

**MORGAN HILL UNIFIED
SCHOOL DISTRICT**

ANNUAL FINANCIAL REPORT

JUNE 30, 2011

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

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, 2011, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. 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; 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 Educational Agencies 2010-11*, 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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, 2011, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in the Notes to the basic financial statements, the accompanying financial statements reflect certain changes required as a result of the implementation of GASB Statement No. 54 for the year ended June 30, 2011. These changes required a restatement to the beginning fund balance of the General Fund and the Non-Major Governmental Funds, as discussed in Note 17.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 28, 2011, on our consideration of the 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

Management's discussion and analysis and the required supplementary information, such as budgetary comparison, and other postemployment information, are not a required part of the basic financial statements, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's basic financial statements. The supplementary information listed in the table of contents, including the Schedule of Expenditures of Federal Awards which is required by U.S. Office of Management and Budget Circular A-133, *Audits of State, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Wassinek, Trine, Day & Co., LLP

Palo Alto, California
November 28, 2011

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2011

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, 2011. 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 in taking action to make the very difficult necessary budget reductions ensuring the district maintains its fiscal solvency.
- The District maintains sufficient reserves for a district its size. It meets the state required reserve for economic uncertainty of 3% of total general fund expenditures, transfers out, and other uses.
- Fiscal Services staff met with school site and program managers to review budget monitoring and provide training on appropriate use of expenditures.
- The District followed recommendations from School Services and swept Tier III carryover to reduce budget reductions.
- Steps were taken in March to close spending one month earlier in order to control year end spending, resulting in a larger ending balance. During fiscal year 2010-11 general fund expenditures and other financing uses totaled \$67.3 million.
- Long-term liabilities on outstanding general obligation bonds decreased by \$3.1 million due to combination of \$4.7 million payments and \$1.6 accreted interest in the current year.
- Certificates of Participation (COPs) were issued during fiscal year 2010-11 for solar panel installation at the two high schools. At the end of the fiscal year, the COPs had an outstanding balance of \$13.5 million.
- At June 30, 2011, the District had available reserves of \$8.5 million in the general fund representing a reserve of 12.94% of total general fund expenditures.
- The District's financial status remains fiscally stable due to projecting and implementing the appropriate budget reductions thus enabling the district to continue to file a positive certification.

MORGAN HILL UNIFIED SCHOOL DISTRICT

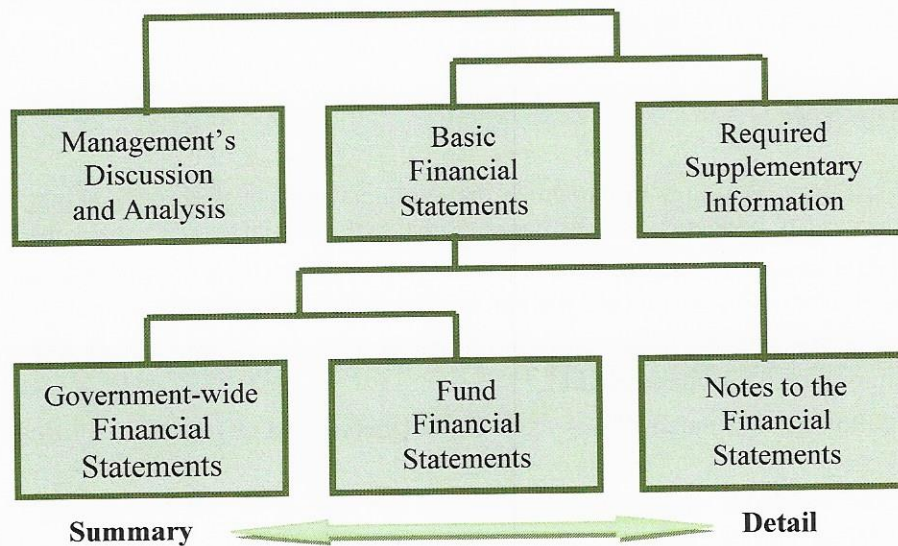
MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2011

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 Assets 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, 2011

REPORTING THE DISTRICT AS A WHOLE

The Statement of Net Assets 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 assets includes all the District's assets and liabilities using the accrual basis of accounting. This basis of accounting takes into accounts 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 2010-2011?"

These two statements report the School District's net assets and changes in those assets. This change in net assets 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 assets, 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, 2011

◆ 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 Assets. 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

The District's net assets were \$143.2 million at June 30, 2010. Of this amount \$13.7 million was unrestricted. For the period ending June 30, 2011, the District's net assets increased to \$150.0 million, or 4.74% increase. Of this amount \$15.8 million was unrestricted.

(Table 1)
Comparative Statement of Net Assets

	Governmental Activities	
	2011	2010
Deposits and investments	\$ 27,985,531	\$ 29,280,492
Receivables	7,998,154	4,609,839
Deferred charges	1,265,696	1,094,851
Stores inventory	48,273	149,163
Other postemployment assets	116,782	128,255
Capital assets	200,462,297	186,273,073
Total Assets	237,876,733	221,535,673
Accounts payable and other current liabilities	2,912,174	3,436,718
Deferred revenue	1,250,472	999,178
Long-term liabilities	83,745,463	73,919,574
Total Liabilities	87,908,109	78,355,470
Net assets		
Invested in capital assets, net of related debt	122,760,463	118,321,295
Restricted	11,422,881	11,203,245
Unrestricted	15,785,280	13,655,663
Total Net Assets	\$ 149,968,624	\$ 143,180,203

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2011

The District's net asset position increased by \$6,788,421 for this fiscal year (see Table 1). The District's expenses for instruction and pupil services represented 77 percent of total expenses. The purely administrative activities of the District account for just 5 percent of total costs. The remaining 18 percent 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 Statement of Change in Net Assets

	Governmental Activities	
	2011	2010
Revenues		
Program revenues:	\$ 16,713,652	\$ 17,011,031
General revenues:		
Taxes levied for general purposes	40,267,195	44,765,725
Taxes levied for debt service	8,023,643	7,306,259
Taxes levied for other specific purpose	943,955	683,462
Federal and state aid not restricted to specific purposes	12,853,111	7,377,008
Interest and investment earnings	219,966	322,216
Miscellaneous	10,834,936	3,407,509
Total Revenues	89,856,458	80,873,210
Expenses		
Instruction	47,694,932	47,603,282
Instruction related services	7,980,988	7,915,326
Pupils support services	8,433,848	7,992,866
General administration	4,094,765	4,502,883
Plant services	6,340,503	6,024,944
Other	8,523,001	7,652,179
Total Expenses	83,068,037	81,691,480
Increase In Net Assets	\$ 6,788,421	\$ (818,270)

MORGAN HILL UNIFIED SCHOOL DISTRICT

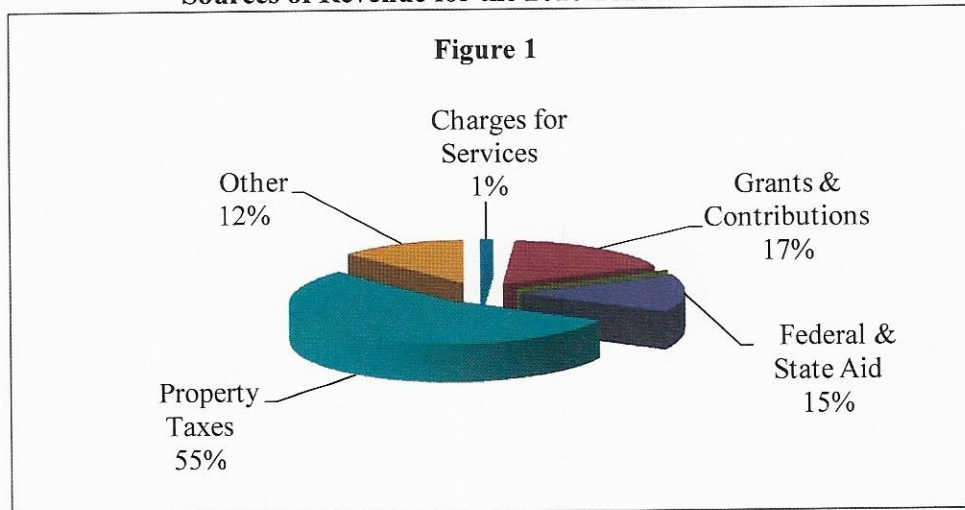
MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2011

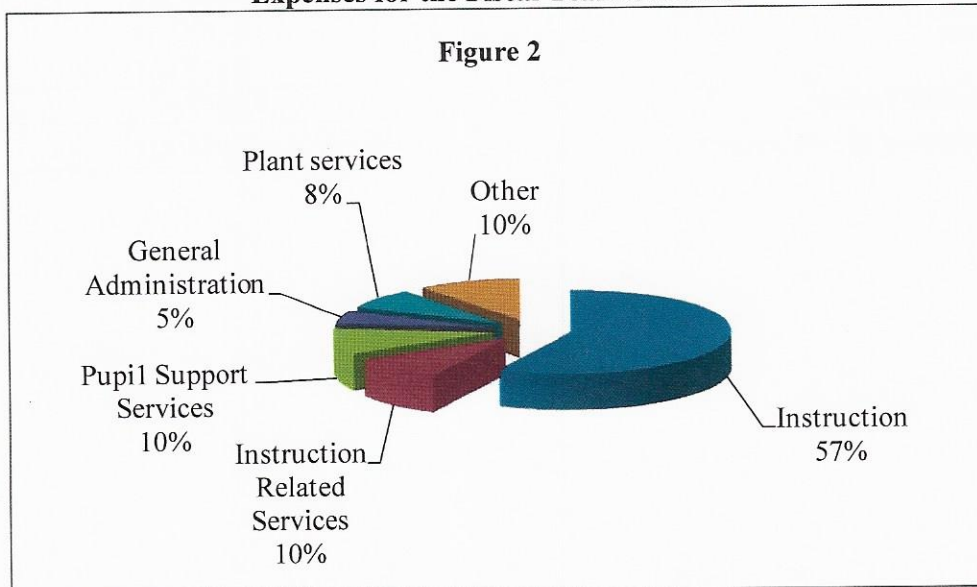
Governmental Activities

As reported in the Statement of Activities, the cost of all the District's governmental activities this year was \$83 million. The amount that our local taxpayers financed for these activities through property taxes was \$49.2 million. Federal and State aid not restricted to specific purposes total \$12.9 million. State and Federal Categorical program revenues which include charges for services and sales of \$1.1 million and operating grants and contributions of \$15.6 million totaling over \$16.7 million, or 19% of the revenue of the entire District (See Figure 1).

Sources of Revenue for the 2010-2011 Fiscal Year



Expenses for the Fiscal Year 2010-2011



MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2011

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 \$32.9 million, an increase of \$2.2 million from the previous fiscal year. This increase is primarily the result of a decrease in expenditures in the General Fund. The General Fund balance increased \$1.6 million.

General Fund Budgetary Highlights

Over the course of the year, the District revised the annual operating budget monthly. 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 \$16.8 million. The State recommends an ending reserve for economic uncertainties of 3%. The District's ending reserve for economic uncertainty was 3%.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2011

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

By the end of the 2010-2011 fiscal year, the District had investments of \$248.8 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 \$200.5 million at June 30, 2011 which is an increase of \$14.2 million from the previous year due to the addition of Sobrato High School land donation and solar panel construction project.

(Table 3)
Comparative Schedule of Capital Assets
(net of depreciation)
June 30, 2011 and 2010

	2011	2010	Difference	Percentage Change
Land	\$ 7,467,149	\$ 724,021	\$ 6,743,128	931.3%
Buildings & Improvements	190,667,726	182,434,391	8,233,335	4.5%
Machinery & Equipment	2,327,422	2,580,057	(252,635)	-9.8%
Work In Progress	-	534,604	(534,604)	-100.0%
Totals	\$ 200,462,297	\$ 186,273,073	\$ 14,189,224	7.6%

Long-Term Obligations

As of June 30, 2011, the District had \$83.7 million in long-term obligations outstanding.

(Table 4)
Comparative Schedule of Outstanding Debt
June 30, 2011 and 2010

	2011	2010
General obligation bonds (Including premiums, accretions and defeasance costs)	\$ 70,099,420	\$ 73,614,583
Certificates of participation	13,283,567	-
Compensated absences	362,506	304,991
Totals	\$ 83,745,493	\$ 73,919,574

The long-term obligations paid by the District were \$4.9 million.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2011

FACTORS BEARING ON THE DISTRICT'S FUTURE

Under the leadership of superintendent, Dr. Wesley Smith, 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. The Morgan Hill Unified School District has set the following goals:

- **STUDENT ACHIEVEMENT:** Student achievement is at the core of all of our district goals. We believe that students succeed best in an exciting and challenging environment where they are actively engaged in the learning process.
- **HIGHLY QUALIFIED AND DEDICATED EMPLOYEES:** We value, respect, and support our highly qualified and dedicated staff of classified, certificated and administrative employees who are committed to academic achievement for all students.
- **RESPONSIBLE FINANCIAL PRACTICES:** In a dynamic financial environment, the district will continue to ensure students' academic success. The district will maintain fiscal solvency and align priorities to expenses to support critical educational programs, by applying sound financial principles and practices.
- **SAFE, HEALTHY, AND SUSTAINABLE ENVIRONMENT:** By maintaining, modernizing and constructing facilities and providing appropriate services, the district will support students and staff in their educational endeavors. We will work to create schools that are safe; menus and programs that promote healthy living; and energy usage policies that are sustainable.
- **PARTNERSHIP THROUGH COMMUNICATION:** We appreciate the strong support network of parents and community members who work side-by-side with us, providing resources and enrichment that we would not otherwise have for our students.

The Morgan Hill Unified School District has five elementary schools in Program Improvement. Jackson Elementary and Walsh Elementary, each in year five of Program Improvement, have dedicated categorical resources and intensive staff development to assist the schools in working with their English language learner students. The District continues to focus on assisting the students, parents and staff to ensure appropriate support to close this achievement gap.

The District provides post-employment health care benefits in accordance with District 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. Currently a total of 210 employees meet these eligibility requirements. During the 2010-11 school year, expenditures of \$559,300 were recognized for retiree's health care benefits. In July, 2009 the District implemented GASB 45 (Governmental Accounting Standards Board 45) by establishing Fund 20 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.

Financially, we will continue to meet our obligations and maintain a 3% economic uncertainty reserve. The District will strive to achieve the goals defined by the Morgan Hill Board of Education; student achievement, fiscal solvency, and safe and orderly environment.

Stabilization of the State's economic health is desirable and would be beneficial to the District's financial environment. The Morgan Hill Board of Education and management will continue to provide the resources to ensure the support of our student's needs and capabilities.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2011

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 second year in a row. The chart below depicts actual ADA for 2007-2011.

<u>ADA P-2</u>	<u>2006-2007</u>	<u>2007-2008</u>	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Elementary	5,738.38	5,825.40	5,939.36	5,858.56	5,808.59
High School	2,729.65	2,769.16	2,812.69	2,821.06	2,733.02
Total ADA	8,468.03	8,594.56	8,752.05	8,679.62	8,541.61
ADA Change	137.34	126.53	157.49	(72.43)	(138.01)
% Change	1.65%	1.49%	1.83%	-0.83%	-1.59%

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 Kirsten Perez, Director of Fiscal Services, Morgan Hill Unified School District, 15600 Concord Circle, Morgan Hill, CA 95037.

MORGAN HILL UNIFIED SCHOOL DISTRICT

STATEMENT OF NET ASSETS

JUNE 30, 2011

	Governmental Activities
ASSETS	
Deposits and investments	\$ 27,985,531
Receivables	7,998,154
Deferred charges	1,265,696
Stores inventories	48,273
Other postemployment benefit asset	116,782
Capital assets not depreciated	7,467,149
Capital assets, net of accumulated depreciation	192,995,148
Total Assets	237,876,733
LIABILITIES	
Accounts payable	1,841,382
Interest payable	1,070,792
Deferred revenue	1,250,472
Current portion of long-term obligations	5,604,767
Noncurrent portion of long-term obligations	78,140,696
Total Liabilities	87,908,109
NET ASSETS	
Invested in capital assets, net of related debt	122,760,463
Restricted for:	
Legally restricted	3,514,094
Debt service	5,673,904
Capital projects	2,234,883
Unrestricted	15,785,280
Total Net Assets	\$ 149,968,624

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, 2011

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenues and Changes in Net Assets
		Charges for Services and Sales	Operating Grants and Contributions	
Governmental Activities:				
Instruction	\$ 47,694,932	\$ 59,842	\$ 8,852,684	\$ (38,782,406)
Instruction-related activities:				
Supervision of instruction	1,365,802	2,227	395,115	(968,460)
Instructional library and technology	225,560	529	5,903	(219,128)
School site administration	6,389,626	77	534,114	(5,855,435)
Pupil services:				
Home-to-school transportation	2,903,833	203,459	1,469,388	(1,230,986)
Food services	2,703,414	715,397	1,855,162	(132,855)
All other pupil services	2,826,601	-	661,366	(2,165,235)
General administration:				
Data processing	728,224	-	-	(728,224)
All other general administration	3,366,541	41,767	526,681	(2,798,093)
Plant services	6,340,503	72,132	46,002	(6,222,369)
Ancillary services	544,535	-	-	(544,535)
Community services	15,635	-	-	(15,635)
Interest on long-term obligations	4,722,052	-	-	(4,722,052)
Other outgo	3,240,779	13,285	1,258,522	(1,968,972)
Total Governmental-Type Activities	\$ 83,068,037	\$ 1,108,715	\$ 15,604,937	(66,354,385)
General revenues and subventions:				
Property taxes, levied for general purposes				40,267,195
Property taxes, levied for debt service				8,023,643
Taxes levied for other specific purposes				943,955
Federal and state aid not restricted to specific purposes				12,853,111
Interest and investment earnings				219,966
Miscellaneous				10,834,936
Subtotal, General Revenues				73,142,806
Change in Net Assets				6,788,421
Net Assets - Beginning				143,180,203
Net Assets - Ending				\$ 149,968,624

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, 2011

	General Fund	Building Fund	Bond Interest and Redemption Fund
ASSETS			
Deposits and investments	\$ 12,464,122	\$ 5,643,590	\$ 6,739,267
Receivables	7,426,642	37,533	5,429
Due from other funds	30	-	-
Stores inventories	46,380	-	-
Total Assets	<u>\$ 19,937,174</u>	<u>\$ 5,681,123</u>	<u>\$ 6,744,696</u>
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 1,839,474	\$ -	\$ -
Due to other funds	-	-	-
Deferred revenue	1,250,472	-	-
Total Liabilities	<u>3,089,946</u>	<u>-</u>	<u>-</u>
Fund Balances:			
Nonspendable	60,880	-	-
Restricted	1,498,310	5,681,123	6,744,696
Committed	-	-	-
Assigned	6,747,844	-	-
Unassigned	8,540,194	-	-
Total Fund Balances	<u>16,847,228</u>	<u>5,681,123</u>	<u>6,744,696</u>
Total Liabilities and Fund Balances	<u>\$ 19,937,174</u>	<u>\$ 5,681,123</u>	<u>\$ 6,744,696</u>

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

Non Major Governmental Funds	Total Governmental Funds
\$ 3,138,552	\$ 27,985,531
528,550	7,998,154
-	30
1,893	48,273
<u>\$ 3,668,995</u>	<u>\$ 36,031,988</u>
\$ 1,908	\$ 1,841,382
30	30
-	1,250,472
<u>1,938</u>	<u>3,091,884</u>
7,893	68,773
2,916,198	16,840,327
742,966	742,966
-	6,747,844
-	8,540,194
<u>3,667,057</u>	<u>32,940,104</u>
<u>\$ 3,668,995</u>	<u>\$ 36,031,988</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET ASSETS JUNE 30, 2011

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

Total Fund Balance - Governmental Funds		\$ 32,940,104
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	\$ 248,871,667	
Accumulated depreciation is	<u>(48,409,370)</u>	
Net Capital Assets		200,462,297
Expenditures relating to issuance of long-term debt were recognized on modified accrual basis, but are not capitalized on the statement of net assets.		1,265,696
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.		(1,070,792)
Excess contributions over the annual OPEB cost for other post-employment benefits are recognized as a OPEB asset in the government-wide statements. On the governmental funds, the contribution are treated as expenditures.		116,782
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	70,099,390	
COP payable	13,283,567	
Compensated absences (vacations)	<u>362,506</u>	
Total Long-Term Liabilities		(83,745,463)
Total Net Assets - Governmental Activities		<u>\$ 149,968,624</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 BALANCE FOR THE YEAR ENDED JUNE 30, 2011

	General Fund	Building Fund	Bond Interest and Redemption Fund
REVENUES			
Revenue limit sources	\$ 45,598,746	\$ -	\$ -
Federal sources	5,517,808	650,221	-
Other state sources	11,487,507	-	58,123
Other local sources	6,361,528	127,197	7,985,483
Total Revenues	68,965,589	777,418	8,043,606
EXPENDITURES			
Current	42,311,890	-	-
Instruction			
Instruction-related activities:			
Supervision of instruction	1,223,511	-	-
Instructional library, media and technology	202,055	-	-
School site administration	5,429,740	-	-
Pupil services:			
Home-to-school transportation	2,601,386	-	-
Food services	-	-	-
All other pupil services	2,532,219	-	-
General administration:			
Data processing	652,439	-	-
All other general administration	2,772,159	-	-
Plant services	5,680,992	-	-
Facility acquisition and construction	1,890	13,080,931	-
Ancillary services	486,241	-	-
Community services	14,009	-	-
Other outgo	3,240,779	-	-
Debt service			
Principal	-	45,000	4,660,000
Interest and other	-	1,383,169	2,664,020
Total Expenditures	67,149,310	14,509,100	7,324,020
Excess (Deficiency) of			
Revenues Over Expenditures	1,816,279	(13,731,682)	719,586
Other Financing Sources (Uses):			
Transfers in	25,392	200,000	-
Other sources	-	13,550,000	-
Transfers out	(200,000)	-	-
Net Financing Sources (Uses)	(174,608)	13,750,000	-
NET CHANGE IN FUND BALANCES	1,641,671	18,318	719,586
Fund Balance - Beginning	15,205,557	5,662,805	6,025,110
Fund Balance - Ending	\$ 16,847,228	\$ 5,681,123	\$ 6,744,696

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

Nonmajor Governmental Funds	Total Governmental Funds
\$ -	\$ 45,598,746
1,830,332	7,998,361
1,283,373	12,829,003
2,195,135	16,669,343
5,308,840	83,095,453
561,973	42,873,863
-	1,223,511
-	202,055
294,349	5,724,089
-	2,601,386
2,421,897	2,421,897
-	2,532,219
-	652,439
141,457	2,913,616
259,227	5,940,219
1,757,077	14,839,898
-	486,241
-	14,009
-	3,240,779
-	4,705,000
-	4,047,189
5,435,980	94,418,410
(127,140)	(11,322,957)
-	225,392
-	13,550,000
(25,392)	(225,392)
(25,392)	13,550,000
(152,532)	2,227,043
3,819,589	30,713,061
\$ 3,667,057	\$ 32,940,104

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, 2011

Total Net Change in Fund Balances - Governmental Funds		\$ 2,227,043
<p>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 assets and allocated over their estimated useful lives as annual depreciation expenses in the statement of activities. This is the amount by which capital outlays exceed depreciation in the period.</p>		
Capital outlays	\$ 21,240,272	
Depreciation expense	<u>(6,994,176)</u>	
Net Expense Adjustment		14,246,096
<p>Loss on disposal of capital assets is reported in the government-wide statement of net assets, but is not recorded in the governmental funds.</p>		
		(56,872)
<p>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).</p>		
		(57,515)
<p>Amortization of issuance cost is not recorded in the governmental funds, but it is amortized over the life of the bond in the statement of activities.</p>		
		(139,931)
<p>Amortization of premium, discount and defeasance cost of long-term liabilities is not recognized in the governmental funds. In the government-wide statements, it is deferred and amortized over the life of the related debt in the statement of activities.</p>		
		389,767
<p>In governmental funds, receipt of the special education mandated cost settlement is reported as revenue in the period received, but in the statement of net assets, the amount is recorded as a receivable and the payment received in the current year reduces the receivable amount.</p>		
		(38,995)

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, 2011

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.	(1,548,414)
Payment of costs for the issuance of certificates of participation is an expenditure in the governmental funds, but is recorded as a prepaid expense and amortized on the Statement of Net Assets over the life of the COP.	310,776
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 assets and does not affect the statement of activities.	4,660,000
Payment of principal on COP is an expenditure in the governmental funds, but it reduces long-term liabilities in the statement of net assets and does not affect the statement of activities.	45,000
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.	77,666
Excess contributions over the annual OPEB cost to the other post-employment benefit plan is recognized as plan assets in the government-wide statements. On the governmental funds, the contribution is treated as expenses.	(11,473)
Discount paid for the sale of COPs is an expenditure in the governmental funds, but it reduces long-term liabilities in the statement of net assets and does not affect the statement of activities.	235,273
Proceeds received from sale of certificates of participation is a revenue source in the governmental funds, but it increases long-term liabilities in the statement of net assets and does not affect the statement of activities.	(13,550,000)
Change in Net Assets of Governmental Activities	\$ 6,788,421

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FIDUCIARY FUND
STATEMENT OF NET ASSETS
JUNE 30, 2011**

	<u>Agency Funds</u>
ASSETS	
Deposits and investments	\$ 645,391
Total Assets	<u>\$ 645,391</u>
 LIABILITIES	
Due to student groups	\$ 645,391
Total Liabilities	<u>\$ 645,391</u>

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

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. For financial reporting purposes, the component unit has a financial and operational relationship which meets the reporting entity definition criteria of the Governmental Accounting Standard Board (GASB) Statement No. 14, *The Financial Reporting Entity*, and thus are included in the financial statements of the District. 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, 2011

Major Governmental Funds

General Fund The General Fund is the chief operating fund for all districts. It is used to account for and report all financial resources not accounted for and reported in another 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.

As a result, the General Fund reflects an increase in assets, fund balance, and revenues of \$2,046,109, \$2,046,109, and \$16,379, respectively.

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 established to account for the proceeds of specific revenue sources that are restricted or committed to expenditures for the specific purpose (other than debt service or capital projects) of the individual funds.

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, except for State revenues which, as a result of Senate Bill 4 of the 2009-10 Third Extraordinary Session (SBX3 4) may be used for any educational purpose. Under the flexibility provisions of current statute, this fund is no longer primarily composed of restricted or committed revenue sources. However, the District has taken formal action to commit the flexed revenues to continue the operation of the original programs.

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

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

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, except for State apportionments which, as a result of Senate Bill 4 of the 2009-10 Third Extraordinary Session (SBX3 4), may be used for any educational purpose. Under the flexibility provisions of current statute, this fund is no longer primarily composed of restricted or committed revenue sources. However, the District has taken formal action to commit the flexed revenues to continue the operation of the original programs.

Capital Project Funds The Capital Project funds are used to account for and report financial resources that are restricted, committed, or assigned to expenditures for capital outlays, including the acquisition or construction of 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 fund reporting focuses on net assets and changes in net assets. The District has only one Fiduciary Fund, which is an agency fund.

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.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

Net assets should be reported as restricted when constraints placed on net asset use 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 assets restricted for other activities result from special revenue funds and the restrictions on their net asset use.

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.

Deferred Revenue Deferred 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 deferred revenue is removed from the balance sheet and revenue is recognized.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

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

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, 2011 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.

Capital Assets and Depreciation

The accounting and reporting treatment applied to the capital assets associated with a fund are determined by its measurement focus. Capital assets are long-lived assets of the District. The District maintains a capitalization threshold of \$20,000. The District does not possess any infrastructure. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized, but are expensed as incurred. When purchased, such assets are recorded as expenditures in the governmental funds and capitalized in the government-wide statement of net assets. 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.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

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 assets.

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 assets. For governmental funds, the current portion of unpaid compensated absences is recognized upon the occurrence of relevant events such as employee resignations and retirements that occur prior to year-end that have not yet been paid with expendable available financial resources. These amounts are reported in the fund from which the employees who have accumulated leave are paid.

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

Accrued Liabilities and Long-Term Obligations

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

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

Deferred Issuance Costs, 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 assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

Fund Balances - Governmental Funds

As of June 30, 2011, fund balances of the governmental funds are classified as follows:

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

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

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

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

Unassigned - all other spendable amounts.

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt 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 assets are 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 assets are 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, 2011

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 1st 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

In March 2009, the GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with inventories. This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

The *restricted* fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation. The *committed* fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Amounts in the *assigned* fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed. *Unassigned* fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned. Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

Governments also are required to classify and report amounts in the appropriate fund balance classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. Disclosure of the policies in the notes to the financial statements is required.

This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements.

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

The District has implemented the provisions of this statement for the year ended June 30, 2011.

New Accounting Pronouncements

In November 2010, the GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus-an amendment of GASB Statements No. 14 and No. 34*. The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of GASB Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements.

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. For organizations that previously were required to be included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit. Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government's management determines that it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationships that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. For component units that currently are blended based on the "substantively the same governing body" criterion, it additionally requires that (1) the primary government and the component unit have a financial benefit or burden relationship or (2) management (below the level of the elected officials) of the primary government have operational responsibility (as defined in paragraph 8a) for the activities of the component unit. New criteria also are added to require blending of component units whose total debt outstanding is expected to be repaid entirely or almost entirely with resources of the primary government. The blending provisions are amended to clarify that funds of a blended component unit have the same financial reporting requirements as a fund of the primary government. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

This Statement also clarifies the reporting of equity interests in legally separate organizations. It requires a primary government to report its equity interest in a component unit as an asset. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012. Early implementation is encouraged. Adoption of the statement is not expected to materially impact the District's financial statements.

NOTE 2 – DEPOSITS AND INVESTMENTS

Summary of Deposits and Investments

Deposits and investments as of June 30, 2011, are classified in the accompanying financial statements as follows:

Governmental activities	\$ 27,985,531
Fiduciary funds	645,391
Total Deposits and Investments	<u>\$ 28,630,922</u>

Deposits and investments as of June 30, 2011, consist of the following:

Cash on hand and in banks	\$ 665,891
Investments	27,965,031
Total Deposits and Investments	<u>\$ 28,630,922</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, 2011

General Authorizations

Limitations as they relate to interest rate risk, credit 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	\$ 794,412	\$ 794,412	6 years
Money Market	883,364	894,504	7/1/2011
County Pool	26,287,255	26,378,735	1.24 years
Total	<u>\$ 27,965,031</u>	<u>\$ 28,067,651</u>	

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

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	Moody Rating as of Year End	
		Aaa	Unrated
Natixis Guaranteed Investment Contract	\$ 794,412	\$ 794,412	\$ -
Money Market	894,504	-	894,504
County Pool	26,378,735	-	26,378,735
Total	<u>\$ 28,067,651</u>	<u>\$ 794,412</u>	<u>\$ 27,273,239</u>

Custodial Credit Risk - Deposits

This is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a policy for custodial credit risk for deposits. However, the California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110 percent of the total amount deposited by the public agency. California law also allows financial institutions to secure public deposits by pledging first trust deed mortgage notes having a value of 150 percent of the secured public deposits and letters of credit issued by the Federal Home Loan Bank of San Francisco having a value of 105 percent of the secured deposits. As of June 30, 2011, the District's bank balance of \$351,367 was exposed to custodial credit risk because it was uninsured and collateralized with securities held by the pledging financial institution's trust department or agent, but not in the name of the District.

Custodial Credit Risk - Investments

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

NOTE 3 - RECEIVABLES

Receivables at June 30, 2011, 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	\$ 713,613	\$ -	\$ -	\$ 286,392	\$ 1,000,005
State Government					
Apportionment	3,434,298	-	-	160,002	3,594,300
Categorical aid	1,736,292	-	-	19,098	1,755,390
Lottery	618,044	-	-	-	618,044
Local Government					
Interest	38,721	6,465	5,429	5,764	56,379
Other Local Sources	885,674	31,068	-	57,294	974,036
Total	<u>\$ 7,426,642</u>	<u>\$ 37,533</u>	<u>\$ 5,429</u>	<u>\$ 528,550</u>	<u>\$ 7,998,154</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2011, was as follows:

	Balance July 1, 2010	Additions	Deductions	Balance June 30, 2011
Governmental Activities				
Capital Assets Not Being Depreciated:				
Land	\$ 724,021	\$ 6,800,000	\$ 56,872	\$ 7,467,149
Construction in progress	534,604	14,341,282	14,875,886	-
Total Capital Assets Not Being Depreciated	1,258,625	21,141,282	14,932,758	7,467,149
Capital Assets Being Depreciated:				
Buildings and improvements	220,978,377	14,875,886	-	235,854,263
Furniture and equipment	5,451,265	98,990	-	5,550,255
Total Capital Assets Being Depreciated	226,429,642	14,974,876	-	241,404,518
Total Capital Assets	227,688,267	36,116,158	14,932,758	248,871,667
Less Accumulated Depreciation:				
Buildings and improvements	38,543,986	6,642,551	-	45,186,537
Furniture and equipment	2,871,208	351,625	-	3,222,833
Total Accumulated Depreciation	41,415,194	6,994,176	-	48,409,370
Governmental Activities Capital Assets, Net	\$ 186,273,073	\$ 29,121,982	\$ 14,932,758	\$ 200,462,297

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

Governmental Activities	\$ 4,815,154
Instruction	142,027
Supervision of instruction	23,455
Instructional library, media, and technology	664,462
School site administration	301,973
Home-to-school transportation	281,138
Food services	293,944
All other pupil services	56,444
Ancillary services	1,626
Community services	338,218
Data processing	75,735
All other general administration	
Total Depreciation Expense All Activities	\$ 6,994,176

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

NOTE 5 – INTERFUND TRANSACTIONS

Interfund Receivables/Payables (Due To/Due From)

There was an interfund due from General fund to the Cafeteria Fund in the amount of \$30.

Operating Transfers

Interfund transfers for the year ended June 30, 2011, consisted of the following:

Transfer Out	Transfer In		Total
	General Fund	Building Fund	
General Fund	\$ -	\$ 200,000	\$ 200,000
Non-Major Governmental funds	25,392	-	25,392
Total	\$ 25,392	\$ 200,000	\$ 225,392

General fund transferred to Building Fund for COPS contribution.	\$ 200,000
Capital Facilities Fund transferred to General Fund for 3% administration fee.	25,392
Total	\$ 225,392

NOTE 6 - ACCOUNTS PAYABLE

Accounts payable at June 30, 2011, consisted of the following:

	General Fund	Non-Major Governmental Funds	Total
Vendor payables	\$ 638,111	\$ 1,908	\$ 640,019
State apportionment	673,954	-	673,954
Salaries and benefits	527,409	-	527,409
Total	\$ 1,839,474	\$ 1,908	\$ 1,841,382

NOTE 7 - DEFERRED REVENUE

Deferred revenue at June 30, 2011, consists of the following:

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

	General Fund
Federal financial assistance	\$ 527,924
State categorical aid	7,647
Other local	714,901
Total	<u>\$ 1,250,472</u>

NOTE 8 - TAX AND REVENUE ANTICIPATION NOTES (TRANS)

On July 1, 2010, the District issued \$10,715,000 Tax and Revenue Anticipation Notes bearing interest at 0.65 percent. The notes were issued to supplement cash flows. Interest and principal were due and payable on June 1, 2011. By May 2011, 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 \$10,715,000 and related accrued interest and cash held in trust are not included in these financial statements.

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, 2010	Additions	Deductions	Balance June 30, 2011	Due in One Year
General obligation bonds	\$ 65,369,040	\$ -	\$ 4,660,000	\$ 60,709,040	\$ 5,215,000
Defeasance cost	(3,646,547)	-	(405,172)	(3,241,375)	(405,172)
Premium	7,279,013	-	808,779	6,470,234	808,779
Accretions on general obligation bonds	4,613,077	1,548,414	-	6,161,491	-
Certificates of participation	-	13,550,000	45,000	13,505,000	-
Discount on COPS	-	(235,273)	(13,840)	(221,433)	(13,840)
Accumulated vacation - net	304,991	57,515	-	362,506	-
	<u>\$ 73,919,574</u>	<u>\$ 14,920,656</u>	<u>\$ 5,094,767</u>	<u>\$ 83,745,463</u>	<u>\$ 5,604,767</u>

The Bond Interest and Redemption fund is used to collect assessed property taxes which are used to repay the general obligation bonds. Compensated absences will be paid by the fund for which the employee works.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

Bonded Debt

The outstanding general obligation bonded debt is as follows:

Issue Date	Maturity Date (August 1)	Interest Rate	Original Issue	Bonds Outstanding July 1, 2010	Accreted Interest	Redeemed	Bonds Outstanding June 30, 2011
2006 Refunding (CIB)	2020	3.5%-4.24%	\$ 68,180,000	\$ 56,595,000	\$ -	\$ 4,660,000	\$ 51,935,000
2006 Refunding (CAB)	2016	4.25%-4.42%	8,774,040	13,387,117	1,548,414	-	14,935,531
			<u>\$ 76,954,040</u>	<u>\$ 69,982,117</u>	<u>\$ 1,548,414</u>	<u>\$ 4,660,000</u>	<u>66,870,531</u>
						Defeasance Premium	(3,241,375) 6,470,234
							<u>\$ 70,099,390</u>

Debt Service Requirements to Maturity

The bonds mature through 2021 as follows:

Fiscal Year	Principal	Interest to Maturity	Total
2012	\$ 5,215,000	\$ 2,439,525	\$ 7,654,525
2013	5,865,000	2,162,525	8,027,525
2014	6,570,000	1,851,650	8,421,650
2015	3,071,226	5,941,174	9,012,400
2016	2,923,802	6,543,598	9,467,400
2017-2021	37,064,012	10,271,138	47,335,150
Total	60,709,040	\$ 29,209,610	\$ 89,918,650
Accretion to Date	6,161,491		
	<u>\$ 66,870,531</u>		

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

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, 2011, the principal balance outstanding was \$13,505,000.

The certificates mature through 2027 as follows:

Fiscal Year	Principal	Interest to Maturity	Total
2012	\$ -	\$ 958,855	\$ 958,855
2013	-	958,855	958,855
2014	-	958,855	958,855
2015	-	958,855	958,855
2016	-	958,855	958,855
2017-2021	-	4,794,275	4,794,275
2022-2026	-	4,794,275	4,794,275
2027	13,505,000	958,855	14,463,855
Total	<u>\$ 13,505,000</u>	<u>\$ 15,341,680</u>	<u>\$ 28,846,680</u>

Accumulated Unpaid Employee Vacation

The long-term portion of accumulated unpaid employee vacation for the District at June 30, 2011 amounted to \$362,506.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

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	46,380	-	-	1,893	48,273
Total Nonspendable	60,880	-	-	7,893	68,773
Restricted					
Legally restricted programs	1,498,310	-	-	681,315	2,179,625
Capital projects	-	5,681,123	-	2,234,883	7,916,006
Debt services	-	-	6,744,696	-	6,744,696
Total Restricted	1,498,310	5,681,123	6,744,696	2,916,198	16,840,327
Committed					
Adult education program	-	-	-	274,256	274,256
Deferred maintenance program	-	-	-	468,710	468,710
Total Committed	-	-	-	742,966	742,966
Assigned					
Special reserve-non Capital	1,493,990	-	-	-	1,493,990
Retiree benefits	225,119	-	-	-	225,119
Program carryover	5,028,735	-	-	-	5,028,735
Total Assigned	6,747,844	-	-	-	6,747,844
Unassigned					
Reserve for economic uncertainties	1,979,234	-	-	-	1,979,234
Remaining unassigned	6,560,960	-	-	-	6,560,960
Total Unassigned	8,540,194	-	-	-	8,540,194
Total	\$ 16,847,228	\$ 5,681,123	\$ 6,744,696	\$ 3,667,057	\$ 32,940,104

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

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 210 retirees currently receiving benefits and 685 active plan members. Board designated amount of the Plan is presented in these financial statements as the Retiree Benefits Special Reserve Fund. Excess portion of annual required contributions (net OPEB assets) is presented in the statement of net assets as assets.

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 2010-2011, the District contributed \$559,300 to the plan, all of which was used for current premiums (approximately 110 percent of current year's annual required contribution). Plan members are paid a monthly administrative charge amount equal to \$81 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 rule 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 Asset

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) (or funding excess) 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 asset to the Plan:

Annual required contribution	\$ 568,374
Interest on net OPEB asset	(5,592)
Adjustment to annual required contribution	7,991
Annual OPEB cost (expense)	570,773
Contributions made	(559,300)
Decrease in net OPEB asset	11,473
Net OPEB asset, beginning of year	(128,255)
Net OPEB asset, end of year	<u>\$ (116,782)</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

Trend Information

Trend information for annual OPEB cost, the percentage of annual OPEB cost contributed to the Plan, and the net OPEB asset for 2011 is as follows:

Year Ended June 30,	Annual OPEB Cost	Actual Contribution	Percentage Contributed	Net OPEB Assets
2009	\$ 554,585	\$ 625,137	113%	\$ 70,552
2010	581,095	638,798	112%	128,255
2011	570,773	559,300	120%	116,782

Funded Status and Funding Progress

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 Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Frozen Entry Age (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, 2009	\$ 68,343	\$ 7,740,862	\$ 7,672,519	1%	\$ 41,743,655	18.38%

Actuarial Methods and Assumptions

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

In the July 1, 2009, 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. The UAAL is being amortized at a level dollar method. The remaining amortization period at July 1, 2011, was 27 years. At June 30, 2011, the District's General Fund has assigned net assets in the amount of \$552,119, which consisted of \$551,095 on deposit with the county treasurer and receivables in the amount of \$1,023.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

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, 2011, 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 2011, 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, 2011

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. 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, 7919 Folsom Blvd., Sacramento, CA 95826.

Funding Policy

Active plan members are required to contribute 8.0 percent of their salary and 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 2010-2011 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, 2011, 2010, and 2009, were \$2,693,510, \$2,798,684, and \$2,882,006, 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. 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, 2011

Funding Policy

Active plan members are required to contribute 7.0 percent of their salary and 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 2010-2011 was 10.707 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, 2011, 2010, and 2009, were \$968,004, \$894,490, and \$901,938, 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 \$1,393,116, \$1,447,512, and \$1,577,943, for the fiscal years ending June 30, 2011, 2010 and 2009. 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.

Fiscal Year	Percent of Annual Payroll	General	Adult Education	Child Development	Total State Contribution
2008-09	4.517%	\$ 1,539,494	\$ 16,323	\$ 22,126	\$ 1,577,943
2009-10	4.267%	1,412,241	14,974	20,297	1,447,512
2010-11	4.267%	1,374,855	9,441	8,820	1,393,116

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, 2011.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

Construction Commitments

As of June 30, 2011, the District had the following commitments with respect to the unfinished capital projects:

Capital Project	Remaining Construction Commitment	Expected Date of Completion
Live Oak Modernization	\$ 2,800,000	12/1/2012

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, 2011, the District made payment of \$265,716 to the Santa Clara County Schools Insurance Group.

NOTE 16 - SUBSEQUENT EVENTS

The District issued \$5,825,000 of Tax and Revenue Anticipation Notes dated July 1, 2011. The notes mature on June 1, 2012, and yield 2 percent interest. The notes were sold to supplement cash flow. Repayment requirements are that a percentage of principal and interest be deposited with the Fiscal Agent each month beginning January, 2012, until 100 percent of principal and interest due is on account in May, 2012.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

NOTE 17 - RESTATEMENT OF PRIOR YEAR FUND BALANCES

The District's prior year fund balances for the General Fund and for the Non-Major Governmental Funds have been restated as of June 30, 2011 to conform to GASB Statement No. 54's definition of governmental funds. Accordingly, the beginning fund balances for Fund 17, Special Reserve Fund for Other Than Capital Outlay Projects, and Fund 20, Special Reserve Fund for Postemployment Benefits, as presented in the Non-Major Governmental Fund opinion unit, are reported as a restatement to the beginning fund balance of the General Fund. The restatement does not change the total fund balance amounts reported in the District's audited financial statements.

As discussed in the Notes to the basic financial statements, the accompanying financial statements reflect certain changes required as a result of the implementation of GASB Statement No. 54 for the year ended June 30, 2011. These changes required a restatement to the beginning fund balance of the General Fund and the Non-Major Governmental Funds, as discussed in Note 1.

General Fund

Fund Balance - Beginning	\$ 13,175,827
Change in accounting principles to conform to GASB Statement No. 54	2,029,730
Fund Balance - Beginning as Restated	<u>\$ 15,205,557</u>

Non-Major Governmental Funds

Fund Balance - Beginning	\$ 5,849,319
Change in accounting principles to conform to GASB Statement No. 54	(2,029,730)
Fund Balance - Beginning as Restated	<u>\$ 3,819,589</u>

REQUIRED SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

GENERAL FUND BUDGETARY COMPARISON SCHEDULE FOR THE YEAR ENDED JUNE 30, 2011

	Budgeted Amounts		Actual	Variances -
	Original	Final	(GAAP Basis)	Favorable (Unfavorable)
				Final to Actual
REVENUES				
Revenue limit sources	\$ 43,281,293	\$ 45,621,649	\$ 45,598,746	\$ (22,903)
Federal sources	3,814,187	7,015,307	5,517,808	(1,497,499)
Other state sources	9,154,420	10,150,755	11,487,507	1,336,752
Other local sources	5,962,764	6,733,764	6,361,528	(372,236)
Total Revenues¹	62,212,664	69,521,475	68,965,589	(555,886)
EXPENDITURES				
Current				
Certificated salaries	31,413,284	31,450,724	31,366,288	84,436
Classified salaries	9,396,901	9,227,387	8,974,267	253,120
Employee benefits	11,726,217	11,592,358	11,692,106	(99,748)
Books and supplies	3,833,401	6,871,306	2,782,452	4,088,854
Services and operating expenditures	7,756,603	9,353,773	7,778,067	1,575,706
Other outgo	3,071,904	3,203,321	3,099,323	103,998
Capital outlay	6,000	28,054	81,954	(53,900)
Total Expenditures¹	67,204,310	71,726,923	65,774,457	5,952,466
Excess (Deficiency) of Revenues Over Expenditures	(4,991,646)	(2,205,448)	3,191,132	5,396,580
Other Financing Sources (Uses):				
Transfers in	116,238	122,238	25,392	(96,846)
Transfers out	(104,238)	(104,238)	(200,000)	(95,762)
Net Financing Sources (Uses)	12,000	18,000	(174,608)	(192,608)
NET CHANGE IN FUND BALANCES	(4,979,646)	(2,187,448)	3,016,524	5,203,972
Fund Balance - Beginning	15,205,557	15,205,557	15,205,557	-
Fund Balance - Ending	\$ 10,225,911	\$ 13,018,109	\$ 18,222,081	\$ 5,203,972

¹ On behalf payments of \$1,374,855 are included in the actual revenues and expenditures for General Fund, but have not been included in the budget amounts. In addition, due to the consolidation of Fund 17, Special Reserve Fund for Other Than Capital Outlay Projects, and Fund 20, Special Reserve Fund for Postemployment Benefits for reporting purposes into the General Fund, additional revenues and expenditures pertaining to these other funds are included in the actual, original and final General Fund budgets.

MORGAN HILL UNIFIED SCHOOL DISTRICT**SCHEDULE OF OTHER POSTEMPLOYMENT BENEFITS (OPEB) FUNDING
PROGRESS
FOR THE YEAR ENDED JUNE 30, 2011**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Frozen Entry Age (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payrol ([b - a] / c)
July 1, 2009	\$ 68,343	\$ 7,740,862	\$ 7,672,519	1%	\$ 41,743,655	18.38%
July 1, 2006	-	7,861,000	7,790,448	0%	44,526,102	17.50%

SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED JUNE 30, 2011

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF EDUCATION			
Passed through California Department of Education (CDE):			
No Child Left Behind			
Title I - Basic Grants Low Income and Neglected	84.010	14329	\$ 849,333
Title I - ARRA, Basic Grants Low Income and Neglected	84.389	15005	342,246
Title I - Migrant Education	84.011	14326	189,173
Title I - Migrant Education Summer Program	84.011	10005	143,897
Title II - Improving Teacher Quality	84.367	14341	125,515
Title II - Enhancing Education Through Technology	84.318	14335	3,247
Title II - ARRA Enhancing Education Through Technology	84.860	15019	16,107
Title II - Administrator Training	84.367	14344	1,882
Title III - Limited English Proficient (LEP) Student Program	84.365	14346	283,379
Title III - Immigrant Education Program	84.365	15146	60,591
Title IV - Drug-Free Schools	84.186	14347	4,290
Teaching American History Grant Program	84.215	2	229,013
Individuals with Disabilities Act (IDEA):			
Basic Local Assistance Entitlement	84.027	13379	1,687,255
ARRA Preschool Grants	84.392	15000	33,070
Preschool Staff Development	84.173A	13431	667
Preschool Local Entitlement	84.027A	13682	58,899
ARRA State Fiscal Stabilization Fund	84.394	25008	406,913
Education Jobs Fund	84.410	25152	995,754
Vocational and Applied Technology	84.048	13924	45,816
Adult Basic Education	84.002	14508	50,948
Adult Secondary Education	84.002	13978	10,624
English Literacy and Civics Education	84.002A	14109	33,369
Subtotal			5,571,988

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - CONTINUED FOR THE YEAR ENDED JUNE 30, 2011

U.S. DEPARTMENT OF AGRICULTURE

Passed through CDE:

National School Lunch Program

10.555 13524 1,189,883

Especially Needy Breakfast

10.553 13526 545,508

Commodity Supplemental Food Program¹

10.555 13524 107,917

Subtotal

1,843,308

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Passed through CDE:

Medi-Cal Administrative Activities

93.778 10060 40,761

Total Expenditures of Federal Awards

\$ 7,456,057

¹ Not recorded in the financial statements.

² PCA number is not available.

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

LOCAL EDUCATION AGENCY ORGANIZATION STRUCTURE JUNE 30, 2011

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>
Peter Mandel	President	2012
Kathy Sullivan	Vice President	2012
Bob Benevento	Member	2012
Don Moody	Member	2014
Claudia Rossi	Member	2014
Shelle Thomas	Member	2014
Ron Woolf	Member	2014

ADMINISTRATION

Wesley Smith	Superintendent
Bonnie Tognazzini	Deputy Superintendent

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF AVERAGE DAILY ATTENDANCE FOR THE YEAR ENDED JUNE 30, 2011

	Revised P-2 Report	Annual Report
ELEMENTARY		
Kindergarten	619	622
First through third	1,873	1,875
Fourth through sixth	1,945	1,944
Seventh and eighth	1,220	1,221
Home and hospital	1	1
Special education	151	151
Total Elementary	5,809	5,814
SECONDARY		
Regular classes	2,564	2,529
Continuation education	111	105
Home and hospital	3	3
Special education	55	54
Total Secondary	2,733	2,691
Total K-12	8,542	8,505

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF INSTRUCTIONAL TIME FOR THE YEAR ENDED JUNE 30, 2011

Grade Level	1982-83 Actual Minutes	Reduced 1982-83 Actual Minutes	1986-87 Minutes Requirement	Reduced 1986-87 Minutes Requirement	2010-11 Actual Minutes	Number of Days Traditional Calendar	Status
Kindergarten	31,680	30,800	36,000	35,000	36,000	180	Complied
Grade 1	47,480	46,161	50,400	49,000	51,025	180	Complied
Grade 2	47,480	46,161	50,400	49,000	51,025	180	Complied
Grade 3	47,480	46,161	50,400	49,000	51,025	180	Complied
Grade 4	52,740	51,275	54,000	52,500	54,550	180	Complied
Grade 5	52,740	51,275	54,000	52,500	54,550	180	Complied
Grade 6	52,740	51,275	54,000	52,500	54,550	180	Complied
Grade 7	54,560	53,044	54,000	52,500	55,730	180	Complied
Grade 8	54,560	53,044	54,000	52,500	55,730	180	Complied
Grade 9	57,726	56,123	64,800	63,000	64,880	180	Complied
Grade 10	57,726	56,123	64,800	63,000	64,880	180	Complied
Grade 11	57,726	56,123	64,800	63,000	64,880	180	Complied
Grade 12	57,726	56,123	64,800	63,000	64,880	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, 2011

Summarized below are the fund balance reconciliations between the unaudited actual financial report and the audited financial statements.

FUND BALANCE

Balance, June 30, 2011, Unaudited Actuals
Increase in accounts receivable
Balance, June 30, 2011, Audited Financial Statement

General Fund	
\$	16,186,787
	660,441
\$	16,847,228

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2011

	(Budget) 2012 ¹	2011	2010	2009
GENERAL FUND ⁴				
Revenues	\$ 63,654,932	\$ 68,965,589	\$ 68,423,600	\$ 75,907,073
Other sources and transfers in	218,000	25,392	17,690	9,534
Total Revenues and Other Sources	63,872,932	68,990,981	68,441,290	75,916,607
Expenditures	66,114,252	67,149,310	69,334,487	70,251,726
Other uses and transfers out	516,000	200,000	239,654	902,467
Total Expenditures and Other Uses	66,630,252	67,349,310	69,574,141	71,154,193
INCREASE (DECREASE) IN FUND BALANCE	\$ (2,757,320)	\$ 1,641,671	\$ (1,132,851)	\$ 4,762,414
ENDING FUND BALANCE	\$ 13,429,466	\$ 16,847,228	\$ 13,175,827	\$ 14,308,678
AVAILABLE RESERVES ²	\$ 11,870,276	\$ 8,540,194	\$ 10,314,274	\$ 4,072,085
AVAILABLE RESERVES AS A PERCENTAGE OF TOTAL OUTGO ³	17.82%	12.94%	15.13%	5.85%
LONG-TERM OBLIGATIONS	\$ 78,140,696	\$ 83,745,463	\$ 73,919,574	\$ 77,063,515
K-12 AVERAGE DAILY ATTENDANCE AT P-2	8,532	8,542	8,679	8,753

The General Fund balance has increased by \$2,538,550 over the past two years. The 2011 General Fund ending fund balance amount includes the consolidation of the Special Reserve Fund in the amount of \$1,493,990 and Special Reserve fund for Retiree Benefits in the amount of \$535,740. The fiscal year 2011-2012 budget projects a decrease of \$2,757,320 (16 percent). 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 operating surplus in the past year, but anticipates incurring an operating deficit during the 2011-2012 fiscal year. Total long-term obligations have increased by \$6,681,948 over the past two years.

Average daily attendance has decreased by 211 over the past two years. A decrease of 10 ADA is anticipated during fiscal year 2011-2012.

¹ Budget 2012 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 \$1,374,855, \$1,412,241, and \$1,539,494 have been excluded from the calculation of the available reserves percentage for fiscal year ending June 30, 2011, 2010 and 2009, respectively.

⁴ General Fund amounts 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, 2011**

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

See accompanying note to supplementary information.

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MORGAN HILL UNIFIED SCHOOL DISTRICT

NON-MAJOR GOVERNMENTAL FUNDS COMBINING BALANCE SHEET JUNE 30, 2011

	Adult Education Fund	Child Development Fund	Cafeteria Fund
ASSETS			
Deposits and investments	\$ 62,489	\$ 149	\$ 434,189
Receivables	216,972	18	249,692
Stores inventories	-	-	1,893
Total Assets	<u>\$ 279,461</u>	<u>\$ 167</u>	<u>\$ 685,774</u>
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 205	\$ 167	\$ 1,536
Due to other funds	-	-	30
Total Liabilities	<u>205</u>	<u>167</u>	<u>1,566</u>
Fund Balances:			
Nonspendable	5,000	-	2,893
Restricted	-	-	681,315
Committed	274,256	-	-
Total Fund Balances	<u>279,256</u>	<u>-</u>	<u>684,208</u>
Total Liabilities and Fund Balances	<u>\$ 279,461</u>	<u>\$ 167</u>	<u>\$ 685,774</u>

See accompanying note to supplementary information

Deferred Maintenance Fund	Capital Facilities Fund	Capital Projects Fund	Total Non-Major Governmental Funds
\$ 467,852	\$ 1,075,224	\$ 1,098,649	\$ 3,138,552
858	59,454	1,556	528,550
-	-	-	1,893
<u>\$ 468,710</u>	<u>\$ 1,134,678</u>	<u>\$ 1,100,205</u>	<u>\$ 3,668,995</u>

\$ -	\$ -	\$ -	\$ 1,908
-	-	-	30
-	-	-	1,938

-	-	-	7,893
-	1,134,678	1,100,205	2,916,198
468,710	-	-	742,966
<u>468,710</u>	<u>1,134,678</u>	<u>1,100,205</u>	<u>3,667,057</u>
<u>\$ 468,710</u>	<u>\$ 1,134,678</u>	<u>\$ 1,100,205</u>	<u>\$ 3,668,995</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NON-MAJOR GOVERNMENTAL FUNDS COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE FOR THE YEAR ENDED JUNE 30, 2011

	Adult Education Fund	Child Development Fund	Cafeteria Fund
REVENUES			
Federal sources	\$ 94,941	\$ -	\$ 1,735,391
Other state sources	532,236	283,480	155,354
Other local sources	70,045	-	792,932
Total Revenues	<u>697,222</u>	<u>283,480</u>	<u>2,683,677</u>
EXPENDITURES			
Current			
Instruction	290,546	271,427	-
Instruction-related activities:			
School site administration	294,349	-	-
Pupil services:			
Food services	-	-	2,421,897
General administration:			
All other general administration	22,827	12,053	106,577
Plant services	16,788	-	-
Facility acquisition and construction	-	-	-
Total Expenditures	<u>624,510</u>	<u>283,480</u>	<u>2,528,474</u>
Excess (Deficiency) of			
Revenues Over Expenditures	72,712	-	155,203
Other Financing Sources (Uses):			
Transfers out	-	-	-
NET CHANGE IN FUND BALANCES	<u>72,712</u>	<u>-</u>	<u>155,203</u>
Fund Balance - Beginning	206,544	-	529,005
Fund Balance - Ending	<u>\$ 279,256</u>	<u>\$ -</u>	<u>\$ 684,208</u>

See accompanying note to supplementary information

Deferred Maintenance Fund	Capital Facilities Fund	Capital Projects Fund	Total Non-Major Governmental Funds
\$ -	\$ -	\$ -	\$ 1,830,332
312,303	-	-	1,283,373
4,391	858,434	469,333	2,195,135
<u>316,694</u>	<u>858,434</u>	<u>469,333</u>	<u>5,308,840</u>
-	-	-	561,973
-	-	-	294,349
-	-	-	2,421,897
-	-	-	141,457
139,819	100,933	1,687	259,227
388,785	1,092,246	276,046	1,757,077
<u>528,604</u>	<u>1,193,179</u>	<u>277,733</u>	<u>5,435,980</u>
(211,910)	(334,745)	191,600	(127,140)
-	(25,392)	-	(25,392)
<u>(211,910)</u>	<u>(360,137)</u>	<u>191,600</u>	<u>(152,532)</u>
680,620	1,494,815	908,605	3,819,589
<u>\$ 468,710</u>	<u>\$ 1,134,678</u>	<u>\$ 1,100,205</u>	<u>\$ 3,667,057</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION JUNE 30, 2011

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
Federal revenues reported in the Statement of Revenues, Expenditures and		\$ 7,998,361
Changes in Fund Balance:		
Build America Bonds interest subsidy is excluded from the provisions of		
OMB Circular A-133 therefore, is not presented by auditees on the		(650,221)
Schedule of Expenditures of Federal Awards.	10.555	107,917
Commodities are not recorded on the financial statement.		\$ 7,456,057
Total Schedule of Expenditures of Federal Awards		

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. 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 either the 1982-83 actual minutes or the 1986-87 requirement, whichever is greater, 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, 2011

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 Balance

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

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 the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Morgan Hill Unified School District as of and for the year ended June 30, 2011, which collectively comprise Morgan Hill Unified School District's basic financial statements and have issued our report thereon dated November 28, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

The management of Morgan Hill Unified School District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Morgan Hill Unified School District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Morgan Hill Unified School District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Morgan Hill Unified School District's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies in internal control over financial reporting as item 2011-1. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Morgan Hill Unified School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Morgan Hill Unified School District's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit Morgan Hill Unified School District's response and, accordingly, express no opinion on it.

This report is intended solely for the information and use of the governing board, management, the California Department of Education, the State Controller's Office, Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Wassinek, Trine, Day & Co., LLP

Palo Alto, California
November 28, 2011



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL
EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

Board of Trustees
Morgan Hill Unified School District
Morgan Hill, California

Compliance

We have audited Morgan Hill Unified School District's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Morgan Hill Unified School District's major Federal programs for the year ended June 30, 2011. Morgan Hill Unified School District's major Federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major Federal programs is the responsibility of Morgan Hill Unified School District's management. Our responsibility is to express an opinion on Morgan Hill Unified School District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about 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. Our audit does not provide a legal determination of Morgan Hill Unified School District's compliance with those requirements.

In our opinion, Morgan Hill Unified School District complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major Federal programs for the year ended June 30, 2011.

Internal Control Over Compliance

The management of Morgan Hill Unified School District is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to Federal programs. In planning and performing our audit, we considered Morgan Hill Unified School District's internal control over compliance with the requirements that could have a direct and material effect on a major Federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance 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 the Morgan Hill Unified School District's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the governing board, management, the California Department of Education, the State Controller's Office, Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Wassinek, Trine, Day & Co., LLP

Palo Alto, California
November 28, 2011



INDEPENDENT AUDITOR'S REPORT ON STATE COMPLIANCE

Board of Trustees
Morgan Hill Unified School District
Morgan Hill, California

We have audited Morgan Hill Unified School District's compliance with the requirements as identified in the *Standards and Procedures for Audit of California K-12 Local Educational Agencies 2010-11* applicable to Morgan Hill Unified School District's government programs as noted below for the year ended June 30, 2011. Compliance with the requirements referred to above is the responsibility of Morgan Hill Unified School District's management. Our responsibility is to express an opinion on Morgan Hill Unified School District's compliance based on our audit.

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 2010-11* 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.

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, 2011.

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:

	Procedures in Audit Guide	Procedures Performed
Attendance Accounting:		
Attendance reporting	8	Yes
Kindergarten continuance	3	Yes
Independent study	23	No
Continuation education	10	Yes
Instructional Time:		
School districts	6	Yes
County offices of education	3	Not Applicable

	<u>Procedures in Audit Guide</u>	<u>Procedures Performed</u>
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
Public hearing requirement - receipt of funds	1	Yes
Class Size Reduction Program (including in Charter Schools):		
General requirements	7	Yes
Option one classes	3	Yes
Option two classes	4	Not Applicable
District or charter schools with only one school serving K-3	4	Not Applicable
After School Education and Safety Program:		
General requirements	4	Yes
After school	4	Yes
Before school	5	Not Applicable
Charter Schools:		
Contemporaneous records of attendance	1	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	3	Not Applicable

We did not perform testing for Independent Study attendance because the reported ADA was below the state minimum audit threshold.

This report is intended solely for the information and use of the governing board, management, the California Department of Education, the State Controller's Office, the California Department of Finance, Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Lavrinek, Trine, Day & Co., LLP

Palo Alto, California
November 28, 2011

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

MORGAN HILL UNIFIED SCHOOL DISTRICT

SUMMARY OF AUDITOR'S RESULTS FOR THE YEAR ENDED JUNE 30, 2011

FINANCIAL STATEMENTS

Type of auditor's report issued:

Unqualified

Internal control over financial reporting:

Material weakness(es) identified?

No

Significant deficiency(ies) identified?

Yes

Noncompliance material to financial statements noted?

No

FEDERAL AWARDS

Internal control over major programs:

Material weakness(es) identified?

No

Significant deficiency(ies) identified?

None reported

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

Unqualified

Any audit findings disclosed that are required to be reported in accordance with

No

Section .510(a) of OMB A-133

Identification of major programs:

CFDA Number(s)

Name of Federal Program or Cluster

84.010, 84.389 (ARRA)

Title I -Basic Grants Low Income and Neglected
(including ARRA)

84.011

Title I -Migrant Ed Cluster

84.410

Educational Jobs Fund

84.394 (ARRA)

State Fiscal Stabilization Funds (ARRA)

Dollar threshold used to distinguish between Type A and Type B programs:

\$ 300,000

Auditee qualified as low-risk auditee?

Yes

STATE AWARDS

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

Unqualified

MORGAN HILL UNIFIED SCHOOL DISTRICT

FINANCIAL STATEMENT FINDINGS FOR THE YEAR ENDED JUNE 30, 2011

The following findings represent significant deficiencies, material weaknesses, and/or instances of noncompliance related to the financial statements that are required to be reported in accordance with *Government Auditing Standards*. The findings have been coded as follows:

<u>Five Digit Code</u>	<u>AB 3627 Finding Type</u>
60000	Miscellaneous

2011-1 Code 60000

Criteria or Specific Requirements

Management is responsible for implementing and maintaining internal controls over financial reporting that provide management with reasonable, but not absolute, assurance that transactions are executed and recorded properly to permit the preparation of the financial statement in accordance with general accepted accounting principles.

Condition

During the audit, we noted that the District had omitted to accrue its charter school in-lieu property tax receivable of \$717,455 and had over accrued other program receivable of 57,014. As a result, audit adjustments were made in the amount of \$660,441 to accounts receivable in the General Fund.

Questioned costs

None. The receivables were properly recorded and included in the audited financial statements through an audit adjustment.

Effect

The unaudited actual receivables were understated by \$660,441.

Recommendation

We recommend that the District review its internal control policies and procedures over the recording of year end accruals and implement a procedure to ensure that transactions are recorded properly.

MORGAN HILL UNIFIED SCHOOL DISTRICT

FINANCIAL STATEMENT FINDINGS FOR THE YEAR ENDED JUNE 30, 2011

District Response

In 2009-10 a new type of property tax was levied on Redevelopment Agencies called Supplemental Educational Revenue Augmentation Fund (SERAF). When the County Office of Education calculated the in-lieu property tax payments to Charter School of Morgan Hill for 2009-10 the SERAF tax was included in the calculation which resulted in additional property tax revenues being transferred to Charter School of Morgan Hill. More than a year later, in March 2011, the County Office of Education notified the District that SERAF taxes should have been excluded from the in-lieu property tax calculation.

At the recommendation of the County Office of Education, with confirmation from the State, the District was advised that in order to correct the in-lieu property tax payments for 2009-10 a prior year adjustment to revenue limit would have to be recorded. The County Office of Education is responsible for carrying out all transactions related to revenue limit including posting at year-end any adjustments, receivables, and/or payables required. Although the County Office of Education made the prior year adjustment to revenue limit to reflect the change for in-lieu property taxes, unbeknownst to the District, the County Office of Education did not set-up a corresponding receivable. The receivable not being set-up resulted in the ending fund balance being understated.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2011**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**STATE AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2011**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS FOR THE YEAR ENDED JUNE 30, 2011

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

Financial Statement Findings

2010-1 Code030000

Internal Control

Finding

During the audit, we noted that the District had omitted fourth quarter unrestricted state lottery entitlement. As a result, audit adjustments were made in the amount of \$147,058 to accounts receivable in the General Fund.

Recommendation

We recommend that the District review its internal control policies and procedures over the recording of year end accruals and implement a procedure to ensure that transactions are recorded properly.

Current Status

Implemented.

Federal Awards Findings

None reported.

State Awards Findings

None reported.

Status

Not Implemented.

