

**MORGAN HILL UNIFIED
SCHOOL DISTRICT**

ANNUAL FINANCIAL REPORT

**FOR THE YEAR ENDED
JUNE 30, 2014**

MORGAN HILL UNIFIED SCHOOL DISTRICT

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FINANCIAL SECTION

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
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 (the District) as of and for the year ended June 30, 2014, 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 *Standards and Procedures for Audits of California K-12 Local Education Agencies 2013-2014*, 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 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 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, 2014, and the respective changes in financial position 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 16 to the financial statements, the District adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. 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 required supplementary information, such as management's discussion and analysis on pages 5 through 14 and budgetary comparison and other postemployment benefit information on pages 52 and 53, respectively, 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 nonmajor fund financial statements and Schedule of Expenditures of Federal Awards, as required by Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* 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 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 _____, 2014, 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

_____, 2014

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT’S DISCUSSION AND ANALYSIS JUNE 30, 2014

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, 2014. 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. The Board approved transferring an additional \$1 million into the Special Reserve, 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 received the first increase in State funding since 2008. The new resources were directed to support school site programs and to partially reinstate some of the \$15 million in budget reductions made during the prior five years.
- The District continued to have positive, collaborative relationships with all bargaining units which resulted in negotiations being settled by July 2013 for 2013-14.
- With the Common Core State Standards grant funds, the District provided professional development and Teachers on Special Assignment (TOSA’s) to support classroom instruction in common core. By year end 97% of classroom teachers had been trained in common core.
- Using bond funds, the District completed Phase I of renovations for the Loritta Bonfante Johnson Educational Center. The new Educational Center enabled digital learning and expanded course offerings for Central High School. Phase II renovations scheduled for summer 2014 will include additional counseling and administrative support spaces with plans to expand program offering once Phase II renovations are completed.

MORGAN HILL UNIFIED SCHOOL DISTRICT

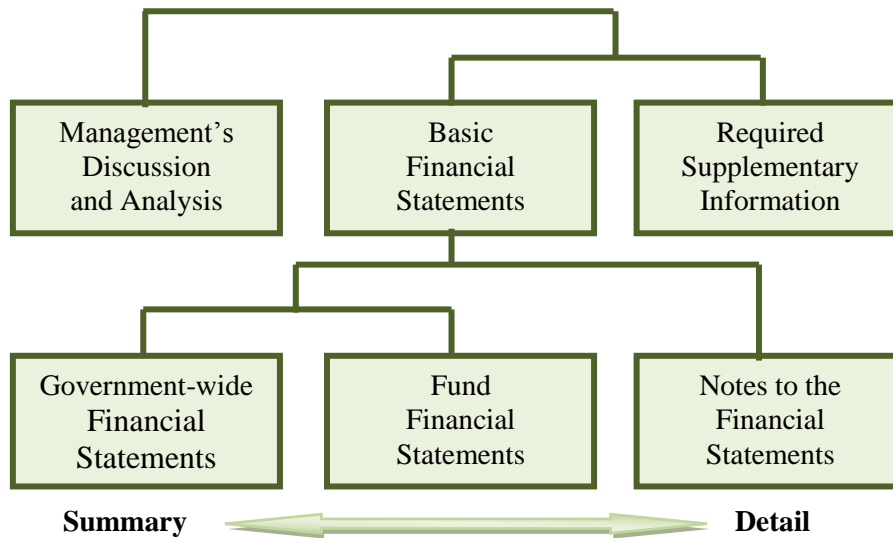
MANAGEMENT’S DISCUSSION AND ANALYSIS

JUNE 30, 2014

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, 2014

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 2013-2014?"

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, 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.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2014

◆ 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.

FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS

The School District as a Whole

For the period ending June 30, 2014, the District's net position increased to \$166.9 million, or a 4.31% increase. Of this amount \$24.4 million was unrestricted (see Table 1).

(Table 1)
Comparative Condensed Statement of Net Position

| | Governmental Activities | |
|------------------------------------------------|------------------------------|------------------------------|
| | 2014 | 2013 |
| Assets | | |
| Deposits and investments | \$ 97,585,654 | \$ 99,466,082 |
| Receivables | 6,018,263 | 5,173,781 |
| Deferred charges | 2,025,859 | 1,464,812 |
| Prepaid expenses | 10,622 | 1,468 |
| Stores inventory | 24,926 | 30,113 |
| Capital assets | 204,237,353 | 196,213,505 |
| Total Assets | <u>309,902,677</u> | <u>302,349,761</u> |
| Liabilities | | |
| Accounts payable and other current liabilities | 7,869,790 | 5,271,127 |
| Unearned revenue | 563,338 | 1,391,474 |
| Long-term liabilities | 134,554,285 | 135,670,683 |
| Total Liabilities | <u>142,987,413</u> | <u>142,333,284</u> |
| Net position | | |
| Net investment in capital assets | 118,684,824 | 119,380,657 |
| Restricted | 25,783,331 | 18,864,887 |
| Unrestricted | 22,447,109 | 21,770,933 |
| Total Net Position | <u>\$ 166,915,264</u> | <u>\$ 160,016,477</u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

**MANAGEMENT’S DISCUSSION AND ANALYSIS
JUNE 30, 2014**

The District’s net position increased \$8,363,599 for this fiscal year (see Table 2). The District’s expenses for instruction and pupil services represented 71% of total expenses. The purely administrative activities of the District account for just 5% of total costs. The remaining 24% 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 | |
|-----------------------------------------------------------|-------------------------|---------------------|
| | 2014 | 2013 |
| Revenues | | |
| Program revenues: | \$ 15,782,533 | \$ 17,387,457 |
| General revenues: | | |
| Taxes levied for general purposes | 44,873,192 | 49,909,610 |
| Taxes levied for debt service | 15,061,932 | 8,396,230 |
| Taxes levied for other specific purposes | 1,119,320 | 1,205,930 |
| Federal and State aid not restricted to specific purposes | 12,131,296 | 6,102,093 |
| Interest and investment earnings | 272,760 | 303,577 |
| Miscellaneous | 5,134,185 | 4,122,563 |
| Total Revenues | 94,375,218 | 87,427,460 |
| Expenses | | |
| Instruction | 44,592,537 | 44,220,400 |
| Instruction related services | 7,958,422 | 7,853,732 |
| Pupil support services | 8,984,169 | 8,836,277 |
| General administration | 4,152,052 | 4,282,883 |
| Plant services | 8,463,224 | 6,602,724 |
| Other | 11,861,215 | 9,795,902 |
| Total Expenses | 86,011,619 | 81,591,918 |
| Increase In Net Position | \$ 8,363,599 | \$ 5,835,542 |

MORGAN HILL UNIFIED SCHOOL DISTRICT

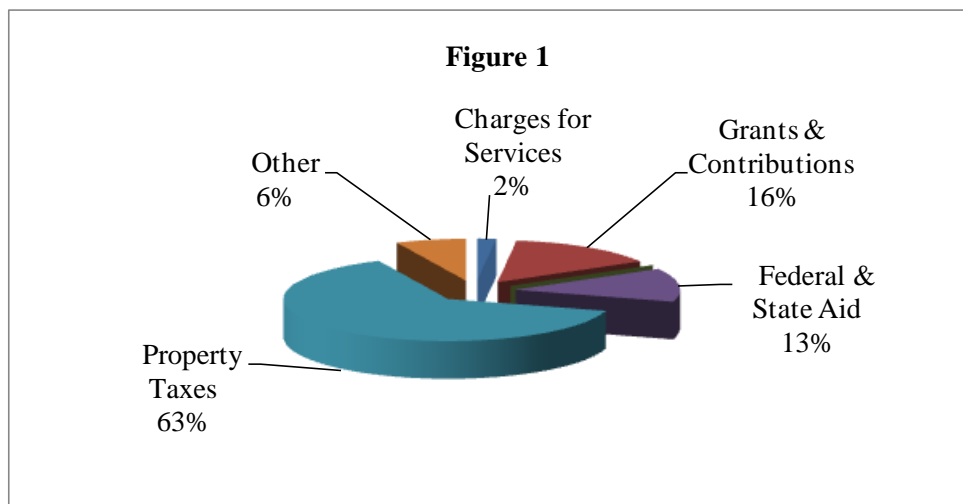
MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2014

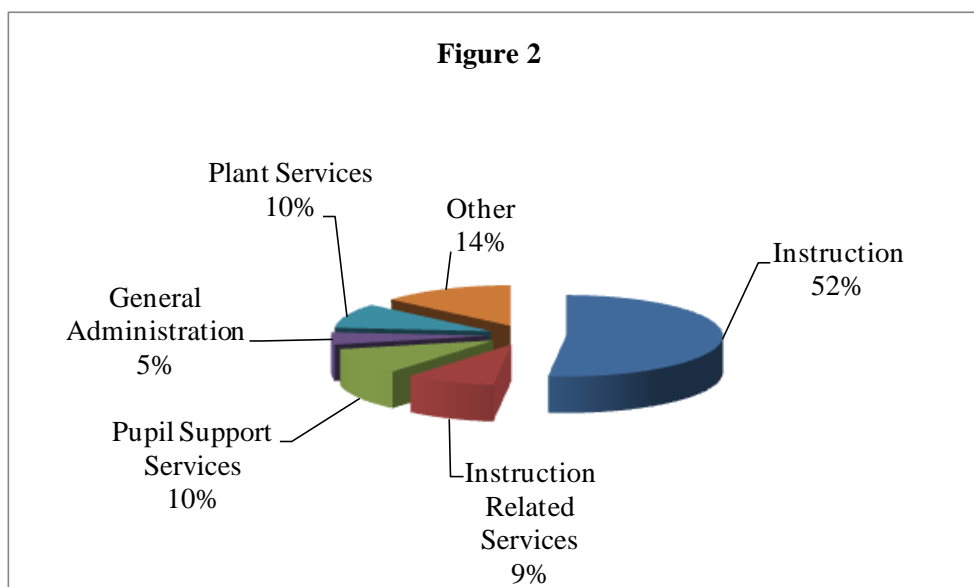
Governmental Activities

As reported in the Statement of Activities, the cost of all the District's governmental activities this year was \$86 million. The amount that our local taxpayers financed for these activities through property taxes was \$59.9 million or 63% of all revenues. Federal and State aid not restricted to specific purposes total \$12.1 million. (See Figure 1).

Revenues for the 2013-2014 Fiscal Year



Expenses for the 2013-2014 Fiscal Year



MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2014

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 \$96.4 million, a decrease of \$2.8 million from the previous fiscal year. This decrease is primarily the result of significant bond expenditures offset by increases in the General Fund and 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 \$24.2 million excluding the Special Reserve Fund for Non Capital. The State recommends an ending reserve for economic uncertainties of 3%. The District's ending reserve for economic uncertainty was 3%.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

By the end of the 2013-2014 fiscal year, the District had investments of \$270.6 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 \$204.2 million at June 30, 2014 which is an increase of \$8.0 million from the previous year.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2014**

**(Table 3)
Comparative Schedule of Capital Assets
(net of depreciation)
June 30, 2014 and 2013**

| | 2014 | 2013 | Difference | Percentage Change |
|----------------------------|-----------------------|-----------------------|---------------------|----------------------|
| Land | \$ 7,467,149 | \$ 7,467,149 | \$ - | 0.0% |
| Buildings and improvements | 177,476,725 | 182,325,428 | (4,848,703) | -2.7% |
| Machinery and equipment | 2,103,200 | 2,590,695 | (487,495) | -18.8% |
| Work in progress | 17,190,279 | 3,830,233 | 13,360,046 | 348.8% |
| Totals | \$ 204,237,353 | \$ 196,213,505 | \$ 8,023,848 | 4.1% |

As of June 30, 2014, the District had \$134.6 million in long-term obligations outstanding.

**(Table 4)
Comparative Schedule of Outstanding Debt
June 30, 2014 and 2013**

| | 2014 | 2013 |
|-----------------------------------------------------------------------------------|-----------------------|-----------------------|
| General obligation bonds (Including premiums, accretions and defeasance costs) | \$ 115,687,801 | \$ 118,794,232 |
| Certificates of participation | 13,325,087 | 13,311,247 |
| Compensated absences | 262,672 | 307,376 |
| Net OPEB obligation | 5,278,725 | 3,257,828 |
| Totals | \$ 134,554,285 | \$ 135,670,683 |

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2014

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 fifth year in a row. The chart below depicts actual ADA for 2008-2014.

| <u>ADA P-2</u> | <u>2007-2008</u> | <u>2008-2009</u> | <u>2009-2010</u> | <u>2010-2011</u> | <u>2011-2012</u> | <u>2012-2013</u> | <u>2013-2014</u> |
|----------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Elementary | 5,825.40 | 5,939.36 | 5,858.56 | 5,809.00 | 5,688.00 | 5,670.00 | 5,655.00 |
| High School | 2,769.16 | 2,812.69 | 2,821.06 | 2,733.00 | 2,686.00 | 2,651.00 | 2,516.00 |
| Total ADA | 8,594.56 | 8,752.05 | 8,679.62 | 8,542.00 | 8,374.00 | 8,321.00 | 8,208.00 |
| ADA Change | 126.53 | 157.49 | (72.43) | (137.62) | (168.00) | (53.00) | (113.00) |
| % Change | 1.49% | 1.83% | -0.83% | -1.59% | -1.97% | -0.63% | -1.36% |

FACTORS BEARING ON THE DISTRICT'S FUTURE

Under the leadership of Superintendent Steve Betando, Morgan Hill Unified School District has focused 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 new robust goals in June 2014:

- **COLLEGE AND CAREER READINESS:** With an equity lens, Morgan Hill Unified School District will provide vigorous curriculum and instruction that includes critical thinking skills, academic and digital literacy in all subject areas to ensure post-secondary success 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 & 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 elementary 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 is opening two new academies in 2014-15: Walsh Elementary as a Science, Technology, Engineering, Arts, and Mathematics (STEAM Academy) and San Martin-Gwinn as an Environmental Science 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, 2014

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 Postemployment 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 fully fund the new funding mechanism within the eight year implementation period. Even if fully funding is achieved within the eight year implementation period, California's funding per student 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, 2014

| | Governmental Activities |
|-------------------------------------------------|------------------------------------|
| ASSETS | |
| Deposits and investments | \$ 97,585,654 |
| Receivables | 6,018,263 |
| Prepaid expenses | 10,622 |
| Stores inventories | 24,926 |
| Capital assets not depreciated | 24,657,428 |
| Capital assets, net of accumulated depreciation | 179,579,925 |
| Total Assets | 307,876,818 |
| DEFERRED OUTFLOWS OF RESOURCES | |
| Deferred amount on refunding | 2,025,859 |
| Total Deferred Outflows of Resources | 2,025,859 |
| LIABILITIES | |
| Accounts payable | 6,667,463 |
| Interest payable | 1,202,327 |
| Unearned revenue | 563,338 |
| Current portion of long-term obligations | 8,590,365 |
| Noncurrent portion of long-term obligations | 125,963,920 |
| Total Liabilities | 142,987,413 |
| NET POSITION | |
| Net investment in capital assets | 118,684,824 |
| Restricted for: | |
| Educational programs | 4,522,666 |
| Child nutrition program | 900,210 |
| Debt service | 12,755,798 |
| Capital projects | 7,568,280 |
| Unrestricted | 22,483,486 |
| Total Net Position | \$ 166,915,264 |

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, 2014**

| Functions/Programs | Expenses | Program Revenues | | Net (Expenses) Revenues and Changes in Net Position |
|-----------------------------------------------------------|----------------------|--------------------------------------|------------------------------------------|--------------------------------------------------------------|
| | | Charges for Services and Sales | Operating Grants and Contributions | Governmental Activities |
| Governmental Activities: | | | | |
| Instruction | \$ 44,592,537 | \$ 6,991 | \$ 7,711,152 | \$ (36,874,394) |
| Instruction-related activities: | | | | |
| Supervision of instruction | 1,481,362 | - | 687,591 | (793,771) |
| Instructional library and technology | 232,437 | 47 | 27,693 | (204,697) |
| School site administration | 6,244,623 | 511 | 139,867 | (6,104,245) |
| Pupil services: | | | | |
| Home-to-school transportation | 3,014,462 | 185,411 | 181,224 | (2,647,827) |
| Food services | 2,528,115 | 517,590 | 1,858,539 | (151,986) |
| All other pupil services | 3,441,592 | 768 | 748,627 | (2,692,197) |
| General administration: | | | | |
| Data processing | 772,814 | - | - | (772,814) |
| All other general administration | 3,379,238 | 37,518 | 626,875 | (2,714,845) |
| Plant services | 8,463,224 | 10,073 | 8,365 | (8,444,786) |
| Ancillary services | 834,662 | - | - | (834,662) |
| Community services | 7,548 | - | - | (7,548) |
| Interest on long-term obligations | 6,089,737 | - | - | (6,089,737) |
| Other outgo | 4,929,268 | 994,359 | 2,039,332 | (1,895,577) |
| Total Governmental-Type Activities | \$ 86,011,619 | \$ 1,753,268 | \$ 14,029,265 | (70,229,086) |
| General revenues and subventions: | | | | |
| Property taxes, levied for general purposes | | | | 44,873,192 |
| Property taxes, levied for debt service | | | | 15,061,932 |
| Taxes levied for other specific purposes | | | | 1,119,320 |
| Federal and State aid not restricted to specific purposes | | | | 12,131,296 |
| Interest and investment earnings | | | | 272,760 |
| Intergovernmental revenues | | | | 142,151 |
| Miscellaneous | | | | 4,992,034 |
| Subtotal, General Revenues | | | | 78,592,685 |
| Change in Net Position | | | | 8,363,599 |
| Net Position - Beginning, as restated | | | | 158,551,665 |
| Net Position - Ending | | | | \$ 166,915,264 |

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

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MORGAN HILL UNIFIED SCHOOL DISTRICT

**GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 2014**

| | General Fund | Building Fund | Bond Interest and Redemption Fund |
|--------------------------------------------|-------------------------|--------------------------|--------------------------------------------------|
| ASSETS | | | |
| Deposits and investments | \$ 25,231,470 | \$ 49,497,546 | \$ 13,950,805 |
| Receivables | 5,541,790 | 111,104 | 7,320 |
| Due from other funds | - | 424,399 | - |
| Prepaid expenditures | 10,622 | - | - |
| Stores inventories | 23,100 | - | - |
| Total Assets | \$ 30,806,982 | \$ 50,033,049 | \$ 13,958,125 |
| LIABILITIES AND FUND BALANCES | | | |
| Liabilities: | | | |
| Accounts payable | \$ 2,657,713 | \$ 3,879,029 | \$ - |
| Due to other funds | 418,731 | - | - |
| Unearned revenue | 563,338 | - | - |
| Total Liabilities | 3,639,782 | 3,879,029 | - |
| Fund Balances: | | | |
| Nonspendable | 48,222 | - | - |
| Restricted | 4,522,665 | 41,434,500 | 13,958,125 |
| Committed | - | - | - |
| Assigned | 6,504,492 | 4,719,520 | - |
| Unassigned | 16,091,821 | - | - |
| Total Fund Balances | 27,167,200 | 46,154,020 | 13,958,125 |
| Total Liabilities and Fund Balances | \$ 30,806,982 | \$ 50,033,049 | \$ 13,958,125 |

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

| Non-Major Governmental Funds | Total Governmental Funds |
|---------------------------------------------|-----------------------------------------|
| \$ 8,905,833 | \$ 97,585,654 |
| 358,049 | 6,018,263 |
| 306,052 | 730,451 |
| - | 10,622 |
| 1,826 | 24,926 |
| <u>\$ 9,571,760</u> | <u>\$ 104,369,916</u> |

| | |
|----------------|------------------|
| \$ 130,721 | \$ 6,667,463 |
| 311,720 | 730,451 |
| - | 563,338 |
| <u>442,441</u> | <u>7,961,252</u> |

| | |
|---------------------|-----------------------|
| 7,826 | 56,048 |
| 8,502,041 | 68,417,331 |
| 619,452 | 619,452 |
| - | 11,224,012 |
| - | 16,091,821 |
| <u>9,129,319</u> | <u>96,408,664</u> |
| <u>\$ 9,571,760</u> | <u>\$ 104,369,916</u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET POSITION JUNE 30, 2014

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

| | | |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|-------------------------------------|
| Total Fund Balance - Governmental Funds | | \$ 96,408,664 |
| 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 | \$ 270,617,483 | |
| Accumulated depreciation is | <u>(66,380,130)</u> | |
| Net Capital Assets | | 204,237,353 |
| 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. | | (1,202,327) |
| Long-term liabilities, 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, premiums and deferred refunding amounts | 113,661,942 | |
| COP payable and discounts | 13,325,087 | |
| Compensated absences (vacations) | 262,672 | |
| Net OPEB obligation | <u>5,278,725</u> | |
| Total Long-Term Liabilities | | <u>(132,528,426)</u> |
| Total Net Position - Governmental Activities | | <u><u>\$ 166,915,264</u></u> |

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

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MORGAN HILL UNIFIED SCHOOL DISTRICT

GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES FOR THE YEAR ENDED JUNE 30, 2014

| | General Fund | Building Fund | Bond Interest and Redemption Fund |
|--------------------------------------------------------------|----------------------|----------------------|-----------------------------------------|
| REVENUES | | | |
| Local control funding formula | \$ 54,181,078 | \$ - | \$ - |
| Federal sources | 3,763,284 | 691,802 | - |
| Other state sources | 6,756,148 | - | 103,070 |
| Other local sources | 6,800,698 | 1,310,131 | 14,976,841 |
| Total Revenues | 71,501,208 | 2,001,933 | 15,079,911 |
| EXPENDITURES | | | |
| Current | | | |
| Instruction | 39,959,281 | - | - |
| Instruction-related activities: | | | |
| Supervision of instruction | 1,328,258 | - | - |
| Instructional library, media and technology | 210,263 | - | - |
| School site administration | 5,343,382 | - | - |
| Pupil services: | | | |
| Home-to-school transportation | 2,700,013 | - | - |
| Food services | - | - | - |
| All other pupil services | 3,089,745 | - | - |
| General administration: | | | |
| Data processing | 699,412 | - | - |
| All other general administration | 2,975,190 | - | - |
| Plant services | 5,555,381 | - | - |
| Facility acquisition and construction | - | 14,078,526 | - |
| Ancillary services | 449,890 | - | - |
| Community services | 6,968 | - | - |
| Other outgo | 4,929,268 | - | - |
| Debt service | | | |
| Principal | - | - | 6,570,000 |
| Interest and other | 83,598 | 940,887 | 3,650,728 |
| Total Expenditures | 67,330,649 | 15,019,413 | 10,220,728 |
| Excess (Deficiency) of Revenues Over Expenditures | 4,170,559 | (13,017,480) | 4,859,183 |
| Other Financing Sources (Uses): | | | |
| Transfers in | 1,109,652 | 416,000 | - |
| Transfers out | (2,306,061) | - | - |
| Net Financing Sources (Uses) | (1,196,409) | 416,000 | - |
| NET CHANGE IN FUND BALANCES | 2,974,150 | (12,601,480) | 4,859,183 |
| Fund Balance - Beginning | 24,193,050 | 58,755,500 | 9,098,942 |
| Fund Balance - Ending | \$ 27,167,200 | \$ 46,154,020 | \$ 13,958,125 |

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

| Non-Major Governmental Funds | Total Governmental Funds |
|---------------------------------------------|-----------------------------------------|
| \$ - | \$ 54,181,078 |
| 1,871,563 | 6,326,649 |
| 323,062 | 7,182,280 |
| 3,597,541 | 26,685,211 |
| <u>5,792,166</u> | <u>94,375,218</u> |
| 411,691 | 40,370,972 |
| - | 1,328,258 |
| - | 210,263 |
| 236,850 | 5,580,232 |
| - | 2,700,013 |
| 2,270,328 | 2,270,328 |
| - | 3,089,745 |
| - | 699,412 |
| 154,280 | 3,129,470 |
| 598,093 | 6,153,474 |
| 972,718 | 15,051,244 |
| - | 449,890 |
| - | 6,968 |
| - | 4,929,268 |
| - | 6,570,000 |
| - | 4,675,213 |
| <u>4,643,960</u> | <u>97,214,750</u> |
| <u>1,148,206</u> | <u>(2,839,532)</u> |
| 853,891 | 2,379,543 |
| (73,482) | (2,379,543) |
| <u>780,409</u> | <u>-</u> |
| 1,928,615 | (2,839,532) |
| 7,200,704 | 99,248,196 |
| <u>\$ 9,129,319</u> | <u>\$ 96,408,664</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, 2014

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

Total Net Change in Fund Balances - Governmental Funds **\$ (2,839,532)**

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 exceeds depreciation in the period.

| | | |
|------------------------|---------------|-----------|
| Capital outlays | \$ 13,384,656 | |
| Depreciation expense | (5,360,808) | |
| Net Expense Adjustment | | 8,023,848 |

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). 44,704

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. (1,905,517)

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 | (405,172) | |
| Amortization of premium of general obligation bonds | 872,979 | |
| Amortization of discount of certificates of participation | (13,840) | |
| Net amortization | | 453,967 |

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, 2014

| | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|
| 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. | 6,570,000 |
| Interest on long-term debt is recorded as an expenditure in the funds when it is due; however, in the Statement of Activities, interest expense is recognized as the interest accrues, regardless of when it is due. | 37,026 |
| 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. | <u>(2,020,897)</u> |
| Change in Net Position of Governmental Activities | <u><u>\$ 8,363,599</u></u> |

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FIDUCIARY FUND
STATEMENT OF NET POSITION
JUNE 30, 2014**

| | <u>Agency Fund</u> |
|--------------------------|------------------------|
| ASSETS | |
| Deposits and investments | \$ 861,149 |
| Total Assets | <u>\$ 861,149</u> |
| | |
| LIABILITIES | |
| Due to student groups | \$ 861,149 |
| Total Liabilities | <u>\$ 861,149</u> |

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014

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, 2014

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 Postemployment 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.

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).

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.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014

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 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).

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, 2014

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, 2014

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, 2014 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 \$5,000. 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, 2014

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.

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, 2014, 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.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014

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.

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.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

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.

Changes in Accounting Principles

As the result of implementing GASB Statement No. 65, the District has restated the beginning net position in the government-wide Statement of Net Position, effectively decreasing net position as of July 1, 2013, by \$1,464,812. The decrease results from no longer deferring and amortizing bond issuance costs.

New Accounting Pronouncements

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions 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 pensions with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

NOTE 2 - DEPOSITS AND INVESTMENTS

Summary of Deposits and Investments

Deposits and investments as of June 30, 2014, are classified in the accompanying financial statements as follows:

| | |
|--------------------------------|----------------------|
| Governmental activities | \$ 97,585,654 |
| Fiduciary funds | 861,149 |
| Total Deposits and Investments | <u>\$ 98,446,803</u> |

Deposits and investments as of June 30, 2014, consist of the following:

| | |
|--------------------------------|----------------------|
| Cash on hand and in banks | \$ 1,063,736 |
| Cash in revolving | 20,500 |
| Investments | 97,362,567 |
| Total Deposits and Investments | <u>\$ 98,446,803</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, 2014

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 | \$ 3,177,647 | \$ 3,177,647 | 5/3/2027 |
| Money Market | 540,300 | 540,300 | Less than a year |
| County Pool | 93,664,020 | 93,749,783 | 416 days |
| Total | \$ 97,381,967 | \$ 97,467,730 | |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

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 | \$ 3,177,647 | \$ 3,177,647 |
| Money Market | 540,300 | 540,300 |
| County Pool | 93,749,783 | 93,749,783 |
| Total | \$ 97,467,730 | \$ 97,467,730 |

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.

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, \$3,717,945 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.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

NOTE 3 - RECEIVABLES

Receivables at June 30, 2014, consisted of intergovernmental grants, entitlements, interest and other local sources. All receivables are considered collectible in full.

| | General Fund | Building Fund | Bond Interest and Redemption Fund | Non-Major Governmental Funds | Total |
|----------------------------------|---------------------|-------------------|-----------------------------------------|------------------------------------|---------------------|
| Federal Government | | | | | |
| Categorical aid | \$ 1,340,250 | \$ - | \$ - | \$ 322,008 | \$ 1,662,258 |
| State Government | | | | | |
| State principal apportionment | 2,368,520 | - | - | - | 2,368,520 |
| Categorical aid | 281,195 | - | - | 27,138 | 308,333 |
| Lottery | 596,009 | - | - | - | 596,009 |
| Local Government | | | | | |
| Interest | 32,440 | 48,117 | 7,320 | 7,697 | 95,574 |
| Other Local Sources | 923,376 | 62,987 | - | 1,206 | 987,569 |
| Total | <u>\$ 5,541,790</u> | <u>\$ 111,104</u> | <u>\$ 7,320</u> | <u>\$ 358,049</u> | <u>\$ 6,018,263</u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2014**

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2014, was as follows:

| | Balance July 1, 2013 | Additions | Deductions | Balance June 30, 2014 |
|----------------------------------------------------------------------------------|-------------------------|---------------------|-------------|--------------------------|
| Governmental Activities | | | | |
| Capital Assets Not Being Depreciated: | | | | |
| Land | \$ 7,467,149 | \$ - | \$ - | \$ 7,467,149 |
| Construction in progress | 3,830,233 | 13,360,046 | - | 17,190,279 |
| Total Capital Assets Not Being Depreciated | <u>11,297,382</u> | <u>13,360,046</u> | <u>-</u> | <u>24,657,428</u> |
| Capital Assets Being Depreciated: | | | | |
| Buildings and improvements | 237,918,712 | - | - | 237,918,712 |
| Furniture and equipment | 8,016,733 | 24,610 | - | 8,041,343 |
| Total Capital Assets Being Depreciated | <u>245,935,445</u> | <u>24,610</u> | <u>-</u> | <u>245,960,055</u> |
| Total Capital Assets | <u>257,232,827</u> | <u>13,384,656</u> | <u>-</u> | <u>270,617,483</u> |
| Less Accumulated Depreciation: | | | | |
| Buildings and improvements | 55,593,284 | 4,848,703 | - | 60,441,987 |
| Furniture and equipment | 5,426,038 | 512,105 | - | 5,938,143 |
| Total Accumulated Depreciation Governmental Activities Capital Assets, Net | <u>61,019,322</u> | <u>5,360,808</u> | <u>-</u> | <u>66,380,130</u> |
| | <u>\$ 196,213,505</u> | <u>\$ 8,023,848</u> | <u>\$ -</u> | <u>\$ 204,237,353</u> |

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

| | |
|----------------------------------------------|---------------------|
| Governmental Activities | |
| Instruction | \$ 3,227,208 |
| Supervision of instruction | 110,624 |
| Instructional library, media, and technology | 17,512 |
| School site administration | 464,750 |
| Home-to-school transportation | 224,871 |
| Food services | 189,084 |
| All other pupil services | 257,329 |
| Ancillary services | 37,469 |
| Community services | 580 |
| Data processing | 58,251 |
| All other general administration | 260,638 |
| Plant services | 512,492 |
| Total Depreciation Expense All Activities | <u>\$ 5,360,808</u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2014**

NOTE 5 - INTERFUND TRANSACTIONS

Interfund Receivables/Payables (Due To/Due From)

| Due To | Due From | | |
|------------------------|-------------------|---------------------------|-------------------|
| | Building Fund | Non-Major Governmental | Total |
| General fund | \$ 112,679 | \$ 306,052 | \$ 418,731 |
| Non-major Governmental | 311,720 | - | 311,720 |
| Total | \$ 424,399 | \$ 306,052 | \$ 730,451 |

Operating Transfers

Interfund transfers for the year ended June 30, 2014, consisted of the following:

| Transfer Out | Transfer In | | | Total |
|------------------------------|---------------------|-------------------|--------------------|---------------------|
| | General Fund | Building Fund | Non-Major Funds | |
| General Fund | \$ 1,036,170 | \$ 416,000 | \$ 853,891 | \$ 2,306,061 |
| Non-Major Governmental Funds | 73,482 | - | - | 73,482 |
| Total | \$ 1,109,652 | \$ 416,000 | \$ 853,891 | \$ 2,379,543 |

| | |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|
| General Fund transferred to Special Reserve Fund for a one time increase to the budget due to the District becoming basic aid in 2012-13. | \$ 1,036,170 |
| 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. | 349,072 |
| General Fund transferred to Cafeteria Fund for an audit finding conducted from the Child Nutrition auditors in CDE. | 198,767 |
| Capital Facilities Fund transferred to General Fund for revenue collected from Capital Facilities Fund that should have been recorded in General fund. | 73,482 |
| 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. | 306,052 |
| Total interfund transfers | \$ 2,379,543 |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014

NOTE 6 - ACCOUNTS PAYABLE

Accounts payable at June 30, 2014, consisted of the following:

| | General Fund | Building Fund | Non-Major Governmental Funds | Total |
|-----------------------|---------------------|---------------------|------------------------------------|---------------------|
| Vendor payables | \$ 2,463,957 | \$ 3,878,233 | \$ 123,470 | \$ 6,465,660 |
| Salaries and benefits | 193,756 | 796 | 7,251 | 201,803 |
| Total | <u>\$ 2,657,713</u> | <u>\$ 3,879,029</u> | <u>\$ 130,721</u> | <u>\$ 6,667,463</u> |

NOTE 7 - UNEARNED REVENUE

Unearned revenue at June 30, 2014, consists of the following:

| | General Fund |
|------------------------------|-------------------|
| Federal financial assistance | \$ 4,869 |
| Other local | 558,469 |
| Total | <u>\$ 563,338</u> |

NOTE 8 - TAX AND REVENUE ANTICIPATION NOTES (TRANS)

On July 2, 2012, the District issued \$4,555,000 Tax and Revenue Anticipation Notes bearing interest at 2 percent. The notes were issued to supplement cash flows. Interest and principal were due and payable on June 1, 2013. By May 2013, the District had paid 100 percent of principal and interest for the sole purpose of satisfying the notes. The District was not required to make any additional payments on the notes. As the District has in substance defeased the debt, the tax anticipation notes of \$4,555,000 and related accrued interest and cash held in trust are not included in these financial statements.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

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, 2013 | Additions | Deductions | Balance June 30, 2014 | Due in One Year |
|-------------------------------|---------------------------|---------------------|-------------------------|---------------------------|-------------------------|
| General Obligation (GO) bonds | \$ 104,629,040 | \$ - | \$ 6,570,000 | \$ 98,059,040 | \$ 7,731,226 |
| Accretions on GO bonds | 9,817,539 | 1,905,517 | - | 11,723,056 | - |
| Premium | 6,778,684 | - | 872,979 | 5,905,705 | 872,979 |
| Sub-Total | 118,794,232 | 1,905,517 | 7,442,979 | 115,687,801 | 8,604,205 |
| Certificates of participation | 13,505,000 | - | - | 13,505,000 | - |
| Discount on COPS | (193,753) | - | (13,840) | (179,913) | (13,840) |
| Accumulated vacation - net | 307,376 | - | 44,704 | 262,672 | - |
| Net OPEB obligations | 3,257,828 | 2,601,921 | 581,024 | 5,278,725 | - |
| | <u>\$ 135,670,683</u> | <u>\$ 4,507,438</u> | <u>\$ 8,054,867</u> | <u>\$ 134,554,285</u> | <u>\$ 8,590,365</u> |
| Defeasance Cost | <u>\$ (2,431,031)</u> | <u>\$ -</u> | <u>\$ (405,172)</u> | <u>\$ (2,025,859)</u> | <u>\$ (405,172)</u> |

The Bond Interest and Redemption fund is used to collect assessed property taxes which are used to repay the general obligation bonds. Payment of certificate of participation will be paid from General fund. Compensated absences and other postemployment benefits will be paid by the fund for which the employee works.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2014**

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, 2013 | Issued / Accreted Interest | Redeemed | Bonds Outstanding June 30, 2014 |
|------------|-----------------------|---------------|-----------------------|--------------------------------|----------------------------|---------------------|---------------------------------|
| 2006 | 2020 | 3.50%-4.24% | \$ 68,180,000 | \$ 40,855,000 | \$ - | \$ 6,570,000 | \$ 34,285,000 |
| 2006 | 2016 | 4.25%-4.42% | 8,774,040 | 18,591,579 | 1,905,517 | - | 20,497,096 |
| 2012 | 2042 | 2.00%-3.25% | 55,000,000 | 55,000,000 | - | - | 55,000,000 |
| | | | <u>\$ 131,954,040</u> | <u>\$ 114,446,579</u> | <u>\$ 1,905,517</u> | <u>\$ 6,570,000</u> | <u>\$ 109,782,096</u> |

Debt Service Requirements to Maturity

The bonds mature through 2043 as follows:

| Fiscal Year | Principal | Interest to Maturity | Total |
|-------------------|-----------------------|----------------------|-----------------------|
| 2015 | \$ 7,731,226 | \$ 7,891,549 | \$ 15,622,775 |
| 2016 | 7,063,802 | 8,405,973 | 15,469,775 |
| 2017 | 2,779,012 | 8,979,363 | 11,758,375 |
| 2018 | 8,875,000 | 3,287,750 | 12,162,750 |
| 2019 | 9,900,000 | 2,821,575 | 12,721,575 |
| 2020-2024 | 18,085,000 | 9,505,600 | 27,590,600 |
| 2025-2029 | 5,095,000 | 8,038,500 | 13,133,500 |
| 2030-2034 | 8,915,000 | 6,689,419 | 15,604,419 |
| 2035-2039 | 13,795,000 | 4,636,900 | 18,431,900 |
| 2040-2043 | 15,820,000 | 1,326,000 | 17,146,000 |
| Total | <u>98,059,040</u> | <u>\$ 61,582,629</u> | <u>\$ 159,641,669</u> |
| Accretion to Date | <u>11,723,056</u> | | |
| | <u>\$ 109,782,096</u> | | |

Accumulated Unpaid Employee Vacation

The long-term portion of accumulated unpaid employee vacation for the District at June 30, 2014 amounted to \$262,672.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

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, 2014, the principal balance outstanding was \$13,505,000. The certificates mature through 2027 as follows:

| <u>Fiscal Year</u> | <u>Principal</u> | <u>Interest to Maturity</u> | <u>Total</u> |
|--------------------|----------------------|---------------------------------|----------------------|
| 2015 | \$ - | \$ 958,855 | \$ 958,855 |
| 2016 | - | 958,855 | 958,855 |
| 2017 | - | 958,855 | 958,855 |
| 2018 | - | 958,855 | 958,855 |
| 2019 | - | 958,855 | 958,855 |
| 2020-2024 | - | 4,794,275 | 4,794,275 |
| 2025-2027 | 13,505,000 | 2,876,565 | 16,381,565 |
| Total | <u>\$ 13,505,000</u> | <u>\$ 12,465,115</u> | <u>\$ 25,970,115</u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

NOTE 10 - FUND BALANCES

Fund balances are composed of the following elements:

| | General Fund | Building Fund | Bond Interest and Redemption Fund | Non-Major Governmental Funds | Total |
|------------------------------------|----------------------|----------------------|-----------------------------------------|------------------------------------|----------------------|
| Nonspendable | | | | | |
| Revolving cash | \$ 14,500 | \$ - | \$ - | \$ 6,000 | \$ 20,500 |
| Stores inventories | 23,100 | - | - | 1,826 | 24,926 |
| Prepaid expenditures | 10,622 | - | - | - | 10,622 |
| Total Nonspendable | 48,222 | - | - | 7,826 | 56,048 |
| Restricted | | | | | |
| Legally restricted programs | 4,522,665 | - | - | 933,761 | 5,456,426 |
| Capital projects | - | 41,434,500 | - | 7,568,280 | 49,002,780 |
| Debt services | - | - | 13,958,125 | - | 13,958,125 |
| Total Restricted | 4,522,665 | 41,434,500 | 13,958,125 | 8,502,041 | 68,417,331 |
| Committed | | | | | |
| Adult education program | - | - | - | 285,394 | 285,394 |
| Deferred maintenance program | - | - | - | 334,058 | 334,058 |
| Total Committed | - | - | - | 619,452 | 619,452 |
| Assigned | | | | | |
| Special reserve-non capital | 2,558,488 | - | - | - | 2,558,488 |
| Retiree benefits | 561,585 | - | - | - | 561,585 |
| Capital projects | - | 4,719,520 | - | - | 4,719,520 |
| Various program carryover | 3,384,419 | - | - | - | 3,384,419 |
| Total Assigned | 6,504,492 | 4,719,520 | - | - | 11,224,012 |
| Unassigned | | | | | |
| Reserve for economic uncertainties | 2,088,081 | - | - | - | 2,088,081 |
| Remaining unassigned | 14,003,740 | - | - | - | 14,003,740 |
| Total Unassigned | 16,091,821 | - | - | - | 16,091,821 |
| Total | \$ 27,167,200 | \$ 46,154,020 | \$ 13,958,125 | \$ 9,129,319 | \$ 96,408,664 |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014

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

Plan Description

The Postemployment 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 229 retirees currently receiving benefits and 742 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 2013-2014, the District contributed \$581,024 to the plan, all of which was used for current premiums (approximately 22.33 percent of current year's annual required contribution). Plan members are paid a monthly administrative charge amount equal to \$90 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. This annual adjustment to the minimum monthly employer contribution for an annuitant authorized by this change cannot exceed one hundred dollars (\$100) per retiree per month. 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, instead of the administrative charge.

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 | \$ 2,638,755 |
| Interest on net OPEB obligation | 146,602 |
| Adjustment to annual required contribution | <u>(183,436)</u> |
| Annual OPEB cost (expense) | 2,601,921 |
| Contributions made | <u>(581,024)</u> |
| Increase in net OPEB asset/obligation | 2,020,897 |
| Net OPEB obligation, beginning of year | <u>3,257,828</u> |
| Net OPEB obligation, end of year | <u><u>\$ 5,278,725</u></u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

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 Asset/Obligation |
|------------------------|---------------------|------------------------|---------------------------|------------------------------|
| 2014 | \$ 2,601,921 | \$ 581,024 | 22% | \$ 5,278,725 |
| 2013 | 2,447,916 | 668,535 | 27% | 3,257,828 |
| 2012 | 2,555,669 | 960,440 | 38% | 1,478,447 |

Funded Status and Funding Progress

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

| 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, 2013 | \$ - | \$ 20,977,123 | \$ 20,977,123 | 0% | \$ 41,678,437 | 50.33% |

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.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

In the July 1, 2013, 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, 2013, was 25 years on a close basis. At June 30, 2014, the District's General Fund has assigned net position in the amount of \$561,585, which consisted of \$561,035 on deposit with the county treasurer and receivables in the amount of \$550.

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, 2014, 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 2014, 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, 2014

NOTE 13 - EMPLOYEE RETIREMENT SYSTEMS

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

CalSTRS

Plan Description

The District contributes to the California State Teachers' Retirement System (CalSTRS), a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by CalSTRS. The plan provides retirement and disability benefits, annual cost-of-living adjustments, and survivor benefits to beneficiaries. As a result of the Public Employee Pension Reform Act of 2013 (PEPRA), changes have been made to the defined benefit pension plan effective January 1, 2013. Benefit provisions are established by State statutes, as legislatively amended, within the State Teachers' Retirement Law. STRS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalSTRS annual financial report may be obtained from CalSTRS, 100 Waterfront Place, West Sacramento, CA 95605.

Funding Policy

Due to the implementation of the Public Employee Pension Act of 2013 (PERA), new members must pay at least 50 percent of the normal costs of the plan, which can fluctuate from year to year. For 2013-14, the required contribution rate for new members is 8.0 percent. "Classic plan members are also required to contribute 8.0 percent of their salary. The District is required to contribute an actuarially determined rate. The actuarial methods and assumptions used for determining the rate are those adopted by CalSTRS Teachers' Retirement Board. The required employer contribution rate for fiscal year 2013-2014 was 8.25 percent of annual payroll. The contribution requirements of the plan members are established by State statute. The District's contributions to CalSTRS for the fiscal years ending June 30, 2014, 2013, and 2012, were \$2,480,652, \$2,440,861, and \$2,414,574, respectively, and equal 100 percent of the required contributions for each year.

CalPERS

Plan Description

The District contributes to the School Employer 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. The plan provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. As a result of the Public Employee Pension Reform Act of 2013 (PERA), changes have been made to the defined benefit pension plan effective January 1, 2013. Benefit provisions are established by State statutes, as legislatively amended, within the Public Employees' Retirement Laws. CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalPERS' annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, CA 95811.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014

Funding Policy

As a result of the implementation of the Public Employee Pension Act of 2013 (PERRA), new members must pay at least 50 percent of the normal costs of the plan, which can fluctuate from year to year. For 2013-14, the normal cost is 11.85 percent, which rounds to a 6.0 percent contribution rate. "Classic plan members continue to contribute 7.0 percent. The District is required to contribute an actuarially determined rate. The actuarial methods and assumptions used for determining the rate are those adopted by the CalPERS Board of Administration. The Morgan Hill Unified School District pays the employee's portion of the CalPERS. The required employer contribution rate for fiscal year 2013-2014 was 11.442 percent of covered payroll. The contribution requirements of the plan members are established by State statute. The District's contributions of the employer's portion to CalPERS for the fiscal years ending June 30, 2014, 2013, and 2012, were \$1,122,743, \$1,084,315, and \$979,258, respectively, and equal 100 percent of the required contributions for each year.

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 \$1,622,011, \$1,540,259, and \$1,646,643, for the fiscal years ending June 30, 2014, 2013 and 2012. 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, 2014.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

Construction Commitments

As of June 30, 2014, the District had the following commitments with respect to the unfinished capital projects:

| Capital Project | Remaining Construction Commitment | Expected Date of Completion |
|----------------------------------------------|-----------------------------------------|-----------------------------------|
| Burnett Modernization | \$ 100,875 | Nov-14 |
| Technology Infrastructure upgrade - District | 17,752,946 | Aug-15 |
| MPR Room - MH Charter School | 4,747,260 | Jun-16 |
| San Martin/Gwinn Modernization | 4,491,760 | Aug-15 |
| JAMM/Paradise/Nordstrom/Mechanical Restroom | 4,778,551 | Sep-14 |
| Walsh Modernization | 3,772,457 | Aug-15 |
| | \$ 35,643,849 | |

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, 2014, the District made payment of \$659,330 for workers' compensation insurance and \$516,637 for property liability coverage to the Santa Clara County Schools Insurance Group.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2014

NOTE 16 - RESTATEMENT OF PRIOR YEAR NET POSITION

The District adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, in the current year. As a result, the effect on the current fiscal year is as follows:

Statement of Net Position

| | |
|--------------------------------------|-----------------------|
| Net Position - Beginning | \$ 160,016,477 |
| Restatement/cost of issuance | 1,464,812 |
| Net Position - Beginning as Restated | <u>\$ 158,551,665</u> |

REQUIRED SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

**GENERAL FUND
BUDGETARY COMPARISON SCHEDULE
FOR THE YEAR ENDED JUNE 30, 2014**

| | <u>Budgeted Amounts</u> | | <u>Actual</u> | <u>Variances -</u> |
|--------------------------------------------------------------------|-------------------------|----------------------|----------------------|--------------------------------------------------------------------------|
| | <u>Original</u> | <u>Final</u> | | <u>Positive</u> <u>(Negative)</u> <u>Final</u> <u>to Actual</u> |
| REVENUES | | | | |
| Local control funding formula | \$ 44,219,391 | \$ 54,181,078 | \$ 54,181,078 | \$ - |
| Federal sources | 3,731,456 | 3,763,284 | 3,763,284 | - |
| Other state sources | 9,842,517 | 5,134,137 | 5,134,137 | - |
| Other local sources | 5,381,582 | 6,789,027 | 6,789,028 | 1 |
| Total Revenues¹ | 63,174,946 | 69,867,526 | 69,867,527 | 1 |
| EXPENDITURES | | | | |
| Current | | | | |
| Certificated salaries | 29,451,777 | 30,321,516 | 30,321,519 | (3) |
| Classified salaries | 10,177,540 | 9,874,988 | 9,874,988 | - |
| Employee benefits | 10,576,248 | 10,331,490 | 10,331,489 | 1 |
| Books and supplies | 3,417,506 | 2,884,599 | 2,884,599 | - |
| Services and operating expenditures | 7,000,644 | 7,224,403 | 7,224,402 | 1 |
| Other outgo | 3,982,288 | 4,928,678 | 4,929,268 | (590) |
| Capital outlay | 2 | 142,374 | 142,374 | - |
| Total Expenditures¹ | 64,606,005 | 65,708,048 | 65,708,639 | (591) |
| Excess (Deficiency) of Revenues Over Expenditures | (1,431,059) | 4,159,478 | 4,158,888 | (590) |
| Other Financing Sources (Uses): | | | | |
| Transfers in | 127,000 | 1,661,500 | 1,661,500 | - |
| Transfers out | (416,000) | (3,894,079) | (3,894,079) | - |
| Net Financing Sources (Uses) | (289,000) | (2,232,579) | (2,232,579) | - |
| NET CHANGE | | | | |
| IN FUND BALANCES | (1,720,059) | 1,926,899 | 1,926,309 | (590) |
| Fund Balance - Beginning, Non-GAAP | 22,120,817 | 22,120,817 | 22,120,817 | - |
| Fund Balance - Ending, Non-GAAP | \$ 20,400,758 | \$ 24,047,716 | 24,047,126 | \$ (590) |
| Special Reserve Fund for Other Than Capital Outlay | | | 2,558,488 | |
| Special Reserve Fund for Retiree Benefits | | | 561,586 | |
| Fund Balance - Ending, GAAP | | | \$ 27,167,200 | |

¹ For comparison purposes, on behalf payments of \$1,622,011 has been excluded from this schedule.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF OTHER POSTEMPLOYMENT BENEFITS (OPEB) FUNDING
PROGRESS
FOR THE YEAR ENDED JUNE 30, 2014**

| 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, 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% |
| July 1, 2009 | 68,343 | 5,616,811 | 5,548,468 | 1% | 40,673,421 | 13.29% |

SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2014**

| 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): | | | |
| Advanced Placement Test Fees | 84.330B | 14381 | \$ 9,375 |
| No Child Left Behind | | | |
| Title I - Basic Grants Low Income and Neglected | 84.010 | 14981 | 1,049,124 |
| Title I - Migrant Education | 84.011 | 14326 | 265,089 |
| Title I - Migrant Education Summer Program | 84.011 | 10005 | 109,814 |
| Title I - Part A, Program Improvement LEA | 84.010 | 14955 | 114,266 |
| Title II - Improving Teacher Quality | 84.367 | 14341 | 267,027 |
| Title III - Limited English Proficient (LEP) Student Program | 84.365 | 14346 | 307,165 |
| Title III - Immigrant Education Program | 84.365 | 15146 | 14,031 |
| Individuals with Disabilities Act (IDEA): | | | |
| Basic Local Assistance Entitlement | 84.027 | 13379 | 1,272,993 |
| IDEA, Part B, Section 611, Private Schools | 84.027 | 10115 | 1,452 |
| IDEA, Preschool Grants, Part B, Section 611 | 84.027A | 13682 | 57,874 |
| IDEA, Preschool Grants, Part B, Section 619 | 84.173 | 13430 | 34,525 |
| IDEA, Mental Health Allocation Plan, Part B, Section 611 | 84.027A | 14468 | 103,412 |
| IDEA, Preschool Staff Development, Part B, Section 619 | 84.173A | 13431 | 367 |
| Carl Perkins Act: | | | |
| Vocational and Applied Technology | 84.048 | 14894 | 56,507 |
| Adult Education Act: | | | |
| Adult Basic Education | 84.002A | 14508 | 33,812 |
| Adult Secondary Education | 84.002 | 13978 | 46,004 |
| English Literacy and Civics Education | 84.002A | 14109 | 10,000 |
| Subtotal | | | <u>3,752,837</u> |
| U.S. DEPARTMENT OF AGRICULTURE | | | |
| Passed through CDE: | | | |
| Child Nutrition Act | | | |
| National School Lunch Program | 10.555 | 13391 | 1,161,860 |
| Basic School Breakfast | 10.553 | 13390 | 11,854 |
| Especially Needy Breakfast | 10.553 | 13526 | 508,498 |
| Meal Supplement | 10.556 | 13568 | 30,719 |
| Child and Adult Care Food Program | 10.558 | N/A | 68,816 |
| Commodity Supplemental Food Program ¹ | 10.555 | 13524 | 353,961 |
| Subtotal | | | <u>2,135,708</u> |
| U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES | | | |
| Passed through CDE: | | | |
| Medi-Cal Billing Option | 93.778 | 10013 | 100,264 |
| Total Expenditures of Federal Awards | | | <u>\$ 5,988,809</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, 2014

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> |
|-------------------|----------------|---------------------|
| Don Moody | President | 2014 |
| Shelle Thomas | Vice President | 2014 |
| Ron Woolf | Member | 2014 |
| Bob Benevento | Member | 2016 |
| Claudia Rossi | Member | 2014 |
| Rick Badillo | Member | 2016 |
| Amy Porter Jensen | Member | 2016 |

ADMINISTRATION

| | |
|---------------------------|--------------------------------------------------|
| Steve Betando | Interim Superintendent |
| Kirsten Perez | Assistant Superintendent of Business Services |
| Sharon Fawn Myers | Assistant Superintendent of Human Resources |
| Dr. Norma Martinez-Palmer | 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, 2014

| | Final Report | |
|--------------------------------------------------------------------|-------------------------|------------------|
| | Second Period Report | Annual Report |
| Regular ADA | | |
| Transitional kindergarten through third | 2,560 | 2,559 |
| Fourth through sixth | 1,883 | 1,881 |
| Seventh and eighth | 1,206 | 1,202 |
| Ninth through twelfth | 2,540 | 2,510 |
| Total Regular ADA | <u>8,189</u> | <u>8,151</u> |
| Extended Year Special Education | | |
| Transitional kindergarten through third | 3 | 3 |
| Fourth through sixth | 3 | 3 |
| Seventh and eighth | 1 | 1 |
| Ninth through twelfth | 1 | 1 |
| Total Extended Year Special Education | <u>8</u> | <u>8</u> |
| Special Education, Nonpublic, Nonsectarian Schools | | |
| Transitional kindergarten through third | 2 | 2 |
| Fourth through sixth | 1 | 1 |
| Seventh and eighth | 2 | 3 |
| Ninth through twelfth | 5 | 5 |
| Total Special Education, Nonpublic, Nonsectarian Schools | <u>10</u> | <u>11</u> |
| Extended Year Special Education - Non public, Nonsectarian Schools | | |
| Transitional kindergarten through third | - | - |
| Fourth through sixth | 1 | 1 |
| Seventh and eighth | - | - |
| Ninth through twelfth | 1 | - |
| Total Extended Year School | <u>2</u> | <u>1</u> |
| Total ADA | <u>8,208</u> | <u>8,171</u> |

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF INSTRUCTIONAL TIME FOR THE YEAR ENDED JUNE 30, 2014

| Grade Level | 1986-87 Minutes Requirement | Reduced 1986-87 Minutes Requirement | 2013-14 Actual Minutes | Number of Days Traditional Calendar | Status |
|--------------|-----------------------------------|----------------------------------------------|------------------------------|----------------------------------------------|----------|
| Kindergarten | 36,000 | 35,000 | 37,425 | 180 | Complied |
| Grade 1 | 50,400 | 49,000 | 50,925 | 180 | Complied |
| Grade 2 | 50,400 | 49,000 | 50,925 | 180 | Complied |
| Grade 3 | 50,400 | 49,000 | 50,925 | 180 | Complied |
| Grade 4 | 54,000 | 52,500 | 54,525 | 180 | Complied |
| Grade 5 | 54,000 | 52,500 | 54,525 | 180 | Complied |
| Grade 6 | 54,000 | 52,500 | 54,525 | 180 | Complied |
| Grade 7 | 54,000 | 52,500 | 54,525 | 180 | Complied |
| Grade 8 | 54,000 | 52,500 | 54,525 | 180 | Complied |
| Grade 9 | 64,800 | 63,000 | 64,890 | 180 | Complied |
| Grade 10 | 64,800 | 63,000 | 64,890 | 180 | Complied |
| Grade 11 | 64,800 | 63,000 | 64,890 | 180 | Complied |
| Grade 12 | 64,800 | 63,000 | 64,890 | 180 | 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, 2014

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

| | <u>General</u> | <u>Special Reserve Other</u> | <u>Special Reserve Retiree Benefits</u> |
|----------------------------------------------------------------------------------------------------------------------------------|----------------------|----------------------------------|---------------------------------------------|
| FUND BALANCE | | | |
| Balance, June 30, 2014, Unaudited Actuals | \$ 24,047,127 | \$ 2,558,488 | \$ 561,585 |
| As a result of the implementation of GASB Statement No. 54, Fund 17 and Fund 20 are combined into the financial statement. | 3,120,073 | (2,558,488) | (561,585) |
| Balance, June 30, 2014, Audited Financial Statement | <u>\$ 27,167,200</u> | <u>\$ -</u> | <u>\$ -</u> |

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2014

| | (Budget) | | | |
|--------------------------------------------------------------------------|-----------------------|-----------------------|-----------------------|----------------------|
| | 2015 ¹ | 2014 | 2013 | 2012 |
| GENERAL FUND⁴ | | | | |
| Revenues | \$ 70,765,454 | \$ 69,867,527 | \$ 68,459,432 | \$ 66,240,909 |
| Transfers in | 142,000 | 1,661,500 | 185,812 | 133,790 |
| Total Revenues and Transfers In | 70,907,454 | 71,529,027 | 68,645,244 | 66,374,699 |
| Expenditures | 67,870,889 | 65,708,639 | 62,854,643 | 63,513,602 |
| Transfers out | 1,176,042 | 3,894,079 | 416,000 | 916,000 |
| Total Expenditures and Transfers Out | 69,046,931 | 69,602,718 | 63,270,643 | 64,429,602 |
| INCREASE (DECREASE) IN FUND BALANCE | \$ 1,860,523 | \$ 1,926,309 | \$ 5,374,601 | \$ 1,945,097 |
| ENDING FUND BALANCE | \$ 25,907,649 | \$ 24,047,126 | \$ 22,120,817 | \$ 16,746,216 |
| AVAILABLE RESERVES² | \$ 14,744,952 | \$ 16,091,821 | \$ 12,004,602 | \$ 8,699,663 |
| AVAILABLE RESERVES AS A PERCENTAGE OF TOTAL OUTGO³ | 21.35% | 23.12% | 18.97% | 13.50% |
| LONG-TERM OBLIGATIONS | \$ 125,963,920 | \$ 134,554,285 | \$ 135,670,683 | \$ 81,280,346 |
| K-12 AVERAGE DAILY ATTENDANCE AT P-2 | 8,287 | 8,208 | 8,321 | 8,374 |

The General Fund balance has increased by \$7,300,911 over the past two years. The fiscal year 2014-2015 budget projects a increase of \$1,860,523 (8 percent) in General Fund balance. For a district this size, the State recommends available reserves of at least 3 percent of total General Fund expenditures, transfers out, and other uses (total outgo).

The District has incurred an operating surplus in the past three years, but anticipates incurring an operating deficit during the 2014-2015 fiscal year. Total long-term obligations have increased by \$53,273,939 over the past two years.

Average daily attendance has decreased by 166 over the past two years. The ADA is expected to increase 79 during fiscal year 2014-2015.

¹ Budget 2015 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.

³ On-behalf payments of \$1,622,011, \$1,521,813, and \$1,627,081, have been excluded from this schedule for fiscal year ending June 30, 2014, 2013 and 2012, 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, 2014**

| <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.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NON-MAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
JUNE 30, 2014**

| | Adult Education Fund | Child Development Fund | Cafeteria Fund |
|--------------------------------------------|-------------------------------------|---------------------------------------|---------------------------|
| ASSETS | | | |
| Deposits and investments | \$ 382,283 | \$ 43,346 | \$ 752,523 |
| Receivables | 49,601 | 27,154 | 274,387 |
| Due from other funds | - | - | - |
| Stores inventories | - | - | 1,826 |
| Total Assets | \$ 431,884 | \$ 70,500 | \$ 1,028,736 |
| LIABILITIES AND FUND BALANCES | | | |
| Liabilities: | | | |
| Accounts payable | \$ 4,192 | \$ 60,661 | \$ 9,448 |
| Due to other funds | 100,922 | 9,838 | 119,078 |
| Total Liabilities | 105,114 | 70,499 | 128,526 |
| Fund Balances: | | | |
| Nonspendable | 5,000 | - | 2,826 |
| Restricted | 36,376 | 1 | 897,384 |
| Committed | 285,394 | - | - |
| Total Fund Balances | 326,770 | 1 | 900,210 |
| Total Liabilities and Fund Balances | \$ 431,884 | \$ 70,500 | \$ 1,028,736 |

See accompanying note to supplementary information

| Deferred Maintenance Fund | Capital Facilities Fund | Capital Projects Fund | Total Non-Major Governmental Funds |
|------------------------------------------|----------------------------------------|--------------------------------------|---------------------------------------------------|
| \$ 28,225 | \$ 5,996,225 | \$ 1,703,231 | \$ 8,905,833 |
| 72 | 5,347 | 1,488 | 358,049 |
| 306,052 | - | - | 306,052 |
| - | - | - | 1,826 |
| <u>\$ 334,349</u> | <u>\$ 6,001,572</u> | <u>\$ 1,704,719</u> | <u>\$ 9,571,760</u> |
| | | | |
| \$ 291 | \$ 21,129 | \$ 35,000 | \$ 130,721 |
| - | 81,882 | - | 311,720 |
| <u>291</u> | <u>103,011</u> | <u>35,000</u> | <u>442,441</u> |
| | | | |
| - | - | - | 7,826 |
| - | 5,898,561 | 1,669,719 | 8,502,041 |
| 334,058 | - | - | 619,452 |
| <u>334,058</u> | <u>5,898,561</u> | <u>1,669,719</u> | <u>9,129,319</u> |
| | | | |
| <u>\$ 334,349</u> | <u>\$ 6,001,572</u> | <u>\$ 1,704,719</u> | <u>\$ 9,571,760</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, 2014**

| | Adult Education Fund | Child Development Fund | Cafeteria Fund |
|----------------------------------------------------------|-------------------------------------|---------------------------------------|---------------------------|
| REVENUES | | | |
| Federal sources | \$ 89,816 | \$ - | \$ 1,781,747 |
| Other state sources | 12,228 | 169,888 | 140,946 |
| Other local sources | 38,358 | 152 | 578,063 |
| Total Revenues | <u>140,402</u> | <u>170,040</u> | <u>2,500,756</u> |
| EXPENDITURES | | | |
| Current | | | |
| Instruction | 251,490 | 160,201 | - |
| Instruction-related activities: | | | |
| School site administration | 236,850 | - | - |
| Pupil services: | | | |
| Food services | - | - | 2,270,328 |
| General administration: | | | |
| All other general administration | 25,364 | 9,838 | 119,078 |
| Plant services | 15,487 | - | - |
| Facility acquisition and construction | - | - | - |
| Total Expenditures | <u>529,191</u> | <u>170,039</u> | <u>2,389,406</u> |
| Excess (Deficiency) of Revenues Over Expenditures | <u>(388,789)</u> | <u>1</u> | <u>111,350</u> |
| Other Financing Uses: | | | |
| Transfers in | 349,072 | - | 198,767 |
| Transfers out | - | - | - |
| Net Financing Uses | <u>349,072</u> | <u>-</u> | <u>198,767</u> |
| NET CHANGE IN FUND BALANCES | <u>(39,717)</u> | <u>1</u> | <u>310,117</u> |
| Fund Balance - Beginning | 366,487 | - | 590,093 |
| Fund Balance - Ending | <u>\$ 326,770</u> | <u>\$ 1</u> | <u>\$ 900,210</u> |

See accompanying note to supplementary information

| Deferred Maintenance Fund | Capital Facilities Fund | Capital Projects Fund | Total Non-Major Governmental Funds |
|------------------------------------------|----------------------------------------|--------------------------------------|---------------------------------------------------|
| \$ - | \$ - | \$ - | \$ 1,871,563 |
| - | - | - | 323,062 |
| 1,124 | 2,470,279 | 509,565 | 3,597,541 |
| 1,124 | 2,470,279 | 509,565 | 5,792,166 |
| - | - | - | 411,691 |
| - | - | - | 236,850 |
| - | - | - | 2,270,328 |
| - | - | - | 154,280 |
| 501,814 | 78,852 | 1,940 | 598,093 |
| - | 784,426 | 188,292 | 972,718 |
| 501,814 | 863,278 | 190,232 | 4,643,960 |
| (500,690) | 1,607,001 | 319,333 | 1,148,206 |
| 306,052 | - | - | 1,890,061 |
| - | (73,482) | - | (73,482) |
| 306,052 | (73,482) | - | 1,816,579 |
| (194,638) | 1,533,519 | 319,333 | 1,928,615 |
| 528,696 | 4,365,042 | 1,350,386 | 7,200,704 |
| \$ 334,058 | \$ 5,898,561 | \$ 1,669,719 | \$ 9,129,319 |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION JUNE 30, 2014

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 United States Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

| Description | CFDA Number | Amount |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|---------------------|
| Total Federal Revenues Statement of Revenues, Expenditures and Changes in Fund Balance: | | \$ 6,326,649 |
| 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 | (691,801) |
| Commodities are not recorded on the financial statement. | 10.555 | 353,961 |
| Total Schedule of Expenditures of Federal Awards | | <u>\$ 5,988,809</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, 2014

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***

Board of Trustees
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, 2014, 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 _____, 2014.

Emphasis of matter regarding the adoption of our report included in

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. 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

_____, 2014



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR
EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL
OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133**

Board of Trustees
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 Circular A-133 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, 2014. Morgan Hill Unified School District's (the District) 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 requirements of laws, regulations, contracts, and grants 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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about 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.

Unmodified Opinion on Each Major Federal Programs

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 other major Federal programs identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs for the year ended June 30, 2014.

Other Matters

The results of our auditing procedures disclosed other instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2014-001. Our opinion on each major Federal program is not modified with respect to these matters.

Morgan Hill Unified School District's response to the noncompliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Morgan Hill Unified School District's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

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 OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Morgan Hill Unified School District's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and significant deficiencies.

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. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2004-001.

Morgan Hill Unified School District's response to the internal control over compliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Morgan Hill Unified School District's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

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 OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Palo Alto, California

_____, 2014



INDEPENDENT AUDITOR'S REPORT ON STATE COMPLIANCE

Board of Trustees
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 *Standards and Procedures for Audit of California K-12 Local Educational Agencies 2013-2014* 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, 2014.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its State's 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 *Standards and Procedures for Audits of California K-12 Local Educational Agencies 2013-2014*. 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.

Basis for Qualified Opinion for Public Hearing for Instructional Material

As described in the accompanying schedule of findings and questioned costs 2014-002, Morgan Hill Unified School District did not comply with requirements regarding Public Hearing for Instructional Material. Compliance with such requirements is necessary, in our opinion, for Morgan Hill Unified School District to comply with the requirements applicable to that program.

Qualified Opinion

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, Morgan Hill Unified School District complied, in all material respects, with the types of compliance requirements referred to above for the year ended June 30, 2014.

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, 2014, except as described in the Schedule of State Awards Findings and Questioned Costs section of the accompanying Schedule of Findings and Questioned Costs.

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 in Audit Guide</u> | <u>Procedures Performed</u> |
|---------------------------------------------------------|--------------------------------------|---------------------------------|
| Attendance Accounting: | | |
| Attendance Reporting | 6 | Yes |
| Teacher Certification and Misassignments | 3 | Yes |
| Kindergarten Continuance | 3 | Yes |
| Independent Study | 23 | Yes |
| Continuation Education | 10 | Yes |
| Instructional Time: | | |
| School Districts | 10 | Yes |
| Instructional Materials: | | |
| General Requirements | 8 | Yes |
| Ratios of Administrative Employees to Teachers | 1 | Yes |
| Classroom Teacher Salaries | 1 | Yes |
| Early Retirement Incentive | 4 | Not Applicable |
| Gann Limit Calculation | 1 | Yes |
| School Accountability Report Card | 3 | Yes |
| Juvenile Court Schools | 8 | Not Applicable |
| Local Control Funding Formula Certification | 1 | Yes |
| California Clean Energy Jobs Act | 3 | No |
| After School Education and Safety Program: | | |
| General Requirements | 4 | Yes |
| After School | 5 | Yes |
| Before School | 6 | Not Applicable |
| Education Protection Account Funds | 1 | Yes |
| Common Core Implementation Funds | 3 | Yes |
| Unduplicated Local Control Funding Formula Pupil Counts | 3 | Yes |

| | <u>Procedures in Audit Guide</u> | <u>Procedures Performed</u> |
|--------------------------------------------------------------|--------------------------------------|---------------------------------|
| Charter Schools: | | |
| Contemporaneous Records of Attendance | 8 | Not Applicable |
| Mode of Instruction | 1 | Not Applicable |
| Non Classroom-Based Instruction/Independent Study | 15 | Not Applicable |
| Determination of Funding for Non Classroom-Based Instruction | 3 | Not Applicable |
| Annual Instruction Minutes Classroom-Based | 4 | Not Applicable |
| Charter School Facility Grant Program | 1 | Not Applicable |

We did not test the California Clean Energy Jobs Act because the District did not expend of those funds in the current fiscal year.

Palo Alto, California
 _____, 2014

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SUMMARY OF AUDITOR’S RESULTS
FOR THE YEAR ENDED JUNE 30, 2014**

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>Yes</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 .510(a) of OMB A-133 | <u>Yes</u> |
| Identification of major programs: | <u>Unmodified</u> |

| <u>CFDA Number(s)</u> | <u>Name of Federal Program or Cluster</u> |
|-----------------------|----------------------------------------------------------------|
| <u>84.365</u> | <u>Title III - Limited English Proficiency Student Program</u> |
| <u>10.555,10.553</u> | <u>Child Nutrituion Cluster</u> |
| <u>84.011</u> | <u>Migrant Education</u> |

| | |
|--------------------------------------------------------------------------|-------------------|
| Dollar threshold used to distinguish between Type A and Type B programs: | <u>\$ 300,000</u> |
| Auditee qualified as low-risk auditee? | <u>Yes</u> |

STATE AWARDS

| | |
|-----------------------------------------------------------------|------------------|
| Type of auditor's report issued on compliance for all programs: | <u>Qualified</u> |
|-----------------------------------------------------------------|------------------|

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FINANCIAL STATEMENT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2014**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2014

Finding: 2014-01

Program: Title III – Limited English Proficiency (LEP) Student Program

CFDA No.: 84.365

Federal Grantor: U.S. Department of Education

Passed-through: Not Applicable, Direct Grant

Award No.: Various

Award Fiscal Year: 2014

Compliance Requirement: Activities Allowed/Allowable Costs

Five Digit Code: 5000

AB 3627 Finding Types: Federal Compliance

Criteria:

The Supplement not Supplant requirement under the Federal compliance of Matching, Level of Effort, Earmarking requires that a District may use program funds only to supplement and, to the extent practical, increase the level of funds that would, in the absence of the Federal funds, be made available from non-Federal sources for the education of participating students. In no case may an LEA use Federal program funds to supplant funds from non-Federal sources.

Condition:

During our testing of compliance with the Matching, Level of Effort, Earmarking requirements, it was noted that Morgan Hill Unified School District (the District) purchased core curriculum materials and textbooks for the ELD and dual immersion programs.

Questioned Costs:

\$14,409

Context:

The condition noted above was identified during our examination of the District's compliance with the Supplement not Supplant requirement under Matching, Level of Effort, Earmarking federal compliance.

Effect:

Title III – Limited English Proficiency funds were spent on core curriculum materials and textbooks for the ELD and dual immersion programs. The requirement is to spend the funds on supplemental curriculum materials.

Recommendation:

We recommend the District to reverse of the funds to an allowable funding source.

Views of Responsible Official:

Section 3301 defines an educational language instruction program as a class “that may make instructional use of both English and the native language to enable the child to develop and attain English proficiency, and may include the participation of English proficient children if such course is designed to enable all participating children to become proficient in English and a second language.” Section 3315(d)(7)(A) states that Title III funds may be used for “the acquisition or development of educational technology or instructional materials.” In addition the posted Frequently Asked Questions on the California Department of Education website provides similar guidance stating that using Title III funds to support a bilingual education program is allowable. The District paid for and provided the English versions of all required textbooks using non-federal funds; however, the

MORGAN HILL UNIFIED SCHOOL DISTRICT

FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2014

Spanish versions were additional texts and therefore are an allowable expenditure because they are supplemental and only provided to the support a bilingual program.

In regard to ELD materials, the State has not provided State adopted ELD materials, the materials purchased for ELD instruction were purchased to supplement the ELA core curriculum materials. The District has sent a letter to CDE Federal Program Unit contesting the finding

MORGAN HILL UNIFIED SCHOOL DISTRICT

STATE AWARDS FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2014

Finding: 2014-02

Program: Public Hearing of Instructional Material

Five Digit Code: 5000

AB 3627 Finding Types: State Compliance

Criteria:

The State requires Districts to conduct a public hearing for instructional materials within the first eight weeks of the first day of instruction.

Condition:

It was noted that the District conducted the public hearing for instructional materials on 11/12/13. The first day of instruction was on 8/15/13. Therefore, the public hearing was not within first eight weeks of instruction.

Questioned Costs:

None

Context:

The State requires Districts to meet specific criteria relating to instructional materials per State guidelines.

Effect:

Not meeting this compliance requirement may subject the District to additional action from government oversight agencies.

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.

Views of Responsible Official:

In prior years the District has held public hearings and adopted the corresponding resolution within the required timeframe. This year the District was unable to hold the public hearing within the first eight weeks of school due to the ten day posting period requirement for public hearings. The District conducted the initial public hearing on October 22, 2013. As a result of comments made at this public hearing, staff conducted a supplemental on-site visit at Central High School to verify instructional materials. A second public hearing was held on November 12, 2013 at which time to Board adopted the resolution for the sufficiency of instructional materials.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2014**

There were no audit findings reported in the prior year's schedule of financial statement findings.