MORGAN HILL UNIFIED SCHOOL DISTRICT

ANNUAL FINANCIAL REPORT

JUNE 30, 2008

MORGAN HILL UNIFIED SCHOOL DISTRICT

OF SANTA CLARA COUNTY

MORGAN HILL, CALIFORNIA

JUNE 30, 2008

GOVERNING BOARD

MEMBER	OFFICE	TERM EXPIRES
Julia Hover-Smoot	President	2008
Don Moody	Vice President	2010
Peter Mandel	Member	2008
Kathleen Sulivan	Member	2008
Bart Fisher	Member	2010
Michael J. Hickey.	Member	2010
Shelle Thomas	Member	2010

ADMINISTRATION

Alan K. Nishino	Superintendent
Bonnie Tognazzini	Deputy Superintendent

MORGAN HILL UNIFIED SCHOOL DISTRICT

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FINANCIAL SECTION

INDEPENDENT AUDITORS' 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, 2008, 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 2007-08* 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, 2008, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 15, 2008, 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.

260 Sheridan Avenue, Suite 440 Palo Alto, CA 94306 Tel: 650.462.0400 Fax: 650.462.0500 www.vtdcpa.com
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The required supplementary information, such as management's discussion and analysis and budgetary comparison information, is not a required part of the basic financial statements, but is 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.

The unaudited supplementary information listed in the table of contents, including the Combining Statements - Non-Major Governmental Funds is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Vavrinek Trine Day + Co. LLP

Palo Alto, California
December 15, 2008

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, 2008. 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 district has experienced growth in our enrollment, fiscal stability and operating surplus.

Enrollment and average daily attendance for the third consecutive year has increased. For 2005-06 to 2006-07, ADA increased by 136 or 1.63%. For 2006-07 to 2007-08, ADA increased by 127 or 1.5%.

The increase in general fund revenue is the net result of the increase in ADA, a 4.53% Cost of Living Adjustment (COLA) off-set by in lieu of property taxes now being booked as a decrease in revenue for 2007-08 result in revenue limit resources of almost $632,000 or 1.3% increase over 2006-07. Total general fund revenue decreased by $119,000 or -0.16%. The decrease in the total general fund revenue reflects increase in restricted resources due to COLA off-set by the elimination of one-time State block-grants, the reduction in mandated cost reimbursements, and spending more carryover funds compared to prior periods.

The general fund expenditures increased compared to prior year due to the increase funding and utilizing carryover funds. Our expenditures increased in the general fund by approximately $1.9 million. Instructional and instructional related expenditures increased by $2.8 million or 5.4%. The district's expenditures for pupil services, general administration, maintenance supplies and other outlay decreased by approximately $860,000, or -3.8% compared to 2006-07.

At year end, the district's general fund was able to increase its fund balance to $9.5 million, an increase of $923,279, a 10.7% increase, over the prior year.

The district-wide revenue reflected on the Statement of Activities decreased from $89.1 million for 2006-07 to $87.2 million for 2007-08, a decrease of $1.9 million, or 2.1% decrease. This decrease reflects reductions in capital project funding.

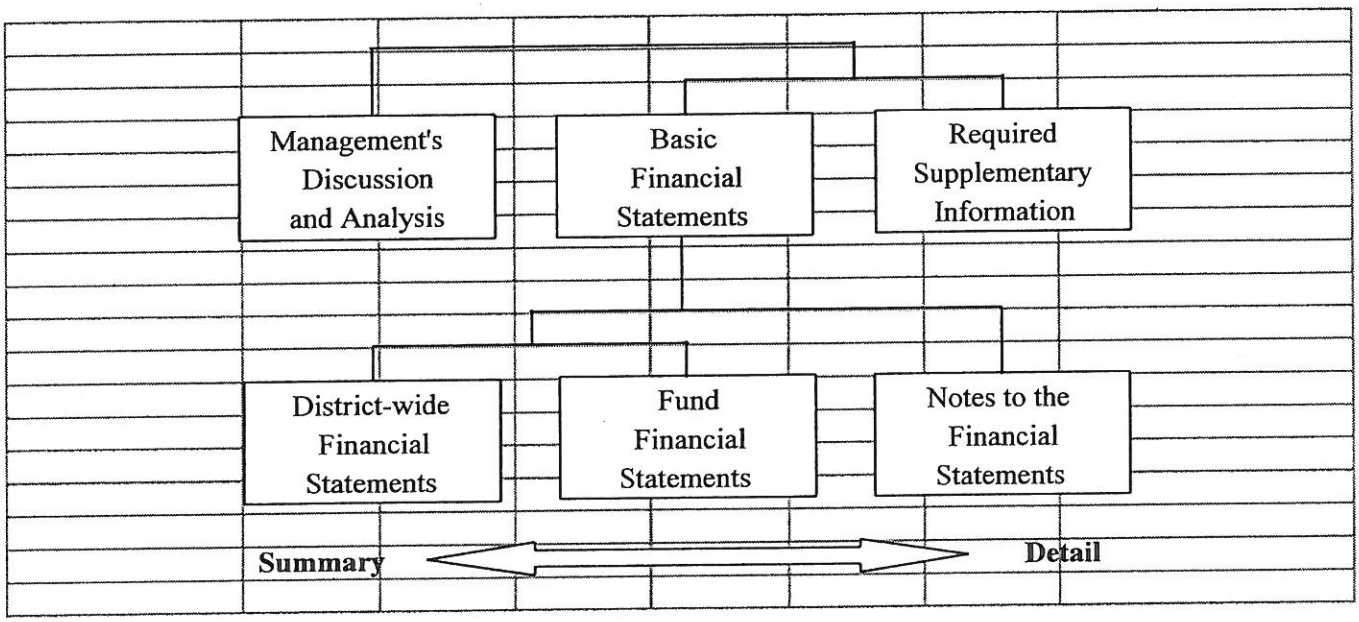
The district-wide expenses reflected on the Statement of Activities increased from $79.9 million for 2006-07 to $82.9 million for 2007-08, an increase of $2.9 million, or 3.7% increase over the prior year.

The district-wide net assets increased to $135.3 million, an increase of $4.2 million or 3.3% compared to 2007-08.

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 district-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. A comparison of the District's general fund is included.

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.

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 account all of the current year's revenues and expenses regardless of when cash is received or paid. These statements report information on the district as a whole and its activities in a way that helps answer the question, "How did we do financially during 2007-08?"

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 to assess the overall health of the District.

- Increases or decreases in the net assets of the District over time are indications of whether its financial position is improving or deteriorating, respectively.
- Additional non-financial factors such as condition of school buildings and other facilities, and changes to the property tax base of the District need to be considered in assessing 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.

- 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 $131million at June 30, 2007. Of this amount $5.8 million was unrestricted. For the period ending June 30, 2008, the District's net assets increased to $135 million, or a 3.3% increase. Of this amount $7.1 million was unrestricted.

(Table 1)
Comparative Statement of Net Assets

	Governmental Activities	
	2008	2007
Deposits and Investments	$ 38,163,170	$ 38,592,650
Receivables	3,714,950	5,511,051
Prepaid expenses	1,425,451	613,106
Stores inventory	169,579	144,346
Capital Assets	178,918,661	176,097,983
Total Assets	**222,391,811**	**220,959,136**
Accounts payable and other current liabilities	3,978,795	3,410,025
Deferred revenue	1,944,370	1,263,285
Long-term liabilities	81,175,457	85,259,247
Total Liabilities	**87,098,622**	**89,932,557**
Net assets		
Invested in capital assets, net of related debt	115,184,402	112,116,549
Restricted	12,933,775	13,048,544
Unrestricted	7,175,012	5,861,486
Total Net Assets	**$ 135,293,189**	**$ 131,026,579**

The District's net asset position increased by $4.2 million for this fiscal year (See Table 1). The District's expenses for instruction and pupil services represented 76 percent of total expenses. The purely administrative activities of the District account for just 6 percent of total costs. The remaining 18 percent was spent in the areas of plant services and other expenses, i.e., interest on long-term obligations, depreciation of capital assets and other outgo.

(Table 2)
Comparative Statement of Change in Net Assets

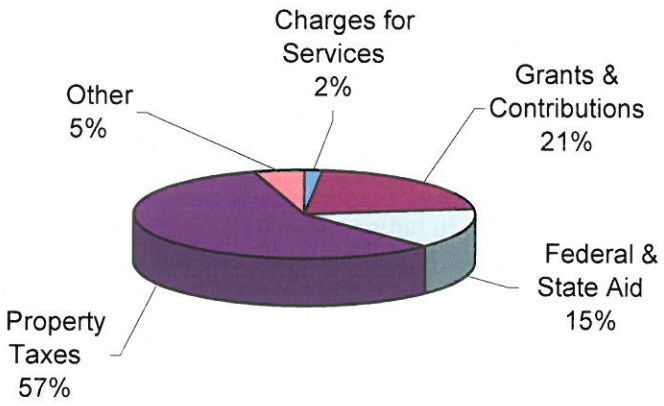
	Governmental Activities	
	2008	2007
Revenues		
Program revenues:	$ 19,990,240	$ 19,694,810
General revenues:		
Taxes levied for general purposes	42,896,801	38,085,638
Taxes levied for debt service	6,606,035	6,897,072
Taxes levied for other specific purpose	826,412	1,303,125
Federal and State Aid not restricted to specific purposes	12,681,075	15,678,115
Interest and investment earnings	803,096	931,620
Miscellanous	3,431,021	6,555,876
Total Revenues	**87,234,680**	**89,146,256**
Expenses		
Instruction	45,975,441	43,177,798
Insturction related services	9,155,797	8,201,434
Pupis support services	8,387,351	7,882,612
General administration	4,686,993	4,736,120
Plant services	7,123,112	7,115,000
Other	7,639,376	8,872,010
Total Expenses	**82,968,070**	**79,984,974**
Increase In Net Assets	**$ 4,266,610**	**$ 9,161,282**

Governmental Activities

As reported in the Statement of Activities, the cost of all the District's governmental activities this year was $82.9 million. The amount that our local taxpayers financed for these activities through property taxes was $50.3 million. Federal and State aid not restricted to specific purposes total $12.6 million. State and Federal Categorical program revenues which include charges for services and sales of $1.4 million and operating grants and contributions of $18.5 million totaling over $19.9 million, or 23% of the revenue of the entire District (See Figure 1).

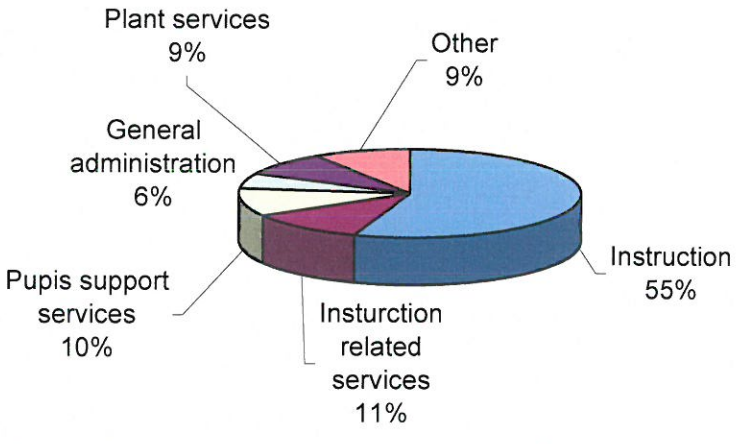
Sources of Revenue for the 2007-08 Fiscal Year

Figure 1



Expenses for the Fiscal Year 2007-08

Figure 2



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 $36.1 million, an decrease of $3 million from the previous fiscal year. This decrease is mainly reflected in the Building Fund and Capital Facilities Fund. The General Fund balance increased $923,279.

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 enrollments.
- 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 adding $923,279 to the General Fund ending balance. The State recommends an ending reserve for economic uncertainties of 3%. The District's ending reserve for economic uncertainty was 3%.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

By the end of the 2007-08 fiscal year, the District had invested $222 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 $178.9 million at June 30, 2008 which is an increase of $4.4 million from the previous year due to acquisitions totaling $17 million and depreciation expense of $3 million.

Table 3
Comparative Schedule of Capital Assets
(net of depreciation)
June 30, 2008 and 2007

	2008	2007	Difference	Percentage Change
Land	$ 724,021	$ 724,021	$ -	0.0%
Buildings & Improvements	81,358,797	74,084,913	7,273,884	9.8%
Machinery & Equipment	3,048,315	3,376,396	(328,081)	-9.7%
Work In Progress	93,787,528	96,331,202	(2,543,674)	-2.6%
Totals	**$ 178,918,661**	**$ 174,516,532**	**$ 4,402,129**	**2.5%**

Long-Term Obligations

As of June 30, 2008, the district has $79.8 million in long-term obligations outstanding.

Table 4

	2008	2007
General obligation bonds (Including premiums, accretions and defeasance costs)	$ 79,589,908	$ 82,663,477
Compensated absences	307,091	344,092
Totals	**$ 79,896,999**	**$ 83,007,569**

The long-term obligations paid by the District were $3,785,000.

FACTORS BEARING ON THE DISTRICT'S FUTURE

Under the leadership of superintendent, Dr. Alan K. Nishino, Morgan Hill Unified School District has focused on improving our student's 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, increase overall academic achievement for all students while aggressively closing the achievement gap between all numerically significant subgroups.
- 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 would not otherwise have for our students.

The district has experienced three years of growth in enrollment and corresponding increase in our average daily attendance (ADA). This increase in ADA translates into additional dollars for our district.

The Morgan Hill Unified School District has been notified that four of the elementary schools are subject to Program Improvement. There will be 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 contacts. Administrative 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. Classified retirees receive the same-post employment health care benefits after attaining age 55 for a specified periods of no more that 5 years. Currently a total of 120 employees meet these eligibility requirements. During the 2007-08 school year, expenditures of $562,154 were recognized for retiree's health care benefits. The District will review the implementation of Governmental Accounting Standards Board (GASB) 45 and the impact of reporting the costs of providing post-employment benefits to our staff.

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.

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 Loreen Dow, 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, 2008

	Governmental Activities
ASSETS	
Deposits and investments	$ 38,163,170
Receivables	3,714,950
Prepaid expenses	87,300
Deferred charges	1,338,151
Stores inventories	169,579
Capital assets not depreciated	94,511,549
Capital assets, net of accumulated depreciation	84,407,112
Total Assets	222,391,811
LIABILITIES	
Accounts payable	3,978,795
Interest payable	1,278,458
Deferred revenue	1,944,370
Current portion of long-term obligations	4,063,607
Noncurrent portion of long-term obligations	75,833,392
Total Liabilities	87,098,622
NET ASSETS	
Invested in capital assets, net of related debt	115,184,402
Restricted for:	
Legally restricted	4,959,724
Debt service	4,233,936
Capital projects	2,014,971
Special revenue	1,725,144
Unrestricted	7,175,012
Total Net Assets	$ 135,293,189

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

STATEMENT OF ACTIVITIES
JUNE 30, 2008

Functions/Programs	Expenses	Program Revenues: Charges for Services and Sales	Program Revenues: Operating Grants and Contributions	Net (Expenses) Revenues and Changes in Net Assets: Governmental Activities
Governmental Activities:				
Instruction	$ 45,975,441	$ 34,199	$ 9,378,046	$ (36,563,196)
Instruction-related activities:				
Supervision of instruction	2,272,880	3,083	1,562,031	(707,766)
Instructional library and technology	282,096	1,437	5,951	(274,708)
School site administration	6,600,821	14,495	551,939	(6,034,387)
Pupil services:				
Home-to-school transportation	3,022,365	257,318	1,801,985	(963,062)
Food services	2,373,073	929,800	1,358,827	(84,446)
All other pupil services	2,991,913	583	987,061	(2,004,269)
General administration:				
Data processing	785,646	-	-	(785,646)
All other general administration	3,901,347	63,473	1,195,346	(2,642,528)
Plant services	7,123,112	96,368	496,147	(6,530,597)
Ancillary services	576,944	-	-	(576,944)
Community services	98,790	-	-	(98,790)
Interest on long-term obligations	3,993,874	-	-	(3,993,874)
Other outgo	2,969,768	8,826	1,243,325	(1,717,617)
Total Governmental-Type Activities	$ 82,968,070	$ 1,409,582	$ 18,580,658	(62,977,830)
General revenues and subventions:				
Property taxes, levied for general purposes				42,896,801
Property taxes, levied for debt service				6,606,035
Taxes levied for other specific purposes				826,412
Federal and state aid not restricted to specific purposes				12,681,075
Interest and investment earnings				803,096
Miscellaneous				3,431,021
Subtotal, General Revenues				67,244,440
Change in Net Assets				4,266,610
Net Assets - Beginning				131,026,579
Net Assets - Ending				$ 135,293,189

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 2008

	General Fund	Building Fund	Bond Interest and Redemption Fund
ASSETS			
Deposits and investments	$ 11,198,653	$ 16,430,918	$ 5,489,706
Receivables	3,018,862	146,513	22,688
Due from other funds	91,802	-	-
Prepaid expenditures	87,300	-	-
Stores inventories	165,102	-	-
Total Assets	$ 14,561,719	$ 16,577,431	$ 5,512,394
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	$ 3,070,537	$ 721,782	$ -
Due to other funds	548	-	-
Deferred revenue	1,944,370	-	-
Total Liabilities	5,015,455	721,782	-
Fund Balances:			
Reserved for:			
Revolving cash	14,500	-	-
Stores inventories	165,102	-	-
Prepaid expenditures	87,300	-	-
Legally restricted programs	3,344,194	-	-
Unreserved:			
Designated	5,273,000	-	-
Undesignated, reported in:			
General fund	662,168	-	-
Special revenue funds	-	-	-
Debt service funds	-	-	5,512,394
Capital projects funds	-	15,855,649	-
Total Fund Balance	9,546,264	15,855,649	5,512,394
Total Liabilities and Fund Balances	$ 14,561,719	$ 16,577,431	$ 5,512,394

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

Non Major Governmental Funds	Total Governmental Funds
$ 5,043,893	$ 38,163,170
409,902	3,597,965
548	92,350
-	87,300
4,477	169,579
$ 5,458,820	$ 42,110,364
$ 186,476	$ 3,978,795
91,802	92,350
-	1,944,370
278,278	6,015,515
6,000	20,500
4,477	169,579
-	87,300
-	3,344,194
-	5,273,000
-	662,168
3,155,094	3,155,094
-	5,512,394
2,014,971	17,870,620
5,180,542	36,094,849
$ 5,458,820	$ 42,110,364

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET ASSETS
JUNE 30, 2008

Total Fund Balance - Governmental Funds		**$ 36,094,849**
Amounts Reported for Governmental Activities in the Statement of Net Assets are Different Because:		
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	$ 222,450,926	
Accumulated depreciation is	(43,532,265)	
Net Capital Assets		178,918,661
Expenditures relating to issuance of debt of next fiscal year were recognized on modified accrual basis, but are not recognized on the accrual basis.		1,338,151
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.		(1,278,458)
In governmental funds, the receipt of the special education mandated cost settlement is reported as revenue in the year received. On the statement of net assets, the settlement amount is recorded as a receivable and payments received in the current year reduce the receivable amount.		116,985
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	73,169,040	
Defeasance cost	(4,456,891)	
Premium	8,896,571	
Accreted interest on the bonds	1,981,188	
Compensated absences (vacations)	307,091	
Total Long-Term Liabilities		(79,896,999)
Total Net Assets - Governmental Activities		**$ 135,293,189**

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, 2008

	General Fund	Building Fund	Bond Interest and Redemption Fund
REVENUES			
Revenue limit sources	$ 49,743,341	$ -	$ -
Federal sources	3,313,274	-	-
Other State sources	13,089,486	-	44,013
Other local sources	7,480,069	825,511	6,642,166
Total Revenues	73,626,170	825,511	6,686,179
EXPENDITURES			
Current			
Instruction	42,739,368	-	-
Instruction-related activities:			
Supervision of instruction	2,156,655	-	-
Instructional library, media and technology	267,671	-	-
School site administration	5,972,289	-	-
Pupil services:			
Home-to-school transportation	2,867,814	-	-
Food services	152	-	-
All other pupil services	2,838,920	-	-
General administration:			
Data processing	745,472	-	-
All other general administration	3,526,812	-	-
Plant services	6,847,033	-	-
Facility acquisition and construction	841,891	5,233,356	-
Ancillary services	547,442	-	-
Community services	93,738	-	-
Other outgo	2,969,768	-	-
Debt service			
Principal	-	-	3,785,000
Interest and other	-	-	3,145,620
Total Expenditures	72,415,025	5,233,356	6,930,620
Excess (Deficiency) of Revenues Over Expenditures	1,211,145	(4,407,845)	(244,441)
Other Financing Sources (Uses):			
Transfers in	45,037	-	-
Transfers out	(332,903)	-	-
Net Financing Sources (Uses)	(287,866)	-	-
NET CHANGE IN FUND BALANCES	923,279	(4,407,845)	(244,441)
Fund Balance - Beginning	8,622,985	20,263,494	5,756,835
Fund Balance - Ending	$ 9,546,264	$ 15,855,649	$ 5,512,394

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

Nonmajor Governmental Funds	Total Governmental Funds
$ 556,862	$ 50,300,203
1,356,618	4,669,892
1,128,460	14,261,959
3,093,874	18,041,620
6,135,814	87,273,674
1,002,884	43,742,252
-	2,156,655
-	267,671
290,995	6,263,284
-	2,867,814
2,251,572	2,251,724
-	2,838,920
-	745,472
175,037	3,701,849
603,270	7,450,303
1,441,186	7,516,433
-	547,442
-	93,738
-	2,969,768
-	3,785,000
-	3,145,620
5,764,944	90,343,945
370,870	(3,070,271)
332,903	377,940
(45,037)	(377,940)
287,866	-
658,736	(3,070,271)
4,521,806	39,165,120
$ 5,180,542	$ 36,094,849

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES TO THE DISTRICT-WIDE STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2008

Total Net Change in Fund Balances - Governmental Funds		**$ (3,070,271)**
Amounts Reported for Governmental Activities in the Statement of Activities are Different Because:		
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.		
Depreciation expense	$ (3,441,496)	
Capital outlays	7,843,625	
Net Expense Adjustment		4,402,129
In the statement of activities, certain operating expenses, such as compensated absences (vacations) are measured by the amounts earned during the year. In the governmental funds, however, expenditures for these items are measured by the amount of financial resources used (essentially, the amounts actually paid). Vacation used was more than the amounts earned by $37,001.		37,001
Amortization of issuance cost is not recorded in the governmental funds, but it is amortized over the life of the bond in the statement of activities.		(121,650)
Amortization of premium on long-term liabilities is not recognized in the governmental funds. In the government-wide statements, it is deferred and amortized over the life of the related debt.		808,779
Debt defeasance costs are not recognized in governmental funds but are amortized to operations in the statement of activities over the life of the refunding bonds.		(405,172)
Accreted interest on capital appreciation bonds does not require the use of current financial resources, and thus is not recorded in the governmental funds. In the statement of activities, however, accreted interest expense is recognized in the entity-wide statements as an addition to long-term liabilities.		(1,115,038)
Payment of principal on long-term liabilities is an expenditure in the governmental funds, but it reduces long-term liabilities in the statement of net assets and does not affect the statement of activities.		3,785,000
Interest on long-term debt is recorded as an expenditure in the funds when it is due; however, in the statement of activities, interest expense is recognized as the interest accrues, regardless of when it is due.		(15,173)
In the governmental funds, the receipt of the special education manadated settlement is reported as reveue in the year received. On the statement of net assets, the settlement amount is recorded as a receivable and payments received in the current year reduce the receivable amount.		(38,995)
Change in Net Assets of Governmental Activities		**$ 4,266,610**

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

FIDUCIARY FUNDS
STATEMENT OF NET ASSETS
JUNE 30, 2008

	Agency Funds
ASSETS	
Deposits and investments	$ 459,811
Total Assets	$ 459,811
LIABILITIES	
Due to student groups	$ 459,811
Total Liabilities	$ 459,811

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

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 nine elementary, two middle, two high schools, a continuation high school and a community adult school as well as a home-schooling program.

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

Component Units

Component units are legally separate organizations for which the District is financially accountable. Component units may also include organizations that are fiscally dependent on the District, in that the District approves their budget, the issuance of their debt or the levying of their taxes. In addition, component units are other legally separate organizations for which the District is not financially accountable but the nature and significance of the organization's relationship with the District is such that exclusion would cause the District's financial statements to be misleading or incomplete. The District has no component units.

Other Related Entities

Joint Powers Agencies and Public Entity Risk Pools The District is associated with one public entity risk pool, the Santa Clara County Schools Insurance Group. These organizations do not meet the criteria for inclusion as component units of the District. Additional information is presented in Note 15 to the financial statements.

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 tow 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:

Major Governmental Funds

General Fund The General Fund is the chief operating fund for all Districts. It is used to account for the ordinary operations of a District. All transactions except those required or permitted by law to be in another fund are accounted for in this fund.

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 from specific revenue sources (other than trusts or for major capital projects) that are restricted to the financing of particular activities:

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

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

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

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

Special Reserve Fund for Other Than Capital Outlay The Special Reserve for Other Than Capital Outlay Projects is used primarily to provide for the accumulation of General Fund monies for general operating purposes other than for capital outlay *(Education Code* Section 42840).

Debt Service Fund for Blended Component Units The Debt Service Fund for Blended Component Units is used to account for the accumulation of resources for the payment of principal and interest on bonds issued by Mello-Roos Community Facilities Districts and similar entities that are considered blended component units of the District under generally accepted accounting principles (GAAP).

Mello Roos Debt Service Fund The Mello Roos Debt Service Fund is used to account for the interest and principal redemption of debt.

Capital Project Funds The Capital Project funds are established to account for financial resources to be used for the acquisition or construction of major capital facilities (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).

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. The District's agency fund accounts for student body activities (ASB) and scholarship activities.

Basis of Accounting - Measurement Focus

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

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

Net 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.

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. Principal and interest on long-term obligations, which have not matured, are recognized when paid in the governmental funds. Allocations of costs, such as depreciation and amortization, are not recognized in the governmental funds.

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, 2008 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.

Restricted Assets

Restricted assets arise when restrictions on their use change the normal understanding of the availability of the asset. Such constraints are either imposed by creditors, contributors, grantors, or laws of other governments or imposed by enabling legislation.

Prepaid Expenditures

Prepaid expenditures (expenses) represent amounts paid in advance of receiving goods or services. The District has the option of reporting expenditure in governmental funds for prepaid items either when purchased or during the benefiting period. The District has chosen to report the expenditures over the benefiting period.

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 and expenses in the proprietary type funds when used.

Capital Assets and Depreciation

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

When purchased, such assets are recorded as expenditures in the governmental funds and capitalized in the government-wide statement of net assets. The valuation basis for capital assets is historical cost, or where historical cost is not available, estimated historical cost based on replacement cost.

Capital assets in the proprietary funds are capitalized in the fund in which they are utilized. The valuation basis for proprietary fund capital assets is the same as those used for the capital assets of governmental funds.

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/infrastructure, 5 to 50 years; equipment, 2 to 15 years.

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

Accumulated unpaid vacation benefits 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.

Fund Balance Reserves and Designations

The District reserves those portions of fund balance which are legally segregated for a specific future use or which do not represent available expendable resources and therefore are not available for appropriation or expenditure. Unreserved fund balance indicates that portion of fund balance which is available for appropriation in future periods. Fund balance reserves have been established for revolving cash accounts, stores inventories, prepaid expenditures (expenses), and legally restricted grants and entitlements.

Designations of fund balances consist of that portion of the fund balance that has been designated (set aside) by the governing board to provide for specific purposes or uses. Fund equity designations have been established for economic uncertainties, and other purposes.

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.

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 purposes of the budget, 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.

New Accounting Pronouncements

In July 2004, GASB issued GASBS No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement will require local governmental employers who provide other postemployment benefits (OPEB) as part of the total compensation offered to employees to recognize the expense and related liabilities (assets) in the government-wide financial statements of net assets and activities. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of State and local governmental employers.

Current financial reporting practices for OPEB generally are based on pay-as-you-go financing approaches. They fail to measure or recognize the cost of OPEB during the periods when employees render the services or to provide relevant information about OPEB obligations and the extent to which progress is being made in funding those obligations.

This Statement generally provides for prospective implementation - that is, that employers set the beginning net OPEB obligation at zero as of the beginning of the initial year. The District will be required to implement the provisions of this Statement for the fiscal year ended June 30, 2009. The District is in the process of determining the impact the implementation of this Statement will have on the government-wide statement of net assets and activities.

In May 2007, GASB issued GASBS No. 50, *Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27*. This Statement more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits (OPEB) and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplementary information (RSI) by pension plans and by employers that provide pension benefits. The reporting changes required by this Statement amend applicable note disclosure and RSI requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, to conform with requirements of Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement is effective for periods beginning after June 15, 2007, except for requirements related to the use of the entry age actuarial cost method for the purpose of reporting a surrogate funded status and funding progress of plans that use the aggregate actuarial cost method, which are effective for periods for which the financial statements and RSI contain information resulting

from actuarial valuations as of June 15, 2007, or later. Early implementation is encouraged. Adoption of this statement is not expected to materially impact the District's financial statement.

In June 2007, GASB issued GASBS No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2009. The provisions of this Statement generally are required to be applied retroactively. For governments that were classified as phase 1 or phase 2 governments for the purpose of implementing Statement No. 34, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980, except for those considered to have indefinite useful lives as of the effective date of this Statement and those that would be considered internally generated. Adoption of this statement is not expected to materially impact the District's financial statement.

In November 2007, GASB issued GASBS No. 52, *Land and Other Real Estate Held as Investments by Endowments*. This Statement establishes consistent standards for the reporting of land and other real estate held as investments by essentially similar entities. It requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the methods and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported at fair value. The guidance in this Statement is effective for financial statements for reporting periods beginning after June 15, 2008, with earlier application encouraged. Adoption of this statement is not expected to materially impact the District's financial statement.

In June 2008, GASB issued GASBS No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This Statement is intended to improve how State and local governments report information about derivative instruments—financial arrangements used by governments to manage specific risks or make investments—in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements and is effective for financial statements for reporting periods beginning after June 15, 2009, with earlier application encouraged. Adoption of this statement is not expected to materially impact the District's financial statement.

NOTE 2 – DEPOSITS AND INVESTMENTS

Summary of Deposits and Investments

Deposits and investments as of June 30, 2008, are classified in the accompanying financial statements as follows:

Governmental activities	$38,163,170
Fiduciary funds	459,811
Total Deposits and Investments	$38,622,981

Deposits and investments as of June 30, 2008, consist of the following:

Cash on hand and in banks	$ 778,365
Investments	37,844,616
Total Deposits and Investments	$38,622,981

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.

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. The fair value of the deposits with county treasurer at June 30, 2008 was $37,923,800 and the weighted average maturity of the pool was 413 days.

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. The District's investments in the county pool is not required to be rated, nor has it been rated as of June 30, 2008.

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 agencies. California law also allows financial institutions to secure public deposits by pledging first trust deed mortgage notes having a value of 150 percent of the secured public deposits and letters of credit issued by the Federal Home Loan Bank of San Francisco having a value of 105 percent of the secured deposits. The District believes it has no significant custodial credit risk with respect to any of its bank deposits.

NOTE 3 - RECEIVABLES

Receivables at June 30, 2008, consisted of intergovernmental grants, entitlements, interest and other local sources. All receivables are considered collectible in full.

	General Fund	Building Fund	Bond Interest and Redemption Fund	Non-Major Governmental Funds	Total
Federal Government					
Categorical aid	$ 1,088,249	$ -	$ -	$ 262,199	$ 1,350,448
State Government					
Apportionment	-	-	-	47,668	47,668
Categorical aid	938,247	-	-	-	938,247
Lottery	570,623	-	-	59,179	629,802
Local Government					
Interest	239,928	145,972	22,688	40,856	449,444
Other Local Sources	181,815	541	-	-	182,356
Total	$ 3,018,862	$ 146,513	$ 22,688	$ 409,902	$ 3,597,965

Long-term receivables of $116,985 consist of the special education mandated settlement which will be received at a rate of approximately $38,995 each year for the next four (4) years.

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2008, was as follows:

	Balance July 1, 2007	Additions	Deductions	Balance June 30, 2008
Governmental Activities				
Capital Assets Not Being Depreciated:				
Land	$ 724,021	$ -	$ -	$ 724,021
Construction in progress	96,331,202	7,271,191	9,814,865	93,787,528
Total Capital Assets Not Being Depreciated	97,055,223	7,271,191	9,814,865	94,511,549
Capital Assets Being Depreciated:				
Buildings and improvements	111,681,875	9,814,865	-	121,496,740
Furniture and equipment	5,870,203	572,434	-	6,442,637
Total Capital Assets Being Depreciated	117,552,078	10,387,299	-	127,939,377
Total Capital Assets	214,607,301	17,658,490	9,814,865	222,450,926
Less Accumulated Depreciation:				
Buildings and improvements	37,596,962	2,540,981	-	40,137,943
Furniture and equipment	2,493,807	900,515	-	3,394,322
Total Accumulated Depreciation	40,090,769	3,441,496	-	43,532,265
Governmental Activities Capital Assets, Net	$ 174,516,532	$ 14,216,994	$ 9,814,865	$ 178,918,661

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

Governmental Activities	
Instruction	$ 2,270,190
Supervision of instruction	116,225
Instructional library, media, and technology	14,425
School site administration	337,537
Home-to-school transportation	154,551
Food services	121,349
All other pupil services	152,993
Ancillary services	29,502
Community services	5,052
Data processing	40,174
All other general administration	199,498
Total Depreciation Expense All Activities	$ 3,441,496

NOTE 5 – INTERFUND TRANSACTIONS

Interfund Receivables/Payables (Due To/Due From)

Interfund receivable and payable balances consist of amounts between major and non-major governmental funds are as follows:

	Due From		
Due To	General Fund	Non-major Governmental	Total
General	$ -	$ 548	$ 548
Non-Major Governmental funds	91,802	-	91,802
Total	$ 91,802	$ 548	$ 92,350

All balances resulted from the time lag between the date that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transaction are recorded in the accounting system, and (3) payments between funds are made.

Operating Transfers

Interfund transfers for the year ended June 30, 2008, consisted of the following:

	Transfer In		
Transfer Out	General Fund	Non-Major Governmental Fund	Total
General Fund	$ -	$ 332,903	$ 332,903
Non-Major Governmental funds	45,037	-	45,037
Total	$ 45,037	$ 332,903	$ 377,940

General Fund transferred to Deferred Maintenance Fund for District match.	$ 332,903
Capital Facilities Fund transferred to General Fund for support.	45,037
Total	$ 377,940

NOTE 6 - ACCOUNTS PAYABLE

Accounts payable at June 30, 2008, consisted of the following:

	General Fund	Building Fund	Non-Major Governmental Funds	Total
Vendor payables	$ 979,711	$ 721,782	$ 182,247	$ 1,883,740
State apportionment	996,593	-	3,276	999,869
Salaries and benefits	1,094,233	-	953	1,095,186
Total	$ 3,070,537	$ 721,782	$ 186,476	$ 3,978,795

NOTE 7 - DEFERRED REVENUE

Deferred revenue at June 30, 2008, consists of the following:

	General Fund	Total
State categorical aid	$ 102,184	$ 102,184
Other local	1,842,186	1,842,186
Total	$ 1,944,370	$ 1,944,370

NOTE 8 - TAX AND REVENUE ANTICIPATION NOTES (TRANS)

On July 6, 2006, the District issued $8,370,000 Tax and Revenue Anticipation Notes bearing interest at 3.5 percent. The notes were issued to supplement cash flows. Interest and principal were due and payable on July 6, 2007. By June 6, 2007, 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. Changes in the outstanding liability for the Tax and Revenue Anticipation Note are as follows:

Issue Date	Rate	Maturity Date	Outstanding July 1, 2007	Additions	Payments	Outstanding June 30, 2008
7/6/2007	3.62%	7/1/08	$ -	$ 8,480,000	$ 8,480,000	$ -

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, 2007	Additions	Deductions	Balance June 30, 2008	Due in One Year
General obligation bonds	$ 76,954,040	$ -	$ 3,785,000	$ 73,169,040	$ 3,660,000
Defeasance cost	(4,862,063)	-	(405,172)	(4,456,891)	(405,172)
Premium	9,705,350	-	808,779	8,896,571	808,779
Accretions on general obligation bonds	866,150	1,115,038	-	1,981,188	-
Accumulated vacation - net	344,092	-	37,001	307,091	-
	$ 83,007,569	$ 1,115,038	$ 4,225,608	$ 79,896,999	$ 4,063,607

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.

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, 2007	Issued/ Accreted	Redeemed/ Defeased	Bonds Outstanding June 30, 2008
2000	2025	4.6%-5.5%	$ 38,000,000	$ -	$ -	$ -	$ -
2002	2020	3.5%-5.25%	28,210,000	-	-	-	-
2002	2026	5.5%-5.6%	6,287,754	-	-	-	-
2006 Refunding (CIB)	2020	3.5%-4.24%	68,180,000	68,180,000	-	3,785,000	64,395,000
2006 Refunding (CAB)	2016	4.25%-4.42%	8,774,040	9,640,190	1,115,038	-	10,755,228
			$ 149,451,794	$ 77,820,190	$ 1,115,038	$ 3,785,000	$ 75,150,228
						Defeasance	(4,456,891)
						Premium	8,896,571
							$ 79,589,908

Debt Service Requirements to Maturity

The bonds mature through 2022 as follows:

Fiscal Year	Principal	Interest to Maturity	Total
2009	$ 3,660,000	$ 3,068,300	$ 6,728,300
2010	4,140,000	2,921,900	7,061,900
2011	4,660,000	2,756,300	7,416,300
2012	5,215,000	2,569,900	7,784,900
2013	5,865,000	2,309,150	8,174,150
2014-2018	24,094,040	23,346,460	47,440,500
2019-2022	25,535,000	2,269,050	27,804,050
Total	73,169,040	$ 39,241,060	$ 112,410,100
Accretion to Date	1,981,188		
	$ 75,150,228		

Accumulated Unpaid Employee Vacation

The long-term portion of accumulated unpaid employee vacation for the District at June 30, 2008 amounted to $307,091.

NOTE 10 - FUND BALANCES

Fund balances with reservations/designations are composed of the following elements:

	General Fund	Building Fund	Bond Interest and Redemption Fund	Non-Major Governmental Funds	Total
Reserved					
Revolving cash	$ 14,500	$ -	$ -	$ 6,000	$ 20,500
Stores inventory	165,102	-	-	4,477	169,579
Prepaid expenditures	87,300	-	-	-	87,300
Restricted programs	3,344,194	-	-	-	3,344,194
Total Reserved	3,611,096	-	-	10,477	3,621,573
Unreserved					
Designated					
Economic uncertainties	2,133,185	-	-	-	2,133,185
Other designation	3,139,815	-	-	-	3,139,815
Total Designated	5,273,000	-	-	-	5,273,000
Undesignated	662,168	15,855,649	5,512,394	5,170,065	27,200,276
Total Unreserved	5,935,168	15,855,649	5,512,394	5,170,065	32,473,276
Total	$9,546,264	$15,855,649	$5,512,394	$ 5,180,542	$36,094,849

NOTE 11 - POSTEMPLOYMENT BENEFITS

Regular Postemployment Benefits

The District provides post-employment health care benefits in accordance with District employment contracts. Administrative 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. Classified retirees receive the same-post employment health care benefits after attaining age 50 for a specified period of no more than 5 years. Currently 120 employees meet these eligibility requirements. During the year, expenditures of $562,154 were recognized for retiree's health care benefits.

The approximate accumulated future liability for the District at June 30, 2008, amounts to $2,273,794. This amount was calculated based upon the number of retirees receiving benefits multiplied by the yearly district payment per employee in effect at June 30, 2008, multiplied by the number of years of payments remaining.

Supplemental Early Retirement Plan (SERP)

The District also provides a supplemental early retirement plan in a single premium annuity contract with the Principal Life Insurance Company to 34 qualified retirees. The total cost to the District for the contract is $1,870,785. The contract is payable in five annual payments of $374,157 beginning in 2003-2004. The District has paid off the last annual payment as of 6/30/2008.

NOTE 12 - RISK MANAGEMENT

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, 2008, 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 2008, 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.

Coverage provided by Santa Clara County Schools Insurance Group for property and liability and workers' compensation is as follows:

Insurance Program / Company Name	Type of Coverage	Limits
Workers' Compensation Program		
Santa Clara County Schools Insurance Group	Workers' Compensation	State Statutory Limit
Property and Liability		
Santa Clara County Schools Insurance Group	Property	$ 5,000,000
	Liability	$ 1,000,000
	Excess Liability	$ 20,000,000
	ExcessProperty	$ 244,750,000

Employee Medical Benefits

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

NOTE 13 - EMPLOYEE RETIREMENT SYSTEMS

Qualified employees are covered under multiple-employer contributory 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 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 2007-2008 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, 2008, 2007, and 2006, were $2,953,829, $2,803,223, and $2,632,560, 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.

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 2007-2008 was 9.306 percent of annual 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, 2008, 2007, and 2006, were $903,171, $842,235, and $760,982, 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 and CalPERS on behalf of the District. These payments consist of State General Fund contributions to CalSTRS in the amount of $1,617,007 (4.517 percent of salaries subject to CalSTRS). This amount has been allocated in General Fund, Adult Fund and Child Development Fund for the amounts of $1,579,934, $14,090 and $22,983 respectively. No contributions were made for CalPERS for the year ended June 30, 2008. 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 Schedule.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

Grants

The District received financial assistance from Federal and State agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the General Fund or other applicable funds. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of the District at June 30, 2008.

Litigation

The District is involved in various litigations arising from the normal course of business. In the opinion of management and legal counsel, the disposition of all litigation pending is not expected to have a material adverse effect on the overall financial position of the District at June 30, 2008, except as noted below.

C.R. v. Morgan Hill Unified School District This special education due process case was filed on June 4, 2008. It settled with a written agreement on October 3, 2008. The settlement included a large lump-sum payment of $85,000.

G.G. v. Morgan Hill Unified School District This special education due process case was filed on November 5, 2008. It is still on-going and likely to end in a hearing. Should the District not prevail, the District could be ordered to put the student into the private school with a cost range, plus ancillary expenses, of $60,000 - $80,000 over the course of a school year.

Construction Commitments

As of June 30, 2008, the District had the following commitments with respect to the unfinished capital projects:

Capital Project	Remaining Construction Commitment	Expected Date of Completion
LOHS Renovation	$ 7,162,121	6/30/2009
Martin Murphy Modernization	30,187	6/30/2009
Britton Boys/Girls Locker Room	777,131	1/30/2009

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, 2008, the District made payment of $665,149 to the Santa Clara County Schools Insurance Group.

NOTE 16 - SUBSEQUENT EVENTS

The District issued $6,145,000 of Tax and Revenue Anticipation Notes dated July 1, 2008. The notes mature on July 6, 2009, and yield 1.65 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 February, 2009, until 100 percent of principal and interest due is on account in May, 2009.

REQUIRED SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

GENERAL FUND
BUDGETARY COMPARISON SCHEDULE
FOR THE YEAR ENDED JUNE 30, 2008

	Budgeted Amounts (GAAP Basis)		Actual	Variances - Favorable (Unfavorable)
	Original	Final	(GAAP Basis)	Final to Actual
REVENUES				
Revenue limit sources	$ 49,288,030	$ 51,915,371	$ 49,743,341	$ -
Federal sources	3,148,652	3,541,023	3,313,274	(227,749)
Other State sources	10,117,867	11,856,821	13,089,486	1,232,665
Other local sources	5,563,276	6,962,407	7,480,069	517,662
Total Revenues[1]	68,117,825	74,275,622	73,626,170	1,522,578
EXPENDITURES				
Current				
Instruction	39,302,115	45,499,145	42,739,368	2,759,777
Instruction-related activities:				
Supervision of instruction	1,685,525	2,479,401	2,156,655	322,746
Instructional library, media, and technology	274,263	294,577	267,671	26,906
School site administration	5,667,274	6,223,123	5,972,289	250,834
Pupil services:				
Home-to-school transportation	3,290,418	3,298,900	2,867,814	431,086
Food services	585	152	152	-
All other pupil services	2,839,335	2,912,989	2,838,920	74,069
General administration:				
Data processing	719,878	744,876	745,472	(596)
All other general administration	3,797,208	3,402,513	3,526,812	(124,299)
Plant services	6,616,690	7,594,663	6,847,033	747,630
Facility acquisition and construction	3,773	310	841,891	(841,581)
Ancillary services	529,243	612,791	547,442	65,349
Community services	-	1,159	93,738	(92,579)
Other outgo	3,111,828	3,025,203	2,969,768	55,435
Total Expenditures[1]	67,838,135	76,089,802	72,415,025	3,674,777
Excess (Deficiency) of Revenues Over Expenditures	279,690	(1,814,180)	1,211,145	3,025,325
Other Financing Sources (Uses):				
Transfers in	175,095	45,037	45,037	-
Transfers out	(310,000)	(365,467)	(332,903)	32,564
Net Financing Sources (Uses)	(134,905)	(320,430)	(287,866)	32,564
NET CHANGE IN FUND BALANCES	144,785	(2,134,610)	923,279	3,057,889
Fund Balance - Beginning	8,622,985	8,622,985	8,622,985	-
Fund Balance - Ending	$ 8,767,770	$ 6,488,375	$ 9,546,264	$ 3,057,889

[1] On behalf payments of $1,579,934 are included in the actual revenues and expenditures for General Fund, but have not been included in the budget amounts

SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED JUNE 30, 2008

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 Act:			
Title I - Basic Grants Low Income and Neglected	84.010	14329	$ 715,537
Title I - Migrant Education	84.011	14326	267,352
Title I - Migrant Education Summer Program	84.011	10005	37,512
Title I - Even Start Migrant Education	84.214	14768	25,750
Title I - Program Improvement School	84.010	14796	44,459
Title I - Advanced Placement Test	84.330	14831	5,135
Title II - Improvfing Teacher Quality	84.367	14341	258,779
Title II - Enhancing Education Through Technology	84.318	14334	7,112
Title III - Limited English Proficiency Student Program	84.365	10084	192,793
Title IV - Drug-Free Schools	84.186	14347	15,995
Title V - Innovative Education Strategies	84.298A	14354	9,420
Individuals with Disabilities Act:			
Basic Local Assistance Entitlement	84.027	13379	1,562,290
Preschool Grants	84.173	13430	46,090
Preschool Local Entitlement	84.027A	13682	72,608
Preschool Staff Development Grants	84.173A	13431	439
Carl Perkins Act:			
Vocational and Applied Technology	84.048	13924	54,171
Adult Education Act:			
Adult Basic Education	84.002A	14508	40,373
Adult Secondary Education	84.002	13978	9,804
English Literacy and Civics Education	84.002A	14109	28,999
Medi-Cal Billing Option	93.778	10013	1,817
Subtotal			3,396,435
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Passed though CDE:			
Child Development Act:			
Quality Improvement Activities	93.575	13979	4,807

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - CONTINUED
FOR THE YEAR ENDED JUNE 30, 2008

U.S. DEPARTMENT OF AGRICULTURE			
Passed though CDE:			
Child Nutrition Act:			
National School Lunch Program	10.555	13524	886,082
Especially Needy Breakfast	10.553	13526	381,685
Basic School Breakfast Program	10.553	13390	883
Commodity Supplemental Food Program [1]	10.555	13524	95,321
Subtotal			1,363,971
Total Expenditures of Federal Awards			$ 4,765,213

[1] Not recorded on the financial statements

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

LOCAL EDUCATION AGENCY ORGANIZATION STRUCTURE
JUNE 30, 2008

ORGANIZATION

The Morgan Hill Unified School District was established in 1999 and consists of an area comprising approximately 300 square miles. The District operates 9 elementary schools, 2 middle schools, 2 high schools, 1 continuation, and 1 adult school.

GOVERNING BOARD

MEMBER	OFFICE	TERM EXPIRES
Julia Hover-Smoot	President	2008
Don Moody	Vice President	2010
Bart Fisher	Member	2010
Michael J. Hickey	Member	2010
Peter Mendel	Member	2008
Shelle Thomas	Member	2010
Kathleen Sulivan	Member	2008

ADMINISTRATION

Alan K. Nishimo	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, 2008

	Second Period Report	Annual Report
ELEMENTARY		
Kindergarten	620	623
First through third	1,891	1,895
Fourth through sixth	1,903	1,905
Seventh and eighth	1,281	1,277
Special education	130	132
Total Elementary	5,825	5,833
SECONDARY		
Regular classes	2,617	2,602
Continuation education	92	86
Home and hospital	1	1
Special education	60	58
Total Secondary	2,770	2,747
Total K-12	8,595	8,579
CLASSES FOR ADULTS		
Concurrently enrolled	25	32
Not concurrently enrolled	167	179
Total Classes for Adults	192	211
Grand Total	8,787	8,790

	Hours of Attendance
Supplemental Instructional Hours	
Core instruction	10,769
Remedial instruction	54,495
Pupils recommended for retaintion	27,739
Pupils at risk of retaintion	1,037
Low STAR score	927
Total Hours	94,967

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF INSTRUCTIONAL TIME
FOR THE YEAR ENDED JUNE 30, 2008

Grade Level	1982-1983 Actual Minutes	1986-1987 Minutes Requirement	2007-2008 Actual Minutes	Number of Days Traditional Calendar	Status
Kindergarten	31,680	36,000	36,000	180	Complied
Grades 1 - 3	47,480	50,400			
Grade 1	-	-	51,025	180	Complied
Grade 2	-	-	51,025	180	Complied
Grade 3	-	-	51,025	180	Complied
Grades 4 - 6	52,740	54,000			
Grade 4	-	-	54,575	180	Complied
Grade 5	-	-	54,575	180	Complied
Grade 6	-	-	54,575	180	Complied
Grades 7-8	54,560	54,000			
Grade 7	-	-	55,730	180	Complied
Grade 8	-	-	55,730	180	Complied
Grade 9-12	57,726	64,800			
Grade 9	-	-	65,084	180	Complied
Grade 10	-	-	65,084	180	Complied
Grade 11	-	-	65,084	180	Complied
Grade 12	-	-	65,084	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, 2008

	General Fund	Building Fund
FUND BALANCE		
Balance, June 30, 2008, Unaudited Actuals	$ 9,819,082	$ 16,515,435
Increase in accounts payable	(272,818)	(659,786)
Balance, June 30, 2008, Audited Financial Statement	$ 9,546,264	$ 15,855,649

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2008

	(Budget) 2009[1]	2008	2007	2006
GENERAL FUND				
Revenues	$ 69,755,101	$ 73,626,170	$ 73,745,108	$ 64,194,647
Other sources	127,338	45,037	108,735	158,806
Total Revenues and Other Sources	69,882,439	73,671,207	73,853,843	64,353,453
Expenditures	70,434,100	72,415,025	70,439,148	63,629,707
Other uses and transfers out	365,467	332,903	336,359	334,067
Total Expenditures and Other Uses	70,799,567	72,747,928	70,775,507	63,963,774
INCREASE (DECREASE) IN FUND BALANCE	$ (917,128)	$ 923,279	$ 3,078,336	$ 389,679
ENDING FUND BALANCE	$ 8,629,136	$ 9,546,264	$ 8,622,985	$ 5,544,649
AVAILABLE RESERVES [2]	$ 2,151,041	$ 4,225,303	$ 4,448,300	$ 2,773,379
AVAILABLE RESERVES AS A PERCENTAGE OF TOTAL OUTGO [3]	3.04%	5.94%	6.42%	4.43%
LONG-TERM OBLIGATIONS	$ 75,800,000	$ 79,896,999	$ 83,007,569	$ 71,833,225
K-12 AVERAGE DAILY ATTENDANCE AT P-2 [4]	8,649	8,595	8,468	8,332

The General Fund balance has increased by $4,001,615, over the past two years. The fiscal year 2008-2009 budget projects a decrease of $917,128 (9.34 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 surpluses in the past three years, but anticipates incurring an operating deficit during the 2008-2009 fiscal year. Total long-term obligations have increased by $8,063,774 over the past two years.

Average daily attendance has increased by 263 over the past two years. A increase of 54 ADA is anticipated during fiscal year 2008-2009.

[1] Budget 2009 is included for analytical purposes only and has not been subjected to audit.

[2] Available reserves consist of all undesignated fund balances and all funds designated for economic uncertainty contained within the General Fund and Special Reserve Fund (other than capital outlay).

[3] On-behalf payments of $1,579,934, $1,503,962 and $1,408,215 have been excluded from the calculation of the available reserves percentage for fiscal year ending June 30, 2008, 2007 and 2006, respectively.

[4] Excludes adult education and ROP ADA.

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

EXCESS SICK LEAVE
JUNE 30, 2008

Section 19833.5 (a)(3)(c) Disclosure

Morgan Hill Unified School District provides more than 12 sick leave days in a school year to the Superintendent who is a CalSTRS member.

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF CHARTER SCHOOLS
FOR THE YEAR ENDED JUNE 30, 2008

Name of Charter School	Included in Audit Report
The Charter School of Morgan Hill	No

See accompanying note to supplementary information.

NOTE 1 - PURPOSE OF SCHEDULES

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*.

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.

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.

Excess Sick Leave

This schedule provides information required by the Audit Guide for California K-12 Local Educational Agencies for excess sick leave authorized or accrued for members of the California State Teachers Retirement System (CalSTRS).

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION
JUNE 30, 2008

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.

SUPPLEMENTARY INFORMATION - UNAUDITED

MORGAN HILL UNIFIED SCHOOL DISTRICT

NON-MAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET - UNAUDITED
JUNE 30, 2008

	Adult Education Fund	Child Development Fund	Cafeteria Fund
ASSETS			
Deposits and investments	$ 273,252	$ 64,772	$ 199,122
Receivables	155,665	7,240	211,537
Due from other funds	548	-	-
Stores inventories	-	-	4,477
Total Assets	$ 429,465	$ 72,012	$ 415,136
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	$ 3,901	$ 70,773	$ 3,658
Due to other funds	-	1,239	12,962
Total Liabilities	3,901	72,012	16,620
Fund Balances:			
Reserved for:			
Revolving cash	5,000	-	1,000
Stores inventories			4,477
Unreserved:			
Undesignated, reported in:			
Special revenue funds	420,564	-	393,039
Capital projects funds	-	-	-
Total Fund Balance	425,564	-	398,516
Total Liabilities and Fund Balances	$ 429,465	$ 72,012	$ 415,136

See accompanying note to supplementary information - unaudited.

Deferred Maintenance Fund	Special Reserve Non-Capital Fund	Capital Facilities Fund	Mello Roos Fund	Total Non-Major Governmental Funds
$ 950,485	$ 1,417,648	$ 1,715,144	$ 423,470	$ 5,043,893
8,443	12,302	12,614	2,101	409,902
-	-	-	-	548
-	-	-	-	4,477
$ 958,928	$ 1,429,950	$ 1,727,758	$ 425,571	$ 5,458,820
$ 14,823	$ -	$ 93,321	$ -	$ 186,476
32,564	-	45,037	-	91,802
47,387	-	138,358	-	278,278
-	-	-	-	6,000
				4,477
911,541	1,429,950	-	-	3,155,094
-	-	1,589,400	425,571	2,014,971
911,541	1,429,950	1,589,400	425,571	5,180,542
$ 958,928	$ 1,429,950	$ 1,727,758	$ 425,571	$ 5,458,820

MORGAN HILL UNIFIED SCHOOL DISTRICT

NON-MAJOR GOVERNMENTAL FUNDS
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - UNAUDITED
FOR THE YEAR ENDED JUNE 30, 2008

	Adult Education Fund	Child Development Fund	Cafeteria Fund
REVENUES			
Revenue limit sources	$ 556,862	$ -	$ -
Federal sources	83,161	4,807	1,268,650
Other state sources	14,090	660,578	120,889
Other local sources	68,129	-	1,005,282
Total Revenues	722,242	665,385	2,394,821
EXPENDITURES			
Current			
Instruction	381,154	621,730	-
Instruction-related activities:			
School site administration	290,995	-	-
Pupil services:			
Food services	-	-	2,251,572
General administration:			
All other general administration	26,909	43,655	104,473
Plant services	19,147	-	-
Facility acquisition and construction	-	-	-
Total Expenditures	718,205	665,385	2,356,045
Excess (Deficiency) of Revenues Over Expenditures	4,037	-	38,776
Other Financing Sources (Uses):			
Transfers in	-	-	-
Transfers out	-	-	-
Net Financing Sources (Uses)	-	-	-
NET CHANGE IN FUND BALANCES	4,037	-	38,776
Fund Balance - Beginning	421,527	-	359,740
Fund Balance - Ending	$ 425,564	$ -	$ 398,516

See accompanying note to supplementary information – unaudited.

Deferred Maintenance Fund	Special Reserve Non-Capital Fund	Capital Facilities Fund	County School Facilities Fund	Mello Roos Fund	Total Non-Major Governmental Funds
$ -	$ -	$ -	$ -	$ -	$ 556,862
-	-	-	-	-	1,356,618
332,903	-	-	-	-	1,128,460
29,739	62,233	1,501,233	-	427,258	3,093,874
362,642	62,233	1,501,233	-	427,258	6,135,814
-	-	-	-	-	1,002,884
-	-	-	-	-	290,995
-	-	-	-	-	2,251,572
-	-	-	-	-	175,037
433,807	-	148,629	-	1,687	603,270
-	-	1,441,186	-	-	1,441,186
433,807	-	1,589,815	-	1,687	5,764,944
(71,165)	62,233	(88,582)	-	425,571	370,870
332,903	-	-	-	-	332,903
-	-	(45,037)	-	-	(45,037)
332,903	-	(45,037)	-	-	287,866
261,738	62,233	(133,619)	-	425,571	658,736
649,803	1,367,717	1,723,019	-	-	4,521,806
$ 911,541	$ 1,429,950	$ 1,589,400	$ -	$ 425,571	$ 5,180,542

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION - UNAUDITED
JUNE 30, 2008

NOTE 1 - PURPOSE OF SCHEDULES

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

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 AUDITORS' REPORTS

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INDEPENDENT AUDITORS' 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, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Morgan Hill Unified School District as of and for the year ended June 30, 2008, which collectively comprise Morgan Hill Unified School District's basic financial statements and have issued our report thereon dated December 15, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered 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 control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the District's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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.

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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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Vavrinek Trine Day + Co. LLP

Palo Alto, California
December 15, 2008

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO 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 the compliance of Morgan Hill Unified School District with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major Federal programs for the year ended June 30, 2008. 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 requirements referred to above that are applicable to each of its major Federal programs for the year ended June 30, 2008.

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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 in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, 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 *control deficiency* in a district's internal control over compliance 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 noncompliance with a type of compliance requirement of a Federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to administer a Federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a Federal program that is more than inconsequential will not be prevented or detected by the District's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material noncompliance with a type of compliance requirement of a Federal program will not be prevented or detected by the District's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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.

Morgan Hill Unified School District's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Morgan Hill Unified School District's response and, accordingly, we 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.

Vavrinek Trine Day + Co. LLP

Palo Alto, California
December 15, 2008

INDEPENDENT AUDITORS' REPORT ON STATE COMPLIANCE

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

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Morgan Hill Unified School District as of and for the year ended June 30, 2008, and have issued our report thereon dated December 15, 2008. 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 2007-08*, 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.

Compliance with the requirements of laws, regulations, contracts, and grants listed below is the responsibility of Morgan Hill Unified School District's management. 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
Adult education	9	Yes
Regional occupational centers and programs	6	Not Applicable
Instructional Time:		
School districts	6	Yes
County offices of education	3	Not Applicable
Community day schools	9	Not Applicable
Morgan-Hart Class Size Reduction	7	Not Applicable

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	Procedures in Audit Guide	Procedures Performed
Instructional Materials:		
General requirements	12	Yes
K-8 only	1	Yes
9-12 only	1	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 Construction Funds:		
School District bonds	3	Yes
State school facilities funds	1	Not Applicable
Excess sick leave	2 or 3	Yes
Notice of right to elect California State Teachers Retirement System (CalSTRS) membership	1	Yes
Proposition 20 Lottery Funds (Cardenas Textbook Act of 2000)	2	Yes
State Lottery Funds (California State Lottery Act of 1984)	2	Yes
California School Age Families Education (Cal-SAFE) Program	3	Not Applicable
School Accountability Report Card	3	Yes
Mathematics and Reading Professional Development	4	Not Applicable
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 the Independent Study attendance because the reported ADA was below the state minimum audit threshold.

Based on our audit, we found that for the items tested, the Morgan Hill Unified School District complied with the State laws and regulations referred to above, except as described in the Schedule of State Award Findings and Questioned Costs section of the accompanying Schedule of Findings and Questioned Costs. Further, based on our audit, for items not tested, nothing came to our attention to indicate that the Morgan Hill Unified School District had not complied with the laws and regulations, except as described in the Schedule of State Award Findings and Questioned Costs included in this report. Our audit does not provide a legal determination on Morgan Hill Unified School District's compliance with the State laws and regulations referred to 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, 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.

Vavrinek Trine Day + Co. LLP

Palo Alto, California
December 15 2008

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS

MORGAN HILL UNIFIED SCHOOL DISTRICT

SUMMARY OF AUDITORS' RESULTS
FOR THE YEAR ENDED JUNE 30, 2008

FINANCIAL STATEMENTS

Type of auditors' report issued:	Unqualified
Internal control over financial reporting:	
Material weaknesses identified?	No
Significant deficiencies identified not considered to be material weaknesses?	None reported
Noncompliance material to financial statements noted?	No

FEDERAL AWARDS

Internal control over major programs:	
Material weaknesses identified?	No
Significant deficiencies identified not considered to be material weaknesses?	None reported
Type of auditors' report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)	No
Identification of major programs:	

CFDA Number(s)	Name of Federal Program or Cluster
84.011	NCLB - Title I, Part C Migrant Education
84.027	Individuals with Disability Act: Special Education

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

STATE AWARDS

Internal control over State programs:	
Material weaknesses identified?	No
Significant deficiencies identified not considered to be material weaknesses?	Yes
Type of auditors' report issued on compliance for State programs:	Qualified

MORGAN HILL UNIFIED SCHOOL DISTRICT

FINANCIAL STATEMENT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2008

None reported.

FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2008

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

STATE AWARDS FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2008

The following findings represent instances of noncompliance and/or questioned costs relating to State program laws and regulations. The findings have been coded as follows:

Five Digit Code	AB 3627 Finding Type
40000	State Compliance

2008-1 Class Size Reduction Code 40000

Criteria or Specific Requirements
CSR classes need to maintain an average daily enrollment of not greater than 20.45 students for the period from the 1st day of class through April 15th in order to qualify for full CSR funding.

Condition
During our audit , we noted that the following situation occurred:
A number of students in classes where the average daily enrollment was greater than 20.45, were transferred to a new class a few days prior to April 15, so that the regular class average daily enrollment was less than 20.45. The school then brought in substitute teachers to teach these students for the few days until April 15. On the J7 CSR claim form, the original classes and the temporary classes were both claimed, resulting in an over- reporting number of eligible classes.

Questioned Costs
This is not an issue of questioned costs. However the District's CSR funding request per the original J-7 CSR is overstated by $210,987.

Context
According to instruction #5 of the J-7CSR form, it states "Per Education Code Section 52124.5, districts should compute class sizes by averaging the daily enrollment in each class for each instruction day from the first day of instruction through April 15". The temporary classes were also claimed for full CSR funding. However, the creation of temporary classes was not the result of enrollment growth, therefore the temporary classes do not qualify for CSR funding. In addition, for the original classes that exceeded the maximum average class size of 20.45, a reduced amount of funding per class is allowable, but not the full funding amount.

Effect
The District overstated the number of classes eligible for CSR funding on the J-7 CSR annual funding document. As a result, the funding request was overstated by $210,987. We have proposed and posted an audit adjustment for this amount.

Cause
Misunderstanding of the calculation instruction.

Recommendation
We recommended that the District re-file its J-7 CSR report to reflect the actual classes that qualify for funding as well as those classes that qualify for reduced funding under the penalty provisions of the J-7 CSR instructions.

District Response
We acknowledge with the auditor's finding and are in the process of correcting the J-7 CSR for the errors noted.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2008

None reported.