discounts

In the government-wide financial statements and in the proprietary fund type financial statements, long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund statement of net position. Debt premiums and discounts are amortized over the life of the bonds using the straight-line method.

Fund Balances - Governmental Funds

As of June 30, 2016, fund balances of the governmental funds are classified as follows:

Nonspendable - amounts that cannot be spent either because they are in nonspendable form or because they are legally or contractually required to be maintained intact.

Restricted - amounts that can be spent only for specific purposes because of constitutional provisions or enabling legislation or because of constraints that are externally imposed by creditors, grantors, contributors, or the laws or regulations of other governments.

Committed - amounts that can be used only for specific purposes determined by a formal action of the governing board. The governing board is the highest level of decision-making authority for the District. Commitments may be established, modified, or rescinded only through resolutions or other action as approved by the governing board.

Assigned - amounts that do not meet the criteria to be classified as restricted or committed but that are intended to be used for specific purposes. Under the District's adopted policy, only the governing board or chief business officer/assistant superintendent of business services may assign amounts for specific purposes.

Unassigned - all other spendable amounts.

Spending Order Policy

When an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available, the District considers restricted funds to have been spent first. When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, the District considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds, as needed, unless the governing board has provided otherwise in its commitment or assignment actions.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Net Position

Net position represents the difference between assets and liabilities. Net position net of investment in capital assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction, or improvement of those assets. Net position is reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. The District first applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position is available.

Interfund Activity

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures in the purchaser funds. Flows of cash or goods from one fund to another without a requirement for repayment are reported as interfund transfers. Interfund transfers are reported as other financing sources/uses in governmental funds. Repayments from funds responsible for particular expenditures to the funds that initially paid for them are not presented in the financial statements. Interfund transfers are eliminated in the governmental columns of the statement of activities.

Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

Budgetary Data

The budgetary process is prescribed by provisions of the California *Education Code* and requires the governing board to hold a public hearing and adopt an operating budget no later than July 1 of each year. The District governing board satisfied these requirements. The adopted budget is subject to amendment throughout the year to give consideration to unanticipated revenue and expenditures primarily resulting from events unknown at the time of budget adoption with the legal restriction that expenditures cannot exceed appropriations by major object account.

The amounts reported as the original budgeted amounts in the budgetary statements reflect the amounts when the original appropriations were adopted. The amounts reported as the final budgeted amounts in the budgetary statements reflect the amounts after all budget amendments have been accounted for. For budget purposes, on-behalf payments have not been included as revenue and expenditures as required under generally accepted accounting principles.

Property Tax

Secured property taxes attach as an enforceable lien on property as of January 1. Taxes are payable in two installments on November 1 and February 1 and become delinquent on December 10 and April 10, respectively. Unsecured property taxes are payable in one installment on or before August 31. The County of Santa Clara bills and collects the taxes on behalf of the District. Local property tax revenues are recorded when received.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

Changes in Accounting Principles

In February 2015, the GASB issued Statement No. 72, *Fair Value Measurement and Application*. This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

The District has implemented the provisions of this Statement as of June 30, 2016.

In June 2015, the GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*. The objective of this Statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

This Statement establishes requirements for defined benefit pensions that are not within the scope of Statement No. 68, *Accounting and Financial Reporting for Pensions*, as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of Statement No. 68. It also amends certain provisions of Statement No. 67, *Financial Reporting for Pension Plans*, and Statement No. 68 for pension plans and pensions that are within their respective scopes.

The provisions in this Statement effective as of June 30, 2016, include the provisions for assets accumulated for purposes of providing pensions through defined benefit plans and the amended provisions of Statements No. 67 and No. 68. The District has implemented these provisions as of June 30, 2016. The provisions in this Statement related to defined benefit pensions that are not within the scope of Statement No. 68 are effective for periods beginning after June 15, 2016.

In June 2015, the GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify—in the context of the current governmental financial reporting environment—the hierarchy of generally accepted accounting principles (GAAP). The "GAAP hierarchy" consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

This Statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*.

The District has implemented the provisions of this Statement as of June 30, 2016.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

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In December 2015, the GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. This Statement addresses accounting and financial reporting for certain external investment pools and pool participants. Specifically, it establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. An external investment pool qualifies for that reporting if it meets all of the applicable criteria established in this Statement. The specific criteria address (1) how the external investment pool transacts with participants, (2) requirements for portfolio maturity, quality, diversification, and liquidity; and (3) calculation and requirements of a shadow price. Significant noncompliance prevents the external investment pool from measuring all of its investments at amortized cost for financial reporting purposes. Professional judgment is required to determine if instances of noncompliance with the criteria established by this Statement during the reporting period, individually or in the aggregate, were significant.

If an external investment pool does not meet the criteria established by this Statement, that pool should apply the provisions in paragraph 16 of Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, as amended. If an external investment pool meets the criteria in this Statement and measures all of its investments at amortized cost, the pool's participants also should measure their investments in that external investment pool at amortized cost for financial reporting purposes. If an external investment pool does not meet the criteria in this Statement, the pool's participants should measure their investments in that pool at fair value, as provided in paragraph 11 of Statement No. 31, as amended.

This Statement establishes additional note disclosure requirements for qualifying external investment pools that measure all of their investments at amortized cost for financial reporting purposes and for governments that participate in those pools. Those disclosures for both the qualifying external investment pools and their participants include information about any limitations or restrictions on participant withdrawals.

The District has implemented the provisions of this Statement as of June 30, 2016.

New Accounting Pronouncements

In June 2015, the GASB issued Statement No. 74, *Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans*. The objective of this Statement is to improve the usefulness of information about post-employment benefits other than pensions (other post-employment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all post-employment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2016. Early implementation is encouraged.

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Post-employment Benefits Other Than Pension*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for post-employment benefits other than pensions (other post-employment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all post-employment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2017. Early implementation is encouraged.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

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In August 2015, the GASB issued Statement No. 77, *Tax Abatement Disclosures*. This Statement requires governments that enter into tax abatement agreements to disclose the following information about the agreements:

- Brief descriptive information, such as the tax being abated, the authority under which tax abatements are provided, eligibility criteria, the mechanism by which taxes are abated, provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients
- The gross dollar amount of taxes abated during the period
- Commitments made by a government, other than to abate taxes, as part of a tax abatement agreement

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2015. Early implementation is encouraged.

In December 2015, the GASB issued Statement No. 78, *Pensions Provided Through Certain Multiple-Employer Defined Benefit Pension Plans*. The objective of this Statement is to address a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local governmental employers whose employees are provided with such pensions. The requirements of this Statement are effective for reporting periods beginning after December 15, 2015. Early implementation is encouraged.

In January 2016, the GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - amendment of GASB Statement No. 14*. The objective of this Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity, as amended*. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. Early implementation is encouraged.

In March 2016, the GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*. The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2016, and should be applied retroactively. Early implementation is encouraged.

In March 2016, the GASB issued Statement No. 82, *Pension Issues - An Amendment of GASB Statements No. 67, No. 68, and No. 73*. The objective of this Statement is to address certain issues that have been raised with respect to Statements No 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68 and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. Early implementation is encouraged.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

NOTE 2 - DEPOSITS AND INVESTMENTS

Summary of Deposits and Investments

Deposits and investments as of June 30, 2016, are classified in the accompanying financial statements as follows:

Governmental activities	\$ 77,352,124
Fiduciary fund	930,463
Total Deposits and Investments	<u>\$ 78,282,587</u>

Deposits and investments as of June 30, 2016, consist of the following:

Cash on hand and in banks	\$ 983,698
Cash in revolving	20,500
Investments	77,278,389
Total Deposits and Investments	<u>\$ 78,282,587</u>

Policies and Practices

The District is authorized under California Government Code to make direct investments in local agency bonds, notes, or warrants within the State; U.S. Treasury instruments; registered State warrants or treasury notes; securities of the U.S. Government, or its agencies; bankers acceptances; commercial paper; certificates of deposit placed with commercial banks and/or savings and loan companies; repurchase or reverse repurchase agreements; medium term corporate notes; shares of beneficial interest issued by diversified management companies, certificates of participation, obligations with first priority security; and collateralized mortgage obligations.

Investment in County Treasury - The District is considered to be an involuntary participant in an external investment pool as the District is required to deposit all receipts and collections of monies with their County Treasurer (*Education Code* Section 41001). The fair value of the District's investment in the pool is reported in the accounting financial statements at amounts based upon the District's pro-rata share of the fair value provided by the County Treasurer for the entire portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by the County Treasurer, which is recorded on the amortized cost basis.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

General Authorizations

Limitations as they relate to interest rate risk and concentration of credit risk are indicated in the schedules below:

Authorized Investment Type	Maximum Remaining Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Local Agency Bonds, Notes, Warrants	5 years	None	None
Registered State Bonds, Notes, Warrants	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptance	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base	None
Medium-Term Corporate Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None
Joint Powers Authority Pools	N/A	None	None

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The District manages its exposure to interest rate risk by investing in the County Treasury Pool and money market accounts.

Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuation is provided by the following schedule that shows the distribution of the District's investment by maturity:

Investment Type	Cost	Fair Value	Maturity
Natixis Guaranteed Investment Contract	\$ 4,766,471	\$ 4,766,471	5/3/2027
Money Market	541,954	541,954	Less than a year
County Pool	71,969,964	72,101,276	439 days
Total	<u>\$ 77,278,389</u>	<u>\$ 77,409,701</u>	

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

Investment Type	Fair Value	Rating Unrated
Natixis Guaranteed Investment Contract	\$ 4,766,471	\$ 4,766,471
Money Market	541,954	541,954
County Pool	72,101,276	72,101,276
Total	<u>\$ 77,409,701</u>	<u>\$ 77,409,701</u>

Custodial Credit Risk - Deposits

This is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a policy for custodial credit risk for deposits. However, the California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110 percent of the total amount deposited by the public agency. California law also allows financial institutions to secure public deposits by pledging first trust deed mortgage notes having a value of 150 percent of the secured public deposits and letters of credit issued by the Federal Home Loan Bank of San Francisco having a value of 105 percent of the secured deposits. The District had no significant exposure with respect to custodial credit risk. On June 30, 2016, District bank balances of \$631,379 were exposed to custodial credit risk because they were uninsured but were collateralized with securities held by the pledging financial institution's trust department or agent, but not in the name of the District.

Custodial Credit Risk - Investments

This is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in possession of an outside party. Of the investment in the District, \$5,058,425 is exposed to custodial credit risk because the related securities are uninsured, unregistered and held by the brokerage firm which is also the counterparty for these securities.

Fair Value Measurements

The District categorizes the fair value measurements of its investments based on the hierarchy established by generally accepted accounting principles. The fair value hierarchy, which has three levels, is based on the valuation inputs used to measure an asset's fair value. The following provides a summary of the hierarchy used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets that the District has the ability to access at the measurement date. Level 1 assets may include debt and equity securities that are traded in an active exchange market and that are highly liquid and are actively traded in over-the-counter markets.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets in active markets, quoted prices for identical or similar assets in markets that are not active, or other inputs that are observable, such as interest rates and curves observable at commonly quoted intervals, implied volatilities, and credit spreads. For financial reporting purposes, if an asset has a specified term, a Level 2 input is required to be observable for substantially the full term of the asset.

Level 3 - Unobservable inputs should be developed using the best information available under the circumstances, which might include the District's own data. The District should adjust that data if reasonably available information indicates that other market participants would use different data or certain circumstances specific to the District are not available to other market participants.

Uncategorized - Investments in the Santa Clara County Treasury Investment Pool and Money Market are not measured using the input levels above because the District's transactions are based on a stable net asset value per share. All contributions and redemptions are transacted at \$1.00 net asset value per share.

The District's fair value measurement of Natixis Guaranteed Investment Contract is categorized as Level 3 at June 30, 2016.

NOTE 3 - RECEIVABLES

Receivables at June 30, 2016, consisted of intergovernmental grants, entitlements, interest and other local sources. All receivables are considered collectible in full.

	General Fund	Building Fund	Capital Facilities Fund	Bond Interest and Redemption Fund	Non-Major Governmental Funds	Total
Federal Government						
Categorical aid	\$ 1,573,296	\$ -	\$ -	\$ -	\$ 365,083	\$ 1,938,379
State Government						
Categorical aid	243,234	-	-	-	41,742	284,976
Lottery	915,481	-	-	-	-	915,481
Local Government						
Interest	73,921	30,906	17,344	13,146	13,494	148,811
Other Local Sources	406,911	2,000	-	-	3,265	412,176
Total	<u>\$ 3,212,843</u>	<u>\$ 32,906</u>	<u>\$ 17,344</u>	<u>\$ 13,146</u>	<u>\$ 423,584</u>	<u>\$ 3,699,823</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2016, was as follows:

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016
Governmental Activities				
Capital Assets Not Being Depreciated:				
Land	\$ 7,467,149	\$ -	\$ -	\$ 7,467,149
Construction in progress	37,245,567	10,706,698	15,349,954	32,602,311
Total Capital Assets Not Being Depreciated	<u>44,712,716</u>	<u>10,706,698</u>	<u>15,349,954</u>	<u>40,069,460</u>
Capital Assets Being Depreciated:				
Buildings and improvements	240,956,083	15,417,879	-	256,373,962
Furniture and equipment	8,522,214	215,236	2,475,612	6,261,838
Total Capital Assets Being Depreciated	<u>249,478,297</u>	<u>15,633,115</u>	<u>2,475,612</u>	<u>262,635,800</u>
Total Capital Assets	<u>294,191,013</u>	<u>26,339,813</u>	<u>17,825,566</u>	<u>302,705,260</u>
Less Accumulated Depreciation:				
Buildings and improvements	65,351,575	4,885,056	-	70,236,631
Furniture and equipment	6,528,391	449,751	2,373,879	4,604,263
Total Accumulated Depreciation	<u>71,879,966</u>	<u>5,334,807</u>	<u>2,373,879</u>	<u>74,840,894</u>
Governmental Activities Capital Assets, Net	<u>\$ 222,311,047</u>	<u>\$ 21,005,006</u>	<u>\$ 15,451,687</u>	<u>\$ 227,864,366</u>

Depreciation expense was charged as a direct expense to governmental activities as follows:

Governmental Activities	
Instruction	\$ 3,168,415
Supervision of instruction	188,980
Instructional library, media, and technology	17,265
School site administration	430,443
Home-to-school transportation	190,918
Food services	163,185
All other pupil services	265,646
Ancillary services	34,481
Community services	593
Data processing	95,046
All other general administration	280,176
Plant services	499,659
Total Depreciation Expense All Activities	<u>\$ 5,334,807</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 5 - INTERFUND TRANSACTIONS

Interfund Receivables/Payables (Due To/Due From)

Due To	Due From		
	General Fund	Non-Major Governmental Funds	Total
General Fund	\$ -	\$ 2,814	\$ 2,814
Non-Major Governmental Funds	173,421	-	173,421
Total	\$ 173,421	\$ 2,814	\$ 176,235

Operating Transfers

Interfund transfers for the year ended June 30, 2016, consisted of the following:

Transfer Out	Transfer In			Total
	General Fund	Building Fund	Non-Major Governmental Funds	
General Fund	\$ -	\$ 416,000	\$ 320,000	\$ 736,000
Capital Facilities Fund	82,681	-	-	82,681
Total	\$ 82,681	\$ 416,000	\$ 320,000	\$ 818,681

General Fund transferred to Building Fund for solar panel energy savings.	\$ 416,000
General Fund transferred to Adult Education Fund for program funds received directly in General Fund through LCFF.	20,000
Capital Facilities Fund transferred to General Fund for revenue collected from Capital Facilities Fund that should have been recorded in General Fund.	82,681
General Fund transferred to Deferred Maintenance Fund for Deferred Maintenance funds was consolidated into the LCFF. Amount transferred was to continue use of the funds for emergency projects that are still eligible under Deferred Maintenance programs - such as new flooring projects, roofing, painting, and hardware replacement.	300,000
Total interfund transfers	\$ 818,681

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 6 - DEFERRED AMOUNT ON REFUNDING

Deferred outflows of resources is a consumption of net position by the District that is applicable to a future reporting period. The \$397,929 balance of the deferred amounts on refunding at June 30, 2016 will be recognized as an expense and as a decrease in net position over the remaining life of related bonds.

Deferred amount on refunding at June 30, 2016 is as follows:

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016
Deferred amounts on refunding	<u>\$ 1,620,687</u>	<u>\$ 397,929</u>	<u>\$ 1,620,687</u>	<u>\$ 397,929</u>

NOTE 7 - ACCOUNTS PAYABLE

Accounts payable at June 30, 2016, consisted of the following:

	General Fund	Building Fund	Capital Facilities Fund	Non-Major Governmental Funds	Total
Vendor payables	\$ 2,567,700	\$ 913,508	\$ 588,406	\$ 559,199	\$ 4,628,813
State principal apportionment	695,759	-	-	-	695,759
Salaries and benefits	289,214	-	-	1,218	290,432
Total	<u>\$ 3,552,673</u>	<u>\$ 913,508</u>	<u>\$ 588,406</u>	<u>\$ 560,417</u>	<u>\$ 5,615,004</u>

NOTE 8 - UNEARNED REVENUE

Unearned revenue at June 30, 2016, consists of the following:

	General Fund
Federal financial assistance	\$ 40,000
State categorical aid	276,355
Other local	594,813
Total	<u>\$ 911,168</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 9 - LONG-TERM OBLIGATIONS

Summary

The changes in the District's long-term obligations during the year consisted of the following:

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016	Due in One Year
GOBs	\$ 90,327,814	\$ 35,730,000	\$ 41,348,802	\$ 84,709,012	\$ 3,999,012
Accretions on GOBs	9,337,778	916,451	4,856,198	5,398,031	5,398,031
Premium on GOBs	5,032,726	453,000	3,299,318	2,186,408	154,800
Sub-Total	104,698,318	37,099,451	49,504,318	92,293,451	9,551,843
COPs	13,505,000	-	-	13,505,000	-
Discount on COPS	(166,073)	-	(13,840)	(152,233)	(13,840)
Net Accumulated vacation	279,982	27,604	-	307,586	-
Net OPEB obligations	6,925,614	2,342,572	-	9,268,186	-
Net pension liability	49,767,876	11,487,861	-	61,255,737	-
Total	<u>\$ 175,010,717</u>	<u>\$ 50,957,488</u>	<u>\$ 49,490,478</u>	<u>\$ 176,477,727</u>	<u>\$ 9,538,003</u>

The Bond Interest and Redemption fund is used to collect assessed property taxes which are used to repay the general obligation bonds (GOBs). Payment of certificate of participation (COPs) will be paid from General fund. Compensated absences, other post-employment benefits (OPEB), and pension liability will be paid by the fund for which the employee works.

Bonded Debt

The outstanding general obligation bonded debt is as follows:

Issue Date	Maturity Date (Aug 1)	Interest Rate	Original Issue	Bonds Outstanding July 1, 2015	Issued / Accreted Interest	Redeemed / Defeased	Bonds Outstanding June 30, 2016
2006	2020	3.50%-5.00%	\$ 68,180,000	\$ 34,285,000	\$ -	\$ 34,285,000	\$ -
2006	2016	4.25%-4.42%	8,774,040	15,040,592	916,451	7,780,000	8,177,043
2012	2042	2.00%-3.25%	55,000,000	50,340,000	-	4,140,000	46,200,000
2015	2020	2.00%-5.00%	3,925,000	-	3,925,000	-	3,925,000
2015	2020	0.73%-2.31%	31,805,000	-	31,805,000	-	31,805,000
	Sub-Total		<u>\$ 167,684,040</u>	<u>\$ 99,665,592</u>	<u>\$ 36,646,451</u>	<u>\$ 46,205,000</u>	<u>90,107,043</u>
					Unamortized premium on GO bonds		2,186,408
					Total		<u>\$ 92,293,451</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

Debt Service Requirements to Maturity

The bonds mature through 2043 as follows:

Fiscal Year	Principal	Interest to Maturity	Total
2017	\$ 3,999,012	\$ 7,886,961	\$ 11,885,973
2018	9,310,000	2,474,098	11,784,098
2019	10,025,000	2,295,581	12,320,581
2020	10,820,000	2,061,916	12,881,916
2021	5,300,000	1,858,256	7,158,256
2022-2026	3,255,000	8,633,550	11,888,550
2027-2031	6,555,000	7,515,740	14,070,740
2032-2036	10,655,000	6,028,454	16,683,454
2037-2041	16,275,000	3,435,500	19,710,500
2042-2043	8,515,000	346,900	8,861,900
Total	84,709,012	\$ 42,536,956	\$ 127,245,968
Accretion to Date	5,398,031		
	\$ 90,107,043		

Advance Refunding

On November 17, 2015, the District issued \$3,925,000 in 2015 General Obligation Refunding Bonds (2015A) with interest rates ranging from two to five percent and \$31,805,000 in General Obligation Refunding Bonds (2015B) with interest rates ranging from 0.73 percent to 2.31 percent, to advance refund a portion of \$34,285,000 of outstanding 2006 Refunding Bonds. The net proceeds of \$35,893,753 (after payment of \$289,247 in issuance costs) were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 2006 Refunding Bonds. As a result, \$34,285,000 of the 2006 Refunding Bonds are considered to be defeased and the liability for those bonds has been removed from the District's long-term liabilities in its statement of net assets. The District advance refunded the 2006 Refunding Bonds to reduce its total debt service payments over the next 5 years by \$1,916,728 and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$1,734,666.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

Certificates of Participation

In May 2011, the Morgan Hill Unified School District issued certificates of participation in the amount of \$13,505,000 with interest rates ranging from 2 to 7.1 percent. As of June 30, 2016, the principal balance outstanding was \$13,505,000. The certificates mature through 2027 as follows:

Fiscal Year	Principal	Interest to Maturity	Total
2017	\$ -	\$ 958,855	\$ 958,855
2018	-	958,855	958,855
2019	-	958,855	958,855
2020	-	958,855	958,855
2021	-	958,855	958,855
2022-2026	-	4,794,275	4,794,275
2027	13,505,000	958,855	14,463,855
Total	\$ 13,505,000	\$ 10,547,405	\$ 24,052,405

Accumulated Unpaid Employee Vacation

The long-term portion of accumulated unpaid employee vacation for the District at June 30, 2016 amounted to \$307,586.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 10 - FUND BALANCES

Fund balances are composed of the following elements:

	General Fund	Building Fund	Capital Facilities Fund	Bond Interest and Redemption Fund	Non-Major Governmental Funds	Total
Nonspendable						
Revolving cash	\$ 14,500	\$ -	\$ -	\$ -	\$ 6,000	\$ 20,500
Stores inventories	-	-	-	-	1,826	1,826
Prepaid expenditures	23,170	-	-	-	-	23,170
Total Nonspendable	<u>37,670</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,826</u>	<u>45,496</u>
Restricted						
Legally restricted programs	3,501,840	-	-	-	1,465,071	4,966,911
Food program	-	-	-	-	844,281	844,281
Capital projects	-	12,278,411	8,041,423	-	-	20,319,834
Debt services	-	-	-	11,320,728	-	11,320,728
Total Restricted	<u>3,501,840</u>	<u>12,278,411</u>	<u>8,041,423</u>	<u>11,320,728</u>	<u>2,309,352</u>	<u>37,451,754</u>
Committed						
Adult education program	-	-	-	-	255,485	255,485
Deferred maintenance program	-	-	-	-	967,649	967,649
Total Committed	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,223,134</u>	<u>1,223,134</u>
Assigned						
Special reserve-non capital	2,588,694	-	-	-	-	2,588,694
Retiree benefits	568,216	-	-	-	-	568,216
Capital projects	-	6,947,649	-	-	-	6,947,649
Various program carryover	7,541,090	-	-	-	-	7,541,090
Total Assigned	<u>10,698,000</u>	<u>6,947,649</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>17,645,649</u>
Unassigned						
Reserve for economic uncertainties	2,433,939	-	-	-	-	2,433,939
Remaining unassigned	15,750,799	-	-	-	-	15,750,799
Total Unassigned	<u>18,184,738</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>18,184,738</u>
Total	<u>\$32,422,248</u>	<u>\$ 19,226,060</u>	<u>\$ 8,041,423</u>	<u>\$ 11,320,728</u>	<u>\$ 3,540,312</u>	<u>\$74,550,771</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

NOTE 11 - POST-EMPLOYMENT HEALTH CARE PLAN AND OTHER POST-EMPLOYMENT BENEFITS (OPEB) OBLIGATION

Plan Description

The Post-employment Benefit Plan (the "Plan") is a single-employer defined benefit healthcare plan administered by the Morgan Hill Unified School District. The Plan provides medical and dental insurance benefits to eligible retirees. Membership of the Plan consists of 294 retirees currently receiving benefits and 802 active plan members. Board designated amount of the Plan is presented in these financial statements as the Retiree Benefits Special Reserve Fund.

Contribution Information

The contribution requirements of plan members and the District are established and may be amended by the District, the District's bargaining units and unrepresented groups. The required contribution is based on projected pay-as-you-go financing requirements. For fiscal year 2015-2016, the District contributed \$997,279 to the plan, all of which was used for current premiums (approximately 8 percent of current year's annual required contribution). Plan members are paid a monthly administrative charge amount equal to \$125 and increases based on Assembly Bill 2544 equal to an amount not less than the number of years the agency has been in the PEMHCA program, multiplied by 5 percent of the current monthly employer contribution for employees, until the time that the employer contribution for annuitants equals the employer contribution paid for employees. Special rules for employees who retire after age 55 with at least 10 years of service during the 2006-07 year: retired employees receive an allotment of \$9,000 per year (\$750 per month) for ten years.

Annual OPEB Cost and Net OPEB Obligation

The District's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial accrued liabilities (UAAL) over a period not to exceed thirty years. The following table shows the components of the District's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the District's net OPEB obligation to the Plan:

Annual required contribution	\$ 3,408,759
Interest on net OPEB obligation	311,653
Adjustment to annual required contribution	<u>(380,561)</u>
Annual OPEB cost (expense)	3,339,851
Contributions made	<u>(997,279)</u>
Increase in net OPEB obligation	2,342,572
Net OPEB obligation, beginning of year	<u>6,925,614</u>
Net OPEB obligation, end of year	<u><u>\$ 9,268,186</u></u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

Trend Information

Trend information for annual OPEB cost, the percentage of annual OPEB cost contributed to the Plan, and the net OPEB obligation is as follows:

Year Ended June 30,	Annual OPEB Cost	Actual Contribution	Percentage Contributed	Net OPEB Obligation
2016	\$ 3,339,851	\$ 997,279	30%	\$ 9,268,186
2015	2,510,366	863,477	34%	6,925,614
2014	2,601,921	581,024	22%	5,278,725

Funded Status and Funding Progress

A schedule of funding progress as of the most recent actuarial valuation is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Projected Unit Credit (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b - a) / c]
July 1, 2015	\$ -	\$ 34,077,385	\$ 34,077,385	0%	\$ 48,496,782	70.27%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, investment returns, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the Plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2015, actuarial valuation, the Frozen Entry Age method was used. The actuarial assumptions included a 4.5 percent investment rate of return (net of administrative expenses), based on the District's investment portfolio in the past years an inflation rate of 2.75% and health care costs increase of 4%. The UAAL is being amortized at a level dollar method. The remaining amortization period at July 1, 2015, was 23 years on a close basis. At June 30, 2016, the District's General Fund has assigned net position in the amount of \$ 568,216, which consisted of \$567,067 on deposit with the county treasurer and receivables in the amount of \$1,149.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

NOTE 12 - RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft, damage and destruction of assets; errors and omissions; injuries to employees; life and health of employees; and natural disasters. The District purchases commercial insurance for property damage with coverage up to a maximum of \$5 million, subject to various policy sublimits generally ranging from \$1 million to \$5 million. Employee health benefits are covered by a commercial insurance policy purchased by the District. The District provides health insurance benefits to District employees electing to participate in the plan by paying a monthly premium based on the number of District employees participating in the plan.

Property and Liability

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees and natural disasters. During fiscal year ending June 30, 2016, the District contracted with Santa Clara County Schools Insurance Group for property and liability insurance coverage. Settled claims have not exceeded this commercial coverage in any of the past three years. There has not been a significant reduction in coverage from the prior year.

Workers' Compensation

For fiscal year 2016, the District participated in the Santa Clara County Schools Insurance Group, an insurance purchasing pool. The intent of the Santa Clara County Schools Insurance Group is to achieve the benefit of a reduced premium for the District by virtue of its grouping and representation with other participants in the Santa Clara County Schools Insurance Group. The workers' compensation experience of the participating districts is calculated as one experience and a common premium rate is applied to all districts in the Santa Clara County Schools Insurance Group. Each participant pays its workers' compensation premium based on its individual rate. A participant will then either receive money from or be required to contribute to the "equity-pooling fund". This "equity pooling" arrangement insures that each participant shares equally in the overall performance of the Santa Clara County Schools Insurance Group. Participation in the Santa Clara County Schools Insurance Group is limited to districts that can meet the Santa Clara County Schools Insurance Group selection criteria.

Employee Medical Benefits

The District has contracted with the CalPERS Medical Insurance Plan to provide employee health benefits. Rates are set through an annual calculation process.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 13 - EMPLOYEE RETIREMENT SYSTEMS

Qualified employees are covered under multiple-employer defined benefit pension plans maintained by agencies of the State of California. Academic employees are members of the California State Teachers' Retirement System (CalSTRS) and classified employees are members of the California Public Employees' Retirement System (CalPERS).

For the fiscal year ended June 30, 2016, the District reported net pension liabilities, deferred outflows of resources, deferred inflows of resources, and pension expense for each of the above plans as follows:

Pension Plan	Collective Net Pension Liability	Collective Deferred Outflows of Resources	Collective Deferred Inflows of Resources	Collective Pension Expense
CalSTRS	\$ 47,100,020	\$ 5,530,063	\$ 4,626,469	\$ 4,231,591
CalPERS	14,155,717	2,316,614	1,354,471	1,311,660
Total	<u>\$ 61,255,737</u>	<u>\$ 7,846,677</u>	<u>\$ 5,980,940</u>	<u>\$ 5,543,251</u>

The details of each plan are as follows:

California State Teachers' Retirement System (CalSTRS)

Plan Description

The District contributes to the State Teachers Retirement Plan (STRP) administered by the California State Teachers' Retirement System (CalSTRS). STRP is a cost-sharing multiple-employer public employee retirement system defined benefit pension plan. Benefit provisions are established by State statutes, as legislatively amended, within the State Teachers' Retirement Law.

A full description of the pension plan regarding benefit provisions, assumptions (for funding, but not accounting purposes), and membership information is listed in the June 30, 2014, annual actuarial valuation report, Defined Benefit Program Actuarial Valuation. This report and CalSTRS audited financial information are publically available reports that can be found on the CalSTRS website under Publications at: <http://www.calstrs.com/member-publications>.

Benefits Provided

The STRP provides retirement, disability and survivor benefits to beneficiaries. Benefits are based on members' final compensation, age and years of service credit. Members hired on or before December 31, 2012, with five years of credited service are eligible for the normal retirement benefit at age 60. Members hired on or after January 1, 2013, with five years of credited service are eligible for the normal retirement benefit at age 62. The normal retirement benefit is equal to 2.0 percent of final compensation for each year of credited service.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

The STRP is comprised of four programs: Defined Benefit Program, Defined Benefit Supplement Program, Cash Balance Benefit Program and Replacement Benefits Program. The STRP holds assets for the exclusive purpose of providing benefits to members and beneficiaries of these programs. CalSTRS also uses plan assets to defray reasonable expenses of administering the STRP. Although CalSTRS is the administrator of the STRP, the state is the sponsor of the STRP and obligor of the trust. In addition, the state is both an employer and nonemployer contributing entity to the STRP.

The District contributes exclusively to the STRP Defined Benefit Program, thus disclosures are not included for the other plans.

The STRP provisions and benefits in effect at June 30, 2016, are summarized as follows:

	<u>STRP Defined Benefit Program</u>	
	On or before December 31, 2012	On or after January 1, 2013
Hire date	December 31, 2012	January 1, 2013
Benefit formula	2% at 60	2% at 62
Benefit vesting schedule	5 years of service	5 years of service
Benefit payments	Monthly for life	Monthly for life
Retirement age	60	62
Monthly benefits as a percentage of eligible compensation	2.0% - 2.4%	2.0% - 2.4%
Required employee contribution rate	9.20%	8.56%
Required employer contribution rate	10.73%	10.73%
Required state contribution rate	7.13%	7.13%

Contributions

Required member, District and State of California contributions rates are set by the California Legislature and Governor and detailed in Teachers' Retirement Law. The contributions rates are expressed as a level percentage of payroll using the entry age normal actuarial method. In accordance with AB 1469, employer contributions into the CalSTRS will be increasing to a total of 19.1 percent of applicable member earnings phased over a seven year period. The contribution rates for each plan for the year ended June 30, 2016, are presented above and the District's total contributions were \$3,680,621.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2016, the District reported a liability for its proportionate share of the net pension liability that reflected a reduction for State pension support provided to the District. The amount recognized by the District as its proportionate share of the net pension liability, the related state support and the total portion of the net pension liability that was associated with the District were as follows:

Total net pension liability, including State share:		
District's proportionate share of net pension liability		\$ 47,100,020
State's proportionate share of the net pension liability associated with the District		24,910,718
Total		<u>\$ 72,010,738</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

The net pension liability was measured as of June 30, 2015. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating school districts and the State, actuarially determined. The District's proportionate share for the measurement period June 30, 2015 and June 30, 2014, respectively was 0.0700 percent and 0.0670 percent, resulting in a net increase in the proportionate share of 0.0030 percent.

For the year ended June 30, 2016, the District recognized its proportionate share pension expense of \$4,231,591. In addition, the District also recorded pension expense and revenue of \$2,144,849 for support provided by the State. At June 30, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension contributions subsequent to measurement date	\$ 3,680,621	\$ -
Net change in proportionate share of net pension liability	1,849,442	-
Difference between projected and actual earnings on pension plan investments	-	(3,839,417)
Differences between expected and actual experience in the measurement of the total pension liability	-	(787,052)
Total	<u>\$ 5,530,063</u>	<u>\$ (4,626,469)</u>

The deferred outflows of resources related to pensions resulting from District contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the subsequent fiscal year. The deferred inflows of resources related to the difference between projected and actual earnings on pension plan investments will be amortized over a closed five-year period and will be recognized in pension expense as follows:

Year Ended June 30,	Deferred Inflows of Resources
2017	\$ 959,854
2018	959,854
2019	959,854
2020	959,855
Total	<u>\$ 3,839,417</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

The deferred outflows of resources related to the net change in proportionate share of net pension liability and differences between expected and actual experience in the measurement of the total pension liability will be amortized over the Expected Average Remaining Service Life (EARSL) of all members that are provided benefits (active, inactive and retirees) as of the beginning of the measurement period. The EARSL for the 2014-2015 measurement period is 7 years and will be recognized in pension expense as follows:

Year Ended June 30,	Deferred Outflows of Resources
2017	\$ 177,065
2018	177,065
2019	177,065
2020	177,065
2021	177,065
Thereafter	177,065
Total	<u>\$ 1,062,390</u>

Actuarial Methods and Assumptions

Total pension liability for STRP was determined by applying update procedures to a financial reporting actuarial valuation as of June 30, 2014, and rolling forward the total pension liability to June 30, 2015. The financial reporting actuarial valuation as of June 30, 2014, used the following methods and assumptions, applied to all prior periods included in the measurement:

Valuation date	June 30, 2014
Measurement date	June 30, 2015
Experience study	July 1, 2006 through June 30, 2010
Actuarial cost method	Entry age normal
Discount rate	7.60%
Investment rate of return	7.60%
Consumer price inflation	3.00%
Wage growth	3.75%

CalSTRS uses custom mortality tables to best fit the patterns of mortality among its members. These custom tables are based on RP2000 series actuarial mortality tables adjusted to fit CalSTRS experience.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. The best estimate ranges were developed using capital market assumptions from CalSTRS general investment consultant. Based on the model for CalSTRS consulting actuary's investment practice, a best estimate range was determined by assuming the portfolio is re-balanced annually and that the annual returns are lognormally distributed and independent from year to year to develop expected percentiles for the long-term distribution of annualized returns. The assumed asset allocation is based on Teachers' Retirement Board of the California State Teachers' Retirement System (board) policy for target asset allocation in effect on February 2, 2012, the date the current experience study was approved by the board. Best estimates of 10-year geometric real rates of return and the assumed asset allocation for each major asset class used as input to develop the actuarial investment rate of return are summarized in the following table:

Asset Class	Assumed Asset Allocation	Long-term Expected Real Rate of Return
Global equity	47%	4.50%
Private equity	12%	6.20%
Real estate	15%	4.35%
Inflation sensitive	5%	3.20%
Fixed income	20%	0.20%
Cash/liquidity	1%	0.00%

Discount Rate

The discount rate used to measure the total pension liability was 7.60 percent. The projection of cash flows used to determine the discount rate assumed the contributions from plan members and employers will be made at statutory contribution rates. Projected inflows from investment earnings were calculated using the long-term assumed investment rate of return (7.60 percent) and assuming that contributions, benefit payments and administrative expense occurred midyear. Based on these assumptions, the STRP's fiduciary net position was projected to be available to make all projected future benefit payments to current plan members. Therefore, the long-term assumed investment rate of return was applied to all periods of projected benefit payments to determine total pension liability.

The following presents the District's proportionate share of the net pension liability calculated using the current discount rate as well as what the net pension liability would be if it were calculated using a discount rate that is one percent lower or higher than the current rate:

Discount Rate	Net Pension Liability
1% decrease (6.60%)	\$ 71,117,364
Current discount rate (7.60%)	\$ 47,100,020
1% increase (8.60%)	\$ 27,139,669

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

California Public Employees Retirement System (CalPERS)

Plan Description

Qualified employees are eligible to participate in the School Employer Pool (SEP) and the Safety Risk Pool under the California Public Employees' Retirement System (CalPERS), a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by CalPERS. Benefit provisions are established by State statutes, as legislatively amended, within the Public Employees' Retirement Law.

A full description of the pension plan regarding benefit provisions, assumptions (for funding, but not accounting purposes), and membership information is listed in the June 30, 2014 annual actuarial valuation reports, Schools Pool Actuarial Valuation, and the Risk Pool Actuarial Valuation Report, Safety, 2014. These reports and CalPERS audited financial information are publically available reports that can be found on the CalPERS website under Forms and Publications at: <https://www.calpers.ca.gov/page/forms-publications>.

Benefits Provided

CalPERS provides service retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. Benefits are based on years of service credit, a benefit factor and the member's final compensation. Members hired on or before December 31, 2012, with five years of total service are eligible to retire at age 50 with statutorily reduced benefits. Members hired on or after January 1, 2013, with five years of total service are eligible to retire at age 52 with statutorily reduced benefits. All members are eligible for non-duty disability benefits after five years of service. The Basic Death Benefit is paid to any member's beneficiary if the member dies while actively employed. An employee's eligible survivor may receive the 1957 Survivor Benefit if the member dies while actively employed, is at least age 50 (or 52 for members hired on or after January 1, 2013), and has at least five years of credited service. The cost of living adjustments for each plan are applied as specified by the Public Employees' Retirement Law.

The CalPERS provisions and benefits in effect at June 30, 2016, are summarized as follows:

	School Employer Pool (CalPERS)	
	On or before December 31, 2012	On or after January 1, 2013
Hire date		
Benefit formula	2% at 55	2% at 62
Benefit vesting schedule	5 years of service	5 years of service
Benefit payments	Monthly for life	Monthly for life
Retirement age	55	62
Monthly benefits as a percentage of eligible compensation	1.1% - 2.5%	1.0% - 2.5%
Required employee contribution rate	7.000%	6.000%
Required employer contribution rate	11.847%	11.847%

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

Contributions

Section 20814(c) of the California Public Employees' Retirement Law requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. Total plan contributions are calculated through the CalPERS annual actuarial valuation process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The District is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. The contributions rates are expressed as percentage of annual payroll. The contribution rates for each plan for the year ended June 30, 2016, are presented above and the total District contributions were \$1,384,676.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

As of June 30, 2016, the District reported net pension liabilities for its proportionate share of the CalPERS net pension liability totaling \$14,155,717. The net pension liability was measured as of June 30, 2015. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating school districts, actuarially determined. The District's proportionate share for the measurement period June 30, 2015 and June 30, 2014, respectively was 0.0960 percent and 0.0935 percent, resulting in a net increase in the proportionate share of 0.0025 percent.

For the year ended June 30, 2016, the District recognized pension expense of \$1,311,660. At June 30, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension contributions subsequent to measurement date	\$ 1,384,676	\$ -
Net change in proportionate share of net pension liability	122,918	-
Difference between projected and actual earnings on pension plan investments	-	(484,704)
Differences between expected and actual experience in the measurement of the total pension liability	809,020	-
Changes of assumptions	-	(869,767)
Total	<u>\$ 2,316,614</u>	<u>-\$ 1,354,471</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

The deferred outflows of resources related to pensions resulting from District contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the subsequent fiscal year. The deferred outflows/(inflows) of resources related to the difference between projected and actual earnings on pension plan investments will be amortized over a closed five-year period and will be recognized in pension expense as follows:

Year Ended June 30,	Deferred Inflows of Resources
2017	\$ 121,176
2018	121,176
2019	121,176
2020	121,176
Total	<u>\$ 484,704</u>

The deferred outflows/(inflows) of resources related to the net change in proportionate share of net pension liability, changes of assumptions, and differences between expected and actual experience in the measurement of the total pension liability will be amortized over the Expected Average Remaining Service Life (EARSL) of all members that are provided benefits (active, inactive, and retirees) as of the beginning of the measurement period. The EARSL for the 2014-2015 measurement period is 3.9 years and will be recognized in pension expense as follows:

Year Ended June 30,	Deferred Outflows of Resources
2017	\$ 20,724
2018	20,724
2019	20,724
Total	<u>\$ 62,172</u>

Actuarial Methods and Assumptions

Total pension liability for the SEP was determined by applying update procedures to a financial reporting actuarial valuation as of June 30, 2014, and rolling forward the total pension liability to June 30, 2015. The financial reporting actuarial valuation as of June 30, 2014, used the following methods and assumptions, applied to all prior periods included in the measurement:

Valuation date	June 30, 2014
Measurement date	June 30, 2015
Experience study	July 1, 1997 through June 30, 2011
Actuarial cost method	Entry age normal
Discount rate	7.65%
Investment rate of return	7.65%
Consumer price inflation	2.75%
Wage growth	Varies by entry age and service

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Mortality assumptions are based on mortality rates resulting from the most recent CalPERS experience study adopted by the CalPERS Board. For purposes of the post-retirement mortality rates, those revised rates include five years of projected ongoing mortality improvement using Scale AA published by the Society of Actuaries.

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Using historical returns of all the funds' asset classes, expected compound returns were calculated over the short-term (first ten years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent. The target asset allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Assumed Asset Allocation	Long-term Expected Real Rate of Return
Global equity	51%	5.25%
Global fixed income	19%	0.99%
Private equity	10%	6.83%
Real estate	10%	4.50%
Inflation sensitive	6%	0.45%
Infrastructure and Forestland	2%	4.50%
Liquidity	2%	-0.55%

Discount Rate

The discount rate used to measure the total pension liability was 7.65 percent. The projection of cash flows used to determine the discount rate assumed the contributions from plan members and employers will be made at statutory contribution rates. Based on these assumptions, the School Employer Pool fiduciary net position was projected to be available to make all projected future benefit payments to current plan members. Therefore, the long-term assumed investment rate of return was applied to all periods of projected benefit payments to determine total pension liability.

The following presents the District's proportionate share of the net pension liability calculated using the current discount rate as well as what the net pension liability would be if it were calculated using a discount rate that is one percent lower or higher than the current rate:

Discount rate	Net Pension Liability
1% decrease (6.65%)	\$ 23,039,609
Current discount rate (7.65%)	\$ 14,155,717
1% increase (8.65%)	\$ 6,768,167

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

Social Security

As established by Federal law, all public sector employees who are not members of their employer's existing retirement system (CalSTRS or CalPERS) must be covered by Social Security or an alternative plan. The District has elected to use Social Security.

On Behalf Payments

The State of California makes contributions to CalSTRS on behalf of the District. These payments consist of State General Fund contributions to CalSTRS in the amount of \$2,144,849 (7.12589 percent of annual payroll), \$1,691,859, and \$1,622,011, for the fiscal years ending June 30, 2016, 2015 and 2014. These amounts have been allocated in General Fund, Adult Education Fund and Child Development Fund for the amounts shown in the following schedules. Under accounting principles generally accepted in the United States of America, these amounts are to be reported as revenues and expenditures. Accordingly, these amounts have been recorded in these financial statements. On behalf payments have been excluded from the calculation of available reserves and have not been included in the budget amounts reported in the General Fund Budgetary Comparison Schedule.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

Grants

The District received financial assistance from Federal and State agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the General Fund or other applicable funds. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of the District at June 30, 2016.

Construction Commitments

As of June 30, 2016, the District had the following commitments with respect to the unfinished capital projects:

<u>Capital Project</u>	<u>Remaining Construction Commitment</u>	<u>Expected Date of Completion</u>
Charter School of Morgan Hill New Multi-Purpose Room	\$ 76,366	Feb-16
San Martin/Gwinn Modernization	454,895	Oct-16
Nordstrom Multi-Purpose Room	256,082	Aug-18
Paradise Valley Multi-Purpose Room	255,480	Dec-17
Britton New Campus	506,628	Aug-20
Total	<u>\$ 1,549,452</u>	

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

NOTE 15 - PARTICIPATION IN PUBLIC ENTITY RISK POOLS

The District is a member of the Santa Clara County Schools Insurance Group public entity risk pool (the pool). The District pays an annual premium to the applicable entity for its health, workers' compensation, and property liability coverage. The relationship between the District and the pool is such that it is not component unit of the District for financial reporting purposes.

This entity has budgeting and financial reporting requirements independent of member units and their financial statements are not presented in these financial statements; however, fund transactions between the entities and the District are included in these statements. Audited financial statements are generally available from the entity.

The District has appointed one board member to the Governing Board of the Santa Clara County Schools Insurance Group.

During the year ended June 30, 2016, the District made a payment of \$832,751 for workers' compensation insurance and \$561,700 for property liability coverage to the Santa Clara County Schools Insurance Group.

NOTE 16 - SUBSEQUENT EVENTS

Management has evaluated events or transactions that may occur for potential recognition or disclosure in the financial statements from the balance sheet dated December 8, 2016, which is the date the financial statements were available to be issued. Management has determined that there were no subsequent events or transactions that would have a material impact on the current year financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

**GENERAL FUND
BUDGETARY COMPARISON SCHEDULE
FOR THE YEAR ENDED JUNE 30, 2016**

	Original	Final	Actual ¹	Variances - Positive (Negative) Final to Actual
REVENUES				
Local control funding formula	\$ 65,170,369	\$ 65,526,136	\$ 65,516,588	\$ (9,548)
Federal sources	3,854,090	4,289,767	4,120,851	(168,916)
Other state sources	8,331,285	7,833,012	8,043,972	210,960
Other local sources	6,388,642	6,732,078	7,370,997	638,919
Total Revenues	83,744,386	84,380,993	85,052,408	671,415
EXPENDITURES				
Current				
Certificated salaries	34,182,154	35,418,190	35,260,263	157,927
Classified salaries	11,470,437	12,020,495	11,655,926	364,569
Employee benefits	13,067,193	13,094,601	12,589,334	505,267
Books and supplies	4,736,920	6,324,428	3,474,861	2,849,567
Services and operating expenditures	10,340,796	13,089,715	10,268,841	2,820,874
Other outgo	921,509	1,994,440	3,565,003	(1,570,563)
Capital outlay	3,943,098	3,834,334	1,436,224	2,398,110
Total Expenditures	78,662,107	85,776,203	78,250,452	7,525,751
Excess of Revenues Over Expenditures	5,082,279	(1,395,210)	6,801,956	8,197,166
Other Financing Sources (Uses):				
Transfers in	191,200	91,200	82,681	(8,519)
Transfers out	(716,000)	(736,000)	(736,000)	-
Net Financing Uses	(524,800)	(644,800)	(653,319)	(8,519)
NET CHANGE				
IN FUND BALANCES	4,557,480	(2,040,010)	6,148,637	8,188,647
Fund Balance - Beginning	23,116,701	23,116,701	23,116,701	-
Fund Balance - Ending	\$ 27,674,181	\$ 21,076,691	29,265,338	\$ 8,188,647
Special Reserve Fund				
Other than Capital Outlay			2,588,694	
Retiree Benefits			568,216	
Fund Balance - Ending, GAAP			\$ 32,422,248	

¹ On behalf payments of \$2,144,849 are excluded from the actual column of state sources and employee benefits expenditures.

See accompanying note to required supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF OTHER POSTEMPLOYMENT BENEFITS (OPEB) FUNDING
PROGRESS
FOR THE YEAR ENDED JUNE 30, 2016**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Projected Unit Credit (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b - a] / c)
July 1, 2015	\$ -	\$ 34,077,385	\$ 34,077,385	0%	\$ 48,496,782	70.27%
July 1, 2013	-	20,977,123	20,977,123	0%	41,678,437	50.33%
July 1, 2011	-	22,666,617	22,666,617	0%	40,673,421	55.73%

See accompanying note to required supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE NET
PENSION LIABILITY
FOR THE YEAR ENDED JUNE 30, 2016**

Measurement date	<u>June 30 2015</u>	<u>June 30 2014</u>
CalSTRS		
District's proportion of the net pension liability (asset)	<u>0.0700%</u>	<u>0.0670%</u>
District's proportionate share of the net pension liability (asset)	\$ 47,100,020	\$ 39,151,313
State's proportionate share of the net pension liability (asset) associated with the District	<u>24,910,718</u>	<u>23,641,253</u>
Total	<u>\$ 72,010,738</u>	<u>\$ 62,792,566</u>
District's covered - employee payroll	<u>\$ 29,917,624</u>	<u>\$ 30,099,374</u>
District's proportionate share of the net pension liability (asset) as a percentage of its covered - employee payroll	<u>157.43%</u>	<u>130.07%</u>
Plan fiduciary net position as a percentage of the total pension liability	<u>74%</u>	<u>77%</u>
CalPERS		
District's proportion of the net pension liability (asset)	<u>0.0960%</u>	<u>0.0935%</u>
District's proportionate share of the net pension liability (asset)	<u>\$ 14,155,717</u>	<u>\$ 10,616,563</u>
District's covered - employee payroll	<u>\$ 10,633,088</u>	<u>\$ 9,812,471</u>
District's proportionate share of the net pension liability (asset) as a percentage of its covered - employee payroll	<u>133.13%</u>	<u>108.19%</u>
Plan fiduciary net position as a percentage of the total pension liability	<u>79%</u>	<u>83%</u>

Note : In the future, as data become available, ten years of information will be presented.

See accompanying note to required supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF DISTRICT PENSION CONTRIBUTIONS
FOR THE YEAR ENDED JUNE 30, 2016**

Fiscal Year	<u>2016</u>	<u>2015</u>
CalSTRS		
Contractually required contribution	\$ 3,688,822	\$ 2,909,037
Contributions in relation to the contractually required contribution	<u>3,688,822</u>	<u>2,909,037</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>
District's covered - employee payroll	<u>\$ 34,366,785</u>	<u>\$ 29,917,624</u>
Contributions as a percentage of covered - employee payroll	<u>10.73%</u>	<u>9.72%</u>
CalPERS		
Contractually required contribution	\$ 1,384,676	\$ 1,216,638
Contributions in relation to the contractually required contribution	<u>1,384,676</u>	<u>1,216,638</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>
District's covered - employee payroll	<u>\$ 11,687,917</u>	<u>\$ 10,633,088</u>
Contributions as a percentage of covered - employee payroll	<u>11.85%</u>	<u>11.44%</u>

Note : In the future, as data become available, ten years of information will be presented.

See accompanying note to required supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO REQUIRED SUPPLEMENTARY INFORMATION JUNE 30, 2016

NOTE 1 - PURPOSE OF SCHEDULES

Budgetary Comparison Schedule

This schedule presents information for the original and final budgets and actual results of operations, as well as the variances from the final budget to actual results of operations.

Schedule of Other Postemployment Benefits (OPEB) Funding Progress

This schedule is intended to show trends about the funding progress of the District's actuarially determined liability for postemployment benefits other than pensions.

Schedule of the District's Proportionate Share of the Net Pension Liability

This schedule presents information on the District's proportionate share of the net pension liability (NPL), the plans' fiduciary net position and, when applicable, the State's proportionate share of the NPL associated with the District. In the future, as data becomes available, ten years of information will be presented.

Schedule of District Contributions

This schedule presents information on the District's required contribution, the amounts actually contributed, and any excess or deficiency related to the required contribution. In the future, as data becomes available, ten years of information will be presented.

Changes in Benefit Terms

There were no changes in benefit terms since the previous valuation for either CalSTRS and CalPERS.

Changes in Assumptions

The CalSTRS plan rate of investment return assumption was not changed from the previous valuation. The CalPERS plan rate of investment return assumption was changed from 7.50 percent to 7.65 percent since the previous valuation.

SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2016**

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF EDUCATION			
Passed through California Department of Education (CDE):			
No Child Left Behind:			
Title I - Basic Grants Low Income and Neglected	84.010	14981	\$ 1,243,870
Title I - Migrant Ed Even Start Program	84.010	14955	<u>104,926</u>
Total Title I Grants to Local Educational			\$ 1,348,796
Title I - Migrant Education	84.011	14326	413,916
Title I - Migrant Education Summer Program	84.011	10005	<u>68,496</u>
Total Migrant education - State Grant Program			482,412
Title I - Advance Placement Program	84.330	14831	14,145
Title II - Improving Teacher Quality	84.367	14341	223,639
Title III - Limited English Proficient	84.365	14346	155,885
Title III - Immigrant Education Program	84.365	15146	<u>11,501</u>
Total English Language Acquisition			167,386
Rehabilitation Services_Vocational Rehabilitation	84.126	10006	125,186
Individuals with Disabilities Act (IDEA):			
Basic Local Assistance Entitlement	84.027	13379	1,315,760
IDEA, Part B, Section 611, Private Schools	84.027	10115	1,492
IDEA, Preschool Grants, Part B, Section 611	84.027A	13682	80,606
IDEA, Preschool Grants, Part B, Section 619	84.173	13430	44,658
IDEA, Mental Health Allocation Plan	84.027A	14468	102,656
IDEA, Preschool Staff Development	84.173A	13431	<u>490</u>
Total Special Education Cluster			1,545,662
Vocational and Applied Technology	84.048	14894	61,055
Adult Education Act:			
Adult Basic Education	84.002A	14508	30,909
Adult Secondary Education	84.002	13978	90,377
English Literacy and Civics Education	84.002A	14109	<u>6,369</u>
Total Adult Education-Basic Grants			127,655
Total U.S. Department of Education			<u>4,095,936</u>

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
FOR THE YEAR ENDED JUNE 30, 2016**

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF AGRICULTURE			
Passed through CDE:			
Child Nutrition Act:			
National School Lunch Program	10.555	13391	1,136,434
Especially Needy Breakfast	10.553	13526	556,800
Meal Supplement	10.556	13568	28,632
Commodity Supplemental Food Program ¹	10.555	13524	<u>183,646</u>
Total Child Nutrition Cluster			1,905,512
Child and Adult Care Food Program	10.558	N/A	<u>126,641</u>
Total U.S. Department of Agriculture			<u><u>2,032,153</u></u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Passed through CDE:			
Child Development Act:			
Medical Assistance Program	93.778	10013	<u>152,571</u>
Total U.S. Department of Human Services			<u>152,571</u>
Total Expenditures of Federal Awards			<u><u>\$ 6,280,660</u></u>

¹ Not recorded in the financial statements.

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

LOCAL EDUCATION AGENCY ORGANIZATION STRUCTURE JUNE 30, 2016

ORGANIZATION

The Morgan Hill Unified School District was established in 1966 and consists of an area comprising approximately 300 square miles. The District operates 8 elementary schools, 2 middle schools, 2 high schools, 1 continuation, and 1 adult education school.

<u>MEMBER</u>	<u>OFFICE</u>	<u>TERM EXPIRES</u>
Gino Borgioli	President	2018
Ron Woolf	Vice President	2018
David Gerard	Member	2018
Donna Ruebush	Member	2018
Bob Benevento	Member	2016
Rick Badillo	Member	2016
Tom Arnett	Member	2016

ADMINISTRATION

Steve Betando	Superintendent
Kirsten Perez	Assistant Superintendent of Business Services
Sharon Fawn Myers	Assistant Superintendent of Human Resources
Dr. Ramon Zavala	Assistant Superintendent of Educational Services

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF AVERAGE DAILY ATTENDANCE
FOR THE YEAR ENDED JUNE 30, 2016**

	Final Report	
	Second Period Report	Annual Report
Regular ADA		
Transitional kindergarten through third	2,425.55	2,423.34
Fourth through sixth	1,908.60	1,904.96
Seventh and eighth	1,173.40	1,172.42
Ninth through twelfth	2,525.31	2,514.91
Total Regular ADA	<u>8,032.86</u>	<u>8,015.63</u>
Extended Year Special Education		
Transitional kindergarten through third	1.38	1.94
Fourth through sixth	0.45	1.73
Seventh and eighth	0.56	0.90
Ninth through twelfth	-	1.14
Total Extended Year Special Education	<u>2.39</u>	<u>5.71</u>
Special Education, Nonpublic, Nonsectarian Schools		
Transitional kindergarten through third	1.74	1.81
Fourth through sixth	3.30	3.46
Seventh and eighth	0.95	1.04
Ninth through twelfth	5.53	5.59
Total Special Education, Nonpublic, Nonsectarian Schools	<u>11.52</u>	<u>11.90</u>
Extended Year Special Education - Non public, Nonsectarian Schools		
Transitional kindergarten through third	0.46	0.19
Fourth through sixth	0.53	0.15
Seventh and eighth	0.36	0.10
Ninth through twelfth	1.03	0.35
Total Extended Year School	<u>2.38</u>	<u>0.79</u>
Total ADA	<u>8,049.15</u>	<u>8,034.03</u>

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF INSTRUCTIONAL TIME
FOR THE YEAR ENDED JUNE 30, 2016**

Grade Level	1986-87 Minutes Requirement	2015-16 Actual Minutes	Number of Days		Status
			Traditional Calendar	Multitrack Calendar	
Kindergarten	36,000	53,930	180	N/A	Complied
Grades 1 - 3					
Grade 1	50,400	50,925	180	N/A	Complied
Grade 2	50,400	50,925	180	N/A	Complied
Grade 3	50,400	50,925	180	N/A	Complied
Grades 4 - 6					
Grade 4	54,000	54,240	180	N/A	Complied
Grade 5	54,000	54,240	180	N/A	Complied
Grade 6	54,000	54,240	180	N/A	Complied
Grades 7 - 8					
Grade 7	54,000	55,730	180	N/A	Complied
Grade 8	54,000	55,730	180	N/A	Complied
Grades 9 - 12					
Grade 9	64,800	64,902	180	N/A	Complied
Grade 10	64,800	64,902	180	N/A	Complied
Grade 11	64,800	64,902	180	N/A	Complied
Grade 12	64,800	64,902	180	N/A	Complied

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**RECONCILIATION OF ANNUAL FINANCIAL AND BUDGET REPORT WITH
AUDITED FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

Summarized below are the fund balance reconciliations between the Unaudited Actual Financial Report and the audited Financial Statements.

	General	Special Reserve Other	Special Reserve Retiree Benefits
FUND BALANCE			
Balance, June 30, 2016, Unaudited Actuals	\$ 29,265,338	\$ 2,588,694	\$ 568,216
As a result of the implementation of GASB Statement No. 54, Fund 17 and Fund 20 are combined into the financial statement.	3,156,910	(2,588,694)	(568,216)
Balance, June 30, 2016, Audited Financial Statement	\$ 32,422,248	\$ -	\$ -

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2016

	(Budget)			
	2017 ¹	2016	2015	2014
GENERAL FUND ⁴				
Revenues	\$ 84,035,134	\$ 87,197,257	\$ 75,813,966	\$ 70,833,137
Transfers in	76,068	82,681	84,135	1,661,500
Total Revenues and Transfers In	84,111,202	87,279,938	75,898,101	72,494,637
Expenditures	81,696,930	80,395,301	74,346,053	67,330,650
Transfers out	736,000	736,000	1,826,072	3,894,079
Total Expenditures and Transfers Out	82,432,930	81,131,301	76,172,125	71,224,729
INCREASE (DECREASE) IN FUND BALANCE	\$ 1,678,272	\$ 6,148,637	\$ (274,024)	\$ 1,269,908
ENDING FUND BALANCE	\$ 30,943,610	\$ 29,265,338	\$ 23,116,701	\$ 23,390,725
AVAILABLE RESERVES ²	\$ 18,936,589	\$ 18,184,738	\$ 16,248,266	\$ 16,091,821
AVAILABLE RESERVES AS A PERCENTAGE OF TOTAL OUTGO ³	22.97%	22.41%	21.33%	23.12%
LONG-TERM OBLIGATIONS	\$ 185,952,292	\$ 181,094,141	\$ 175,010,717	\$ 134,554,285
K-12 AVERAGE DAILY ATTENDANCE AT P-2	8,049	8,049	8,119	8,208

The General Fund balance has increased by \$5,874,613 over the past two years. The fiscal year 2016-2017 budget projects an increase of \$1,678,272 (6 percent) in General Fund balance. For a district this size, the State recommends available reserves of at least three percent of total General Fund expenditures, transfers out, and other uses (total outgo).

The District has incurred an operating surplus in the current fiscal year, and anticipates incurring an operating surplus during the 2016-2017 fiscal year. Total long-term obligations have increased by \$46,539,856 over the past two years. The significant increase is mainly related to GASB 68 implementation that requires the District to recognize its proportionate share of net pension liability of CalPERS and CalSTRS.

Average daily attendance has decreased by 159 over the past two years. The ADA is expected to remain constant during fiscal year 2016-2017.

¹ Budget 2017 is included for analytical purposes only and has not been subjected to audit.

² Available reserves consist of all unassigned fund balances including all amounts reserved for economic uncertainties contained with the General Fund, Special Reserve Non-Capital Fund and the Retiree Benefit Special Reserve Fund.

³ On-behalf payments of \$2,144,849, \$1,691,859, and \$1,622,011, have been included from this schedule for fiscal year ending June 30, 2016, 2015 and 2014, respectively.

⁴ General Fund amounts do not include activity related to the consolidation of the Special Reserve Non-Capital Fund and the Retiree Benefit Special Reserve Fund required by GASB Statement No. 54.

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF CHARTER SCHOOLS
FOR THE YEAR ENDED JUNE 30, 2016**

<u>Name of Charter School</u>	<u>Included in Audit Report</u>
The Charter School of Morgan Hill	No

See accompanying note to supplementary information.

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MORGAN HILL UNIFIED SCHOOL DISTRICT

**NON-MAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
JUNE 30, 2016**

	Adult Education Fund	Child Development Fund	Cafeteria Fund
ASSETS			
Deposits and investments	\$ 254,488	\$ 18,836	\$ 713,777
Receivables	139,869	7,697	271,186
Due from other funds	-	-	2,814
Stores inventories	-	-	1,826
Total Assets	\$ 394,357	\$ 26,533	\$ 989,603
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 25,312	\$ 3,638	\$ 19,235
Due to other funds	27,265	22,895	123,261
Total Liabilities	52,577	26,533	142,496
Fund Balances:			
Nonspendable	5,000	-	2,826
Restricted	81,295	-	844,281
Committed	255,485	-	-
Total Fund Balances	341,780	-	847,107
Total Liabilities and Fund Balances	\$ 394,357	\$ 26,533	\$ 989,603

See accompanying note to supplementary information.

Deferred Maintenance Fund	Capital Projects Fund	Total Non-Major Governmental Funds
\$ 1,140,774	\$ 1,718,051	\$ 3,845,926
1,720	3,112	423,584
-	-	2,814
-	-	1,826
<u>\$ 1,142,494</u>	<u>\$ 1,721,163</u>	<u>\$ 4,274,150</u>
\$ 174,845	\$ 337,387	\$ 560,417
-	-	173,421
<u>174,845</u>	<u>337,387</u>	<u>733,838</u>
-	-	7,826
-	1,383,776	2,309,352
967,649	-	1,223,134
<u>967,649</u>	<u>1,383,776</u>	<u>3,540,312</u>
<u>\$ 1,142,494</u>	<u>\$ 1,721,163</u>	<u>\$ 4,274,150</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NON-MAJOR GOVERNMENTAL FUNDS
COMBINING STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2016**

	Adult Education Fund	Child Development Fund	Cafeteria Fund
REVENUES			
Federal sources	\$ 127,655	\$ -	\$ 1,848,508
Other state sources	501,689	221,567	145,540
Other local sources	27,984	184	504,498
Total Revenues	657,328	221,751	2,498,546
EXPENDITURES			
Current			
Instruction	310,084	210,571	-
Instruction-related activities:			
School site administration	268,834	-	-
Pupil services:			
Food services	-	-	2,411,878
General administration:			
All other general administration	27,263	11,180	123,247
Plant services	7,221	-	-
Facility acquisition and construction	-	-	-
Total Expenditures	613,402	221,751	2,535,125
Excess (Deficiency) of Revenues Over Expenditures	43,926	-	(36,579)
Other Financing Uses:			
Transfers in	20,000	-	-
Net Financing Uses	20,000	-	-
NET CHANGE IN FUND BALANCES	63,926	-	(36,579)
Fund Balance - Beginning	277,854	-	883,686
Fund Balance - Ending	\$ 341,780	\$ -	\$ 847,107

See accompanying note to supplementary information.

Deferred Maintenance Fund	Capital Projects Fund	Total Non-Major Governmental Funds
\$ -	\$ -	\$ 1,976,163
-	-	868,796
5,038	528,783	1,066,487
<u>5,038</u>	<u>528,783</u>	<u>3,911,446</u>
-	-	520,655
-	-	268,834
-	-	2,411,878
-	-	161,690
43,383	2,175	52,779
<u>322,960</u>	<u>693,059</u>	<u>1,016,019</u>
<u>366,343</u>	<u>695,234</u>	<u>4,431,855</u>
<u>(361,305)</u>	<u>(166,451)</u>	<u>(520,409)</u>
<u>300,000</u>	<u>-</u>	<u>320,000</u>
<u>300,000</u>	<u>-</u>	<u>320,000</u>
(61,305)	(166,451)	(200,409)
1,028,954	1,550,227	3,740,721
<u>\$ 967,649</u>	<u>\$ 1,383,776</u>	<u>\$ 3,540,312</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION JUNE 30, 2016

Schedule of Expenditures of Federal Awards

The accompanying schedule of expenditures of Federal awards includes the Federal grant activity of the District and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of the Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

Description	<u>CFDA Number</u>	<u>Amount</u>
Total Federal Revenues Statement of Revenues, Expenditures and Changes in Fund Balances:		\$ 6,791,798
Build America Bonds interest subsidy is excluded from the provisions of OMB Circular A-133, therefore, is not presented by the District on the Schedule of Expenditures of Federal Awards.	N/A	(694,784)
Commodities are not recorded on the financial statement.	10.555	<u>183,646</u>
Total Schedule of Expenditures of Federal Awards		<u>\$ 6,280,660</u>

Local Education Agency Organization Structure

This schedule provides information about the District's boundaries and schools operated, members of the governing board, and members of the administration.

Schedule of Average Daily Attendance (ADA)

Average daily attendance (ADA) is a measurement of the number of pupils attending classes of the District. The purpose of attendance accounting from a fiscal standpoint is to provide the basis on which apportionments of State funds are made to school districts. This schedule provides information regarding the attendance of students at various grade levels and in different programs.

Schedule of Instructional Time

The District has received incentive funding for increasing instructional time as provided by the Incentives for Longer Instructional Day. The District neither met nor exceeded its target funding. This schedule presents information on the amount of instructional time offered by the District and whether the District complied with the provisions of *Education Code* Sections 46200 through 46206.

Districts must maintain their instructional minutes at the 1986-87 requirement, as required by *Education Code* Section 46201.

Reconciliation of Annual Financial and Budget Report with Audited Financial Statements

This schedule provides the information necessary to reconcile the fund balance of all funds reported on the Unaudited Actual Financial Report, to the audited financial statements.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION JUNE 30, 2016

Schedule of Financial Trends and Analysis

This schedule discloses the District's financial trends by displaying past years' data along with current year budget information. These financial trend disclosures are used to evaluate the District's ability to continue as a going concern for a reasonable period of time.

Schedule of Charter Schools

This schedule lists all Charter Schools chartered by the Morgan Hill Unified School District, and displays information for each Charter School on whether or not the Charter School is included in the Morgan Hill Unified School District audit.

Non-Major Governmental Funds - Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balances

The Non-Major Governmental Funds Combining Balance Sheet and Combining Statement of Revenues, Expenditures and Changes in Fund Balances is included to provide information regarding the individual funds that have been included in the Non-Major Governmental Funds column on the Governmental Funds Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balances.

INDEPENDENT AUDITOR'S REPORTS



**INDEPENDENT AUDITOR'S 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**

Governing Board
Morgan Hill Unified School District
Morgan Hill, California

We have audited, in accordance with the 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, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Morgan Hill Unified School District (the District) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise Morgan Hill Unified School District's basic financial statements, and have issued our report thereon dated December 8, 2016.

Emphasis of Matter - Change in Accounting Principles

As discussed in Note 1 to the financial statements, in 2016, the District adopted new accounting guidance, GASB Statement No. 72, *Fair Value Measurement and Application*; GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68*, and *Amendments to Certain Provisions of GASB Statement 67 and 68*; GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*; and GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*. Our opinion is not modified with respect to this matter.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Morgan Hill Unified School District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Morgan Hill Unified School District's internal control. Accordingly, we do not express an opinion on the effectiveness of Morgan Hill Unified School District's internal control.

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 District's financial statements will not be prevented, or detected and corrected on a timely basis. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Morgan Hill Unified School District's financial statements are free from 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*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Palo Alto, California
December 8, 2016



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

Governing Board
Morgan Hill Unified School District
Morgan Hill, California

Report on Compliance for Each Major Federal Program

We have audited Morgan Hill Unified School District's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Morgan Hill Unified School District's (the District) major Federal programs for the year ended June 30, 2016. Morgan Hill Unified School District's major Federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the federal statutes, regulations, and the terms and conditions of its Federal awards applicable to its Federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Morgan Hill Unified School District's major Federal programs based on our audit of the types of compliance requirements referred to above. 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 the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance 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 Morgan Hill Unified School District'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 on compliance for each major Federal program. However, our audit does not provide a legal determination of Morgan Hill Unified School District's compliance.

Opinion on Each Major Federal Program

In our opinion, Morgan Hill Unified School District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major Federal programs for the year ended June 30, 2016.

Report on Internal Control Over Compliance

Management of Morgan Hill Unified School District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Morgan Hill Unified School District's internal control over compliance with the types of requirements that could have a direct and material effect on each major Federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major Federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 Morgan Hill Unified School District's internal control over compliance.

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. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a Federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Palo Alto, California
December 8, 2016



INDEPENDENT AUDITOR'S REPORT ON STATE COMPLIANCE

Governing Board
Morgan Hill Unified School District
Morgan Hill, California

Report on State Compliance

We have audited Morgan Hill Unified School District's compliance with the types of compliance requirements as identified in the *2015-2016 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting* that could have a direct and material effect on each of the Morgan Hill Unified School District's State government programs as noted below for the year ended June 30, 2016.

Management's Responsibility

Management is responsible for compliance with the requirements of State laws, regulations, and the terms and conditions of its State awards applicable to its State programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance of each of the Morgan Hill Unified School District's State programs based on our audit of the types of compliance requirements referred to above. We conducted our audit 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 the *2015-2016 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting*. These standards require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a material effect on the applicable government programs noted below. An audit includes examining, on a test basis, evidence about Morgan Hill Unified School District'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 opinions. Our audit does not provide a legal determination of Morgan Hill Unified School District's compliance with those requirements.

Unmodified Opinion on Each of the Other Programs

In our opinion, Morgan Hill Unified School District complied, in all material respects, with the compliance requirements referred to above that are applicable to the government programs noted below that were audited for the year ended June 30, 2016.

In connection with the audit referred to above, we selected and tested transactions and records to determine the Morgan Hill Unified School District's compliance with the State laws and regulations applicable to the following items:

	<u>Procedures Performed</u>
LOCAL EDUCATION AGENCIES OTHER THAN CHARTER SCHOOLS	
Attendance	Yes
Teacher Certification and Misassignments	Yes
Kindergarten Continuance	Yes
Independent Study	Yes
Continuation Education	Yes
Instructional Time	Yes
Instructional Materials	Yes
Ratios of Administrative Employees to Teachers	Yes
Classroom Teacher Salaries	Yes
Early Retirement Incentive	No, See Below
Gann Limit Calculation	Yes
School Accountability Report Card	Yes
Juvenile Court Schools	No, See Below
Middle or Early College High Schools	No, See Below
K-3 Grade Span Adjustment	Yes
Transportation Maintenance of Effort	No, See Below
SCHOOL DISTRICTS, COUNTY OFFICES OF EDUCATION, AND CHARTER SCHOOLS	
Educator Effectiveness	Yes
California Clean Energy Jobs Act	Yes
After School Education and Safety Program:	
General Requirements	Yes
After School	Yes
Before School	No, See Below
Proper Expenditure of Education Protection Account Funds	Yes
Unduplicated Local Control Funding Formula Pupil Counts	Yes
Local Control Accountability Plan	Yes
Independent Study - Course Based	No, See Below
Immunizations	Yes
CHARTER SCHOOLS	
Attendance	No, See Below
Mode of Instruction	No, See Below
Non Classroom-Based Instruction/Independent Study for Charter Schools	No, See Below
Determination of Funding for Non Classroom-Based Instruction	No, See Below
Annual Instruction Minutes Classroom-Based	No, See Below
Charter School Facility Grant Program	No, See Below

The District did not offer an Early Retirement Incentives, Juvenile Court Schools, Middle or Early College High Schools, Transportation, Before School Education and Safety Programs, Independent Study-Course Based, and Charter Schools. Therefore, we did not perform any procedures related to these programs.

Wassinek, Trine, Day & Co., LLP

Palo Alto, California
December 8, 2016

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SUMMARY OF AUDITOR’S RESULTS
FOR THE YEAR ENDED JUNE 30, 2016**

FINANCIAL STATEMENTS

Type of auditor's report issued:	<u>Unmodified</u>
Internal control over financial reporting:	
Material weaknesses identified?	<u>No</u>
Significant deficiencies identified?	<u>None reported</u>
Noncompliance material to financial statements noted?	<u>No</u>

FEDERAL AWARDS

Internal control over major programs:	
Material weaknesses identified?	<u>No</u>
Significant deficiencies identified?	<u>None reported</u>
Type of auditor's report issued on compliance for major programs:	
Any audit findings disclosed that are required to be reported in accordance with Section 200.516(a) of the Uniform Guidance?	<u>No</u>
Identification of major programs:	<u>Unmodified</u>

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
<u>84.010</u>	<u>Title I, Part A of the ESEA</u>
<u>84.027, 84.173, 84.027A & 84.173A</u>	<u>Special Education</u>

Dollar threshold used to distinguish between Type A and Type B programs:	<u>\$ 750,000</u>
Auditee qualified as low-risk auditee?	<u>Yes</u>

STATE AWARDS

Type of auditor's report issued on compliance for all programs:
Unmodified for all programs

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FINANCIAL STATEMENT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2016**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**STATE AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS FOR THE YEAR ENDED JUNE 30, 2016

Except as specified in previous sections of this report, summarized below is the current status of all audit findings reported in the prior year's schedule of financial statement findings.

Financial Statement Findings

None reported.

Federal Awards Findings

None reported.

State Awards Findings

2015-001 Code 70000

Public Hearing of Instructional Material

Finding

The State requires Districts to conduct a public hearing for instructional materials within the first eight weeks of the first day of instruction. It was noted that the District conducted the public hearing for instructional materials on 10/21/14. The first day of instruction was on 8/14/14. Therefore, the public hearing was not within first eight weeks of instruction.

Recommendation

We recommend the District to provide additional oversight to ensure that the public hearing for instructional materials is performed as according to State guidelines.

Current Status

Implemented