

MORGAN HILL UNIFIED SCHOOL DISTRICT
COUNTY OF SANTA CLARA
MORGAN HILL, CALIFORNIA

ANNUAL FINANCIAL REPORT

JUNE 30, 2004

MORGAN HILL UNIFIED SCHOOL DISTRICT

JUNE 30, 2004

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FINANCIAL SECTION

GOODELL,
PORTER &
FREDERICKS, LLP

CERTIFIED
PUBLIC
ACCOUNTANTS

RICHARD J. GOODELL, CPA
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PAUL D. FREDERICKS, CPA

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

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 as of and for the year ended June 30, 2004, 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 an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 opinion.

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 at June 30, 2004 and the changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on page 3 through 13 and the budgetary comparison information on page 43 are not a required part of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, consisting 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 10, 2004 on our consideration of Morgan Hill Unified School District's internal controls over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Morgan Hill Unified School District's basic financial statements. The other supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements of Morgan Hill Unified School District. The accompanying schedule of expenditures of federal awards is required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of Morgan Hill Unified School District. 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.


GOODELL, PORTER & FREDERICKS, LLP
Certified Public Accountants

November 10, 2004

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

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, 2004. 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 on page 1, 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 new 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 increase in Morgan Hill Unified School Districts Average Daily Attendance (ADA) between 2002-03 to 2003-04 was 66 ADA or an 0.8% increase.

A mid-year freeze on expenditures resulted in a decrease of 2.5% in total expenses. The Board approved reductions of over \$1.4 million between 2002-03 to 2003-04.

In accordance with the budget flexibility provisions set forth in Assembly Bill 1754, the district was able to mitigate the effects of the budget reductions by allowing a one time transfer of restricted carryover funds of over \$390,000 to assist in our general fund operations.

We have restored our Economic Uncertainty for the period ending June 30, 2004 to 3% compared to a 2.7% for the period ending June 30, 2003.

The settlement of the Corporation Yard fuel tank cleanup lawsuit for attorney's fees resulted in one-time reimbursement of attorney's fees of \$359,000 and a total of \$646,000 was placed in a new Special Reserve Fund for future cleanup expenses.

Additional prior year one-time Redevelopment Agency Funds of \$261,000 provided assistance to our general fund operations.

The opening of the Ann Sobrato High School in the fall of 2004 provided the opportunity for ninth graders to enjoy the high school environment for the first time in 25 years, in Morgan Hill. The school opened with housing for ninth and tenth grades only. There will be an escalation of costs as the school expands to serve the Grade nine through twelve configuration.

In complying with GASB 34, fixed assets were valued at historical cost, the total of the District's fixed assets, land, buildings, and equipment, valued on an acquisition cost basis was \$165 million. After depreciation, the June 30, 2004 book value for fixed assets totaled \$133 million.

Budget cuts over the past 3 years have totaled over \$8 million in cost reductions, of which \$6 million were in personnel costs.

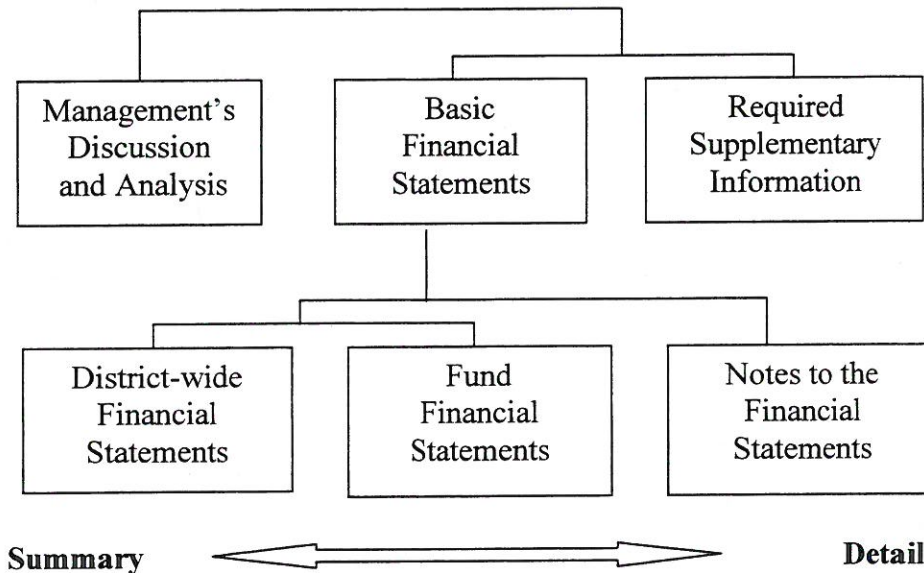
MORGAN HILL UNIFIED SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

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. The 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 those 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 budget is included.

MORGAN HILL UNIFIED SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

Components of the Financial Section (Concluded)

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 School District as a Whole

Statement of Net Assets and the Statement of Activities

These two new 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 of 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 2003-04?"

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.

MORGAN HILL UNIFIED SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

OVERVIEW OF THE FINANCIAL STATEMENTS (CONCLUDED)

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, Capital Facilities Fund and Building 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 its 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.

MORGAN HILL UNIFIED SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS

The School District as a Whole

The District's net assets were \$99 million at June 30, 2004. Of this amount \$2.3 million was unrestricted. Investments in capital assets, net of related debt, account for \$61 million of the total net assets. A comparative analysis of government-wide data is presented in Table 1.

(Table 1)
Comparative Statement of Net Assets

	Governmental Activities	
	2004	2003
Assets		
Cash	\$ 43,754,230	\$ 68,891,782
Receivables	2,612,927	3,248,422
Stores Inventory	149,679	152,351
Prepaid Expenses	376,877	386,078
Capital assets	132,832,127	99,268,153
Total assets	<u>179,725,840</u>	<u>171,946,786</u>
Liabilities		
Accounts payable and other current liabilities	6,609,497	3,547,042
Deferred revenue	577,764	714,092
Long-term liabilities	73,181,752	75,863,911
Total liabilities	<u>80,369,013</u>	<u>80,125,855</u>
Net Assets		
Invested in capital assets, net of related debt	60,753,269	26,934,493
Restricted	36,138,126	65,208,939
Unrestricted	2,465,432	(322,501)
Total net assets	<u>\$ 99,356,827</u>	<u>\$ 91,820,931</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

**FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS
(CONTINUED)**

The District's net asset position increased \$4.3 million this fiscal year (See Table 2). The District's expenses for instructional and pupil services represented 71 percent of total expenses. The purely administrative activities of the District accounted for just 10 percent of total costs. The remaining 19 percent was spent in the areas of plant services and other expenses, interest on long-term debt, depreciation of capital assets and other outgo. (See Figure 2).

(Table 2)
Comparative Statement of Change in Net Assets

	Governmental Activities	
	2004	2003
Revenues		
Program revenues	\$ 19,804,999	\$ 34,436,575
General revenues		
Taxes levied for general purposes	39,129,156	37,820,799
Taxes levied for other specific purpose	5,542,527	5,150,132
Federal and State Aid not restricted to specific purposes	3,497,986	4,844,267
Interest and investment earnings	126,670	207,708
Miscellaneous	1,505,145	930,705
Total revenues	<u>69,606,483</u>	<u>83,390,186</u>
Expenses		
Instruction	33,550,043	36,371,723
Instruction related services	6,288,377	6,778,827
Pupil support services	6,351,947	6,862,049
General administration	6,557,839	3,144,215
Plant services	4,740,818	6,310,988
Other	7,813,300	8,169,205
Total expenses	<u>65,302,324</u>	<u>67,637,007</u>
Increase in net assets	<u>\$ 4,304,159</u>	<u>\$ 15,753,179</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

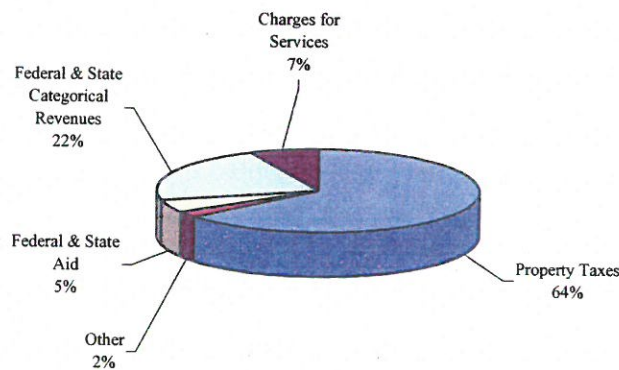
**FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS
(CONTINUED)**

Governmental Activities

As reported in the Statement of Activities, the cost of all of the District's governmental activities this year was \$65 million. The amount that our local taxpayers financed for these activities through property taxes was \$45 million. Federal and State aid not restricted to specific purposes totaled \$3.5 million. State and Federal Categorical revenue totaled over \$15 million, or 17% of the revenue of the entire District (See Figure 1).

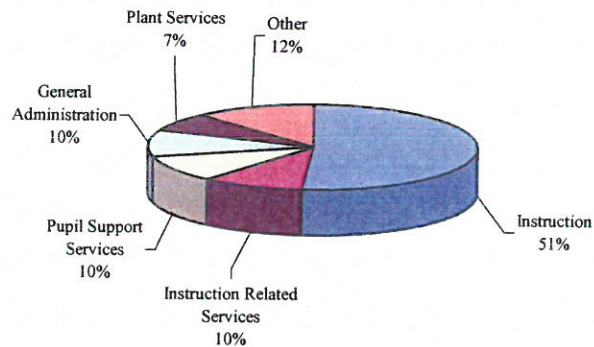
Sources of Revenue for the 2003-04 Fiscal Year

Figure 1



Expenses for the Fiscal Year 2003-04

Figure 2



MORGAN HILL UNIFIED SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

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 \$41 million, a decrease of \$29 million from the previous fiscal year. This decrease is mainly reflected in the Building Fund. The General Fund balance increased \$989 thousand.

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.
- ◆ Adjustments required to reflect the unprecedented mid-year State cuts in revenues.
- ◆ 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 final revised budget for the General Fund reflected a net decrease to the ending balance of \$1,200,893.

The District ended the year adding \$989 thousand to the general fund ending balance. The State recommends an ending reserve for economic uncertainties of 3%. The District's ending reserve was 3.6%.

MORGAN HILL UNIFIED SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

By the end of the 2003-04 fiscal year, the District had invested \$165 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 \$133 million at June 30, 2004, which is an increase of \$33,563,974 from the previous year due to acquisitions totaling \$35 million and depreciation expenses of \$1.8 million.

Table 3
Comparative Schedule of Capital Assets
(net of depreciation)
June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>	<u>Difference</u>	<u>Total Percent Change</u>
Land	\$ 724,021	\$ 724,021	0	0%
Buildings and Improvements	78,717,644	41,022,392	\$37,695,252	92%
Machinery & Equipment	601,327	783,837	(182,510)	(23%)
Work in Progress	52,789,135	56,737,903	(3,948,768)	(7%)
Total	\$132,832,127	\$99,268,153	\$33,563,974	34%

MORGAN HILL UNIFIED SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

CAPITAL ASSET AND DEBT ADMINISTRATION (CONCLUDED)

Long-Term Debt

At June 30, 2004, the District had \$73 million in long-term debt outstanding.

Table 4
Comparative Schedule of Outstanding Debt
June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
General Obligation Bonds	\$72,942,933	\$72,322,754
Capital Lease Obligations	1,104	10,906
Compensated Absences	237,715	298,514
TOTAL	\$73,181,752	\$72,632,174

The long-term debt paid by the District was approximately \$315 thousand in 2004.

FACTORS BEARING ON THE DISTRICT'S FUTURE

The district will continue to budget for stability in enrollment and average daily attendance, although we hope for continued growth in enrollment.

Implementation of position control is planned for the 2004-05 school year. The process will monitor staffing approved by the board, budget for salary placements and provide resources for staff allocations.

With the assistance of the Santa Clara Office of Education, the district will be implementing budget blocking, which will prevent expenditures without adequate financial resources.

The Workers Compensation and Unemployment rates have increased dramatically and we will continue to review them with the goal of reducing them.

The District has an excellent track record in meeting the challenges of declining enrollment and revenue. Stabilization of the state's economic environment is desirable and would provide the district with a financial environment without constant reductions. Management will continue to plan carefully and prudently to continue to provide the resources to meet student needs.

MORGAN HILL UNIFIED SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2004

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 Fred Gallacinao, 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, 2004

		Governmental Activities
<u>ASSETS</u>		
Cash (Note 2)	\$	43,754,230
Accounts Receivable (Note 4)		2,612,927
Stores Inventory (Note 1H)		149,679
Prepaid Expenditures (Note 1H)		376,877
Capital Assets (Note 6):		
Land	\$	724,021
Buildings and Improvements		108,689,981
Machinery and Equipment		3,135,895
Work in Progress		52,789,135
Less Accumulated Depreciation		(32,506,905)
Total Capital Assets, Net of Depreciation		132,832,127
Total Assets	\$	179,725,840
<u>LIABILITIES</u>		
Accounts Payable and Other Current Liabilities	\$	6,609,497
Deferred Income (Note 1H)		577,764
Long-term Liabilities:		
Due Within One Year:		
Capital Lease Obligations (Note 8)	\$	1,104
General Obligation Bonds Payable (Note 7)		1,030,000
Compensated Absences Payable (Note 1H)		237,715
Total Due Within One Year:		1,268,819
Due After One Year:		
General Obligation Bonds Payable (Note 7)		71,912,933
Total Due After One Year:		71,912,933
Total Liabilities	\$	80,369,013
<u>NET ASSETS</u>		
Invested in Capital Assets, Net of Related Debt	\$	60,753,269
Restricted For:		
Capital Projects		32,534,641
Debt Service		2,856,614
Education Programs		746,871
Unrestricted		2,465,432
Total Net Assets	\$	99,356,827

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MORGAN HILL UNIFIED SCHOOL DISTRICT

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2004

Governmental Activities	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
Instruction	\$ 33,550,043	\$ 39,883	\$ 5,305,525	\$ 1,786,761	\$ (26,417,874)
Instruction-related services:					
Supervision of instruction	1,706,523	15,395	1,429,113		(262,015)
Instructional library, media and technology	561,253	329	180,712		(380,212)
School site administration	4,020,601	12,515	387,708		(3,620,378)
Pupil Services:					
Home-to school transportation	2,448,559	193,013	1,529,399		(726,147)
Food services	1,839,963	1,082,149	768,916		11,102
All other pupil services	2,063,425	620	236,566		(1,826,239)
General administration:					
Data processing	435,427				(435,427)
All other general administration	6,122,412	72,732	642,666		(5,407,014)
Plant services	4,740,818	3,313,826	2,663,603		1,236,611
Ancillary services	289,192		25,000		(264,192)
Community services	45,512				(45,512)
Enterprise activities	589		589		
Interest on long-term debt	4,225,641				(4,225,641)
Other Outgo	1,675,356	13,905	104,074		(1,557,377)
Depreciation	1,577,010				(1,577,010)
Total Governmental Activities	\$ 65,302,324	\$ 4,744,367	\$ 13,273,871	\$ 1,786,761	(45,497,325)

General Revenues:

Property Taxes Levied For:	
General Purposes	39,129,156
Taxes Levied for Debt Service	4,249,915
Taxes Levied for Other Specific Purposes	1,292,612
Federal and State Aid not Restricted to Specific Purposes	3,497,986
Interest and Investment Earnings	126,670
Interagency Revenues	41,600
Miscellaneous	1,463,545
Total General Revenue	49,801,484
Change in Net Assets	4,304,159
Net Assets Beginning (Restated - Note 15)	95,052,668
Net Assets Ending	\$ 99,356,827

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MORGAN HILL UNIFIED SCHOOL DISTRICT
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2004

	General Fund	Capital Facilities	Building	Other Governmental Funds	Total Governmental Funds
<u>Assets</u>					
Cash in County Treasury (Note 2)	\$ 3,960,569	\$ 8,373,988	\$ 26,455,204	\$ 4,943,969	\$ 43,733,730
Cash in Revolving Fund (Note 2)	14,500			6,000	20,500
Accounts Receivable (Note 4)	2,217,985	29,460	123,462	242,020	2,612,927
Due From Other Funds (Note 5)	236,862		30,702	114,842	382,406
Stores Inventories (Note 1H)	124,524			25,155	149,679
Prepaid Expenses	376,877				376,877
Total Assets	<u>\$ 6,931,317</u>	<u>\$ 8,403,448</u>	<u>\$ 26,609,368</u>	<u>\$ 5,331,986</u>	<u>\$ 47,276,119</u>
<u>Liabilities and Fund Balances</u>					
Liabilities:					
Accounts Payable	\$ 2,440,834	\$ 2,323	\$ 2,617,406	\$ 149,815	\$ 5,210,378
Deferred Revenue (Note 1H)	402,918			174,846	577,764
Due to Other Funds (Note 5)	132,972	103,552	1,080	144,802	382,406
Total Liabilities	<u>2,976,724</u>	<u>105,875</u>	<u>2,618,486</u>	<u>469,463</u>	<u>6,170,548</u>
Fund Balances (Note 1H):					
Reserved	1,262,772			30,155	1,292,927
Designated	2,384,997			2,856,614	5,241,611
Undesignated	306,824	8,297,573	23,990,882	1,975,754	34,571,033
Total Fund Balances	<u>3,954,593</u>	<u>8,297,573</u>	<u>23,990,882</u>	<u>4,862,523</u>	<u>41,105,571</u>
Total Liabilities and Fund Balances	<u>\$ 6,931,317</u>	<u>\$ 8,403,448</u>	<u>\$ 26,609,368</u>	<u>\$ 5,331,986</u>	<u>\$ 47,276,119</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MORGAN HILL UNIFIED SCHOOL DISTRICT
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO THE STATEMENT OF NET ASSETS
JUNE 30, 2004

Total fund balance – governmental funds \$ 41,105,571

Amounts reported for governmental activities in the
statement of net assets are different because:

Capital assets: In governmental funds, only current
assets are reported. In the statement of net assets, all
assets are reported, including capital assets \$165,339,032
and accumulated depreciation \$32,506,905 132,832,127

Unmatured interest on long-term debt: In governmental
funds, interest on long-term debt is not recognized until
the period in which it matures and is paid. In the
government-wide statement of activities, it is recognized
in the period that it is incurred. The additional liability
for unmatrued interest owing at the end of the period was: (1,399,119)

Long-term liabilities 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:

General obligation bonds payable	\$72,942,933	
Compensated absences payable	237,715	
Capital leases payable	<u>1,104</u>	
		<u>(73,181,752)</u>

Total net assets-governmental activities \$ 99,356,827

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MORGAN HILL UNIFIED SCHOOL DISTRICT
STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General Fund	Capital Facilities	Building	Other Governmental Funds	Total Governmental Funds
REVENUES					
Revenue Limit Sources:					
State Apportionments	\$ 247,147			\$ 376,892	\$ 624,039
Local Sources	39,129,156				39,129,156
Total Revenue Limit	39,376,303			376,892	39,753,195
Federal Revenue	2,925,851			875,351	3,801,202
Other State Revenue	7,732,806		\$ 671,039	1,751,198	10,155,043
Other Local Revenue	4,660,206	\$ 3,451,723	1,718,048	6,067,065	15,897,042
Total Revenues	54,695,166	3,451,723	2,389,087	9,070,506	69,606,482
EXPENDITURES					
Certificated Salaries	28,441,909			256,090	28,697,999
Classified Salaries	7,445,531	489	332,575	713,213	8,491,808
Employee Benefits	8,657,087	44	83,163	342,585	9,082,879
Books and Supplies	2,302,407	271	1,350	987,623	3,291,651
Services and Other					
Operating Expenditures	4,763,863	55,888	587,666	680,156	6,087,573
Capital Outlay	21,730	203,765	36,964,041	183,591	37,373,127
Debt Service:					
Principal Retirement	9,802			245,000	254,802
Interest and Fiscal Charges	1,062			3,365,170	3,366,232
Other Outgo	1,533,450			141,906	1,675,356
Total Expenditures	53,176,841	260,457	37,968,795	6,915,334	98,321,427
Excess of Revenues Over (Under) Expenditures	1,518,325	3,191,266	(35,579,708)	2,155,172	(28,714,945)
Other Financing Sources (Uses):					
Operating Transfers In (Note 5)	126,634		2,779,263	655,345	3,561,242
Operating Transfers Out (Note 5)	(655,345)	(120,790)		(2,785,107)	(3,561,242)
Total Other Financing Sources (Uses)	(528,711)	(120,790)	2,779,263	(2,129,762)	0
Excess of Revenues and Other Financing Sources Over (Under) Expenditures and Other Uses	989,614	3,070,476	(32,800,445)	25,410	(28,714,945)
Fund Balances - July 1, 2003	2,964,979	5,227,097	56,791,327	4,837,113	69,820,516
Fund Balances - June 30, 2004	\$ 3,954,593	\$ 8,297,573	\$ 23,990,882	\$ 4,862,523	\$ 41,105,571

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MORGAN HILL UNIFIED SCHOOL DISTRICT
RECONCILIATION OF THE GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2004

Net change in fund balances – Total governmental funds	\$(28,714,945)
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Amounts reported for governmental activities in the statement of activities are different because:

Capital outlay: In governmental funds, the cost of capital assets are reported as expenditures in the period when the assets are acquired. In the statement of activities, costs of capital assets are allocated over their estimated useful lives as depreciation expense. The difference between capital outlay expenditures and depreciation expense for the period is:

Expenditures for capital outlay:	\$38,210,065	
Depreciation expense:	<u>(1,577,010)</u>	
		36,633,055

Debt service: In governmental funds, repayments of long-term debt are reported as expenditures. In the government-wide statements, repayments of long-term debt are reported as reductions of liabilities. Expenditures for repayment of the principal portion of long-term debt were:	254,802
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Gain or loss from disposal of capital assets: In governmental funds, the entire proceeds from disposal of capital assets are reported as revenue. In the statement of activities, only the resulting gain or loss is reported. The difference between the proceeds from disposal of capital assets and the resulting gain or loss is:	(81,161)
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Unmatured interest on long-term debt: In governmental funds interest on long-term debt is recognized in the period that it becomes due. In the government-wide statement of activities it is recognized in the period that it is incurred. Unmatured interest owing at the end of the period, less matured interest paid during the period owing from the prior period, was:	(860,471)
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Compensated absences: In governmental funds, compensated absences are measured by the amounts paid during the period. In the statement of activities compensated absences are measured by the amounts earned. The difference between compensated absences paid and compensated absences earned was:	60,799
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Cost write-off for cancelled capital projects: If a planned capital Project is canceled and will not be completed, costs previously Capitalized as Work in Process must be written off to expense. Costs written off for canceled projects were:	<u>(2,987,920)</u>
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Total change in net assets-governmental activities	<u>\$4,304,159</u>
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THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MORGAN HILL UNIFIED SCHOOL DISTRICT
STATEMENT OF NET ASSETS
FIDUCIARY FUNDS
JUNE 30, 2004

	Expendable Trust <u>Foundation Trust</u> <u>Fund</u>	Agency <u>Fund</u>
<u>ASSETS</u>		
Cash in Hand and in Bank (Note 2)	\$ 4,094	\$ 345,506
Total Assets	<u>4,094</u>	<u>345,506</u>
<u>LIABILITIES</u>		
Liabilities:		
Due to Student Groups	<u> </u>	<u>345,506</u>
Total Liabilities	<u>0</u>	<u>345,506</u>
<u>NET ASSETS</u>		
Reserved for scholarships	<u>4,094</u>	<u> </u>
Total Net Assets	<u>\$ 4,094</u>	<u>\$ 0</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MORGAN HILL UNIFIED SCHOOL DISTRICT
STATEMENT OF CHANGES IN NET ASSETS
FIDUCIARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2004

	<u>Expendable Trust Scholarship Fund</u>
Additions	
Interest Income	\$ 158
Deductions	
Disbursements	<u>5,325</u>
Change in net assets (decrease)	(5,167)
Net assets – July 1, 2003	<u>9,261</u>
Net assets – June 30, 2004	<u>\$ 4,094</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The District accounts for its financial transactions in accordance with the policies and procedures of the Department of Education's California School Accounting Manual. The accounting policies of the District conform to accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB) and the American Institute of Certified Public Accountants.

A. Reporting Entity

The District includes all funds that are controlled by or dependent on the District's governing board for financial reporting purposes. The District has considered all potential component units in determining how to define the reporting entity, using criteria set forth in generally accepted accounting principles.

B. Basis of Presentation

Government-wide Financial Statements:

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the District and its component units.

The government-wide statements are prepared using the economic resources measurement focus. This is the same approach used in the preparation of the fiduciary fund financial statements but differs from the manner in which governmental fund financial statements are prepared. Governmental fund financial statements, therefore, include a reconciliation with brief explanations to better identify the relationship between the government-wide statements and the statements for the governmental funds.

The government-wide statement of activities presents a comparison between direct expenses and program revenues for each function or program of the district's governmental activities. 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. Program revenues include charges paid by the recipients of goods or services offered by a program, as well as grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues which are not classified as program revenues are presented as general revenues of the District, with certain exceptions. The comparison of direct expenses with program revenues identifies the extent to which each governmental function is self-financing or draws from the general revenues of the District.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Basis of Presentation (Concluded)

Fund Financial Statements:

Fund financial statements report detailed information about the District. The focus of governmental fund financial statements is on major funds rather than reporting funds by type. Each major governmental fund is presented in a separate column, and all non-major funds are aggregated into one column. Fiduciary funds are reported by fund type.

The accounting and financial treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a flow of current financial resources measurement focus. With this measurement focus, only current asset and current liabilities are generally included on the balance sheet. The Statement of Revenues, Expenditures, and Changes in Fund Balances for these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

Fiduciary funds are reported using the economic resources measurement focus.

C. Basis of Accounting

Basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting. Fiduciary funds use the accrual basis of accounting.

Revenues - exchange and non-exchange transactions:

Revenue resulting from exchange transactions, in which each party gives and receives essentially equal value, is recorded under 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 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 collectible within the current period or within 60 days after year-end.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Basis of Accounting (Concluded)

Non-exchange transactions, in which the District receives value without directly giving equal value in return, include property taxes, grants, and entitlements. Under the accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants and entitlements is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are to be used or the fiscal year when use is first permitted; matching requirements, in which the District must provide local resources to be used for a specific purpose; and expenditure requirements, in which the resources are provided to the District on a reimbursement basis. Under the modified accrual basis, revenue from non-exchange transactions must also be available before it can be recognized.

Deferred revenue:

Deferred revenue arises when assets are received before revenue recognition criteria have been satisfied. Grants and entitlements received before eligibility requirements are met are recorded as deferred revenue. On governmental fund financial statements, receivables associated with non-exchange transactions that will not be collected within the availability period have also been recorded as deferred revenue.

Expenses/expenditures:

On the accrual basis of accounting, expenses are recognized at the time a liability is incurred. On the modified accrual basis of accounting, expenditures are generally recognized in the accounting period in which the related fund liability is incurred, as under the accrual basis of accounting. However, under the modified accrual basis of accounting, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due. Allocations of cost, such as depreciation and amortization, are not recognized in the governmental funds.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Fund Accounting

The accounts of the District are organized on the basis of funds, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures or expenses, as appropriate. District resources are allocated to and accounted for in individual funds based upon the purpose for which they are to be spent and the means by which spending activities are controlled. The District's accounts are organized into major, non-major, and fiduciary funds as follows:

MAJOR GOVERNMENTAL FUNDS

1. General Fund is the general operating fund of the District. It is used to account for all financial resources except those require to be accounted for in another fund.
2. Capital Facilities Fund is use to account for resources received from developer impact fees assessed under the provisions of the California Environmental Quality Act.
3. Building Fund is used to account for the acquisition of major governmental capital facilities and building from the sale of bond proceeds.

NON-MAJOR GOVERNMENTAL FUNDS

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes. The District maintains five non-major special revenue funds:

1. Deferred Maintenance Fund is used for the purpose of major repair or replacement of District property.
2. Cafeteria Fund is used to account for revenues received and expenditures made to operate the District's cafeteria program.
3. Adult Education Fund is used to account for resources committed to adult education programs maintained by the District.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Fund Accounting (Continued)

Special Revenue Funds (Concluded)

4. Child Development Fund is used to account for resources committed to child development programs maintained by the District.
5. Special Reserve Fund is used to account for revenues reserved by the Board of Trustees for a specific program or project.

Capital Projects Funds are used to account for the acquisition and/or construction of all major capital assets. The District maintains three non-major capital project funds:

1. Mello-Roos Fund is used to account for the accumulation of resources received from the Mello-Roos Assessment District.
2. County School Facilities Fund is used to account for the deposit of funds received as part of the School Facilities Act of 1998 for the on-going and major maintenance of building programs under the jurisdiction of the Leroy F. Greene School Facilities Act of 1998.
3. State School Building Fund is used to account for the proceeds from the State Lease-Purchase Roof Replacement program allocation and the District's match, and is used for roof replacement.

Debt Service Funds are used to account for the accumulation of resources for, and the payment of general long-term debt principal, interest and related costs. The District maintains two non-major debt service funds:

1. Tax Override Fund is used to account for the accumulation of resources from ad valorem tax levies for the repayment of certificates of participation. The indebtedness was fully paid in 2002-2003 and the fund was closed in 2003-2004 by a transfer to the Building Fund.
2. Bond Interest and Redemption Fund is used to account for the accumulation of resources for, and the repayment of, district bonds, interest and related costs.

FIDUCIARY FUNDS:

Expendable Trust Funds are used to account for assets held by the District as trustee. The District maintains one Scholarship Fund, which is used to provide financial assistance to students of the District.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Fund Accounting (Concluded)

FIDUCIARY FUNDS (CONCLUDED):

Agency Funds are used to account for assets of others for which the District acts as an agent. The District maintains agency funds to account for the activities of the various student body clubs, the high school and both middle schools.

The District maintains student body funds, which are used to account for the raising and expending of money to promote the general welfare, morale, and educational experience of the student body. The amounts reported for student body funds represent the combined totals of all schools within the District.

E. Budgets and Budgetary Accounting

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds. By state law, the District's governing board must adopt a final budget no later than July 1. A public hearing must be conducted to receive comments prior to adoption. The District's governing board satisfied these requirements.

These budgets are revised by the District's Board of Trustees and District Superintendent during the year to give consideration to unanticipated income and expenditures. The original and final revised are presented for the General Fund and Major Special Revenue Funds as required supplementary information in the financial statements.

Formal budgetary integration was employed as a management control device during the year for all budgeted funds. The District employs budget control by minor object and by individual appropriation accounts. Expenditures cannot legally exceed appropriations by major object account. (See Note 3.) The District did not adopt budgets for the Bond Interest and Redemption Fund.

F. Encumbrances

Encumbrance accounting is used in all budgeted funds to reserve portions of applicable appropriations for which commitments have been made. Encumbrances are recorded for purchase orders, contracts, and other commitments when they are written. Encumbrances are liquidated when the commitments are paid. All encumbrances are liquidated at June 30.

G. Estimates

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Assets, Liabilities and Equity

1. Deposits and Investments

Cash balances held in banks and in revolving funds are insured to \$100,000 by the Federal Deposit Insurance Corporation.

In accordance with *Education Code* Section 41001, the District maintains substantially all of its cash in the County Treasury. The county pools these funds with those of other districts in the county and invests the cash. These pooled funds are carried at cost, which approximates market value. Interest earned is deposited quarterly into participating funds. Any investments losses are proportionately shared by all funds in the pool.

The county is authorized to deposit cash and invest excess funds by California *Government Code* Section 53648 et seq. The funds maintained by the county are either secured by federal depository insurance or are collateralized.

2. Stores Inventories and Prepaid Expenditures

Inventories are recorded using the consumption method, in that inventory acquisitions are initially recorded in inventory (asset) accounts, and are charged as expenditures when used. Reported inventories are equally offset by a fund balance reserve, which indicates that these amounts are not "available for appropriation and expenditure" even though they are a component of net current assets.

The District's central warehouse inventory and cafeteria inventory valuation is First-in-First-out (FIFO).

The District has the option of reporting an expenditure in governmental funds for prepaid items either when purchased or during the benefiting period. The District has chosen to report the expenditure in the period it benefits.

3. Capital Assets

Capital assets purchased or acquired with an original cost of \$20,000 or more are reported at historical cost or estimated historical cost. Contributed assets are reported at fair market value as of the date received. Additions, improvements, and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)3. Capital Assets (Concluded)

<u>Asset Class</u>	<u>Examples</u>	<u>Estimated Useful Life in Years</u>
Land		N/A
Site improvements	Paving, flagpoles, retaining walls, sidewalks, fencing, outdoor lighting	20
School buildings		50
Portable classrooms		25
HVAC systems	Heating, ventilation and air conditions systems	20
Roofing		20
Interior construction		25
Carpet replacement		7
Electrical/Plumbing		30
Sprinkler/fire system	Fire suppression systems	25
Outdoor equipment	Playground, radio towers, fuel tanks, pumps	20
Machinery & tools	Shop & maintenance equipment, tools	15
Kitchen equipment	Appliances	15
Custodial equipment	Floor scrubbers, vacuums, other	15
Science & engineering	Lab equipment, scientific apparatus	10
Furniture & accessories	Classroom & other furniture	20
Business machines	Fax, duplicating & printing equipment	10
Copiers		5
Communication equipment	Mobile, portable radios, non-computerized	10
Computer hardware	PCs, printers, network hardware	5
Computer software	Instructional, other short-term	5 to 10
Computer software	Administrative or long-term	10 to 20
Audio visual equipment	Projectors, cameras (still & digital)	10
Athletic equipment	Gymnastics, football, weight machines, wrestling mats	10
Musical instruments	Pianos, strings, brass, percussion	10
Library books	Collections	5 to 7
Licensed vehicles	Buses, other on-road vehicles	8
Contractors equipment	Major off-road vehicles, front-end loaders, large tractors, mobile air compressor	10
Grounds equipment	Mowers, tractors, attachments	15

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Assets, Liabilities and Equity (Continued)

4. Deferred Revenue

Cash received for federal and state special projects and programs is recognized as revenue to the extent that qualified expenditures have been incurred. Deferred revenue is recorded to the extent that cash received on specific projects and programs exceeds qualified expenditures.

5. Compensated Absences

All vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in the governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

Accumulated sick leave benefits are not recognized as liabilities of the District. The District's policy is to record sick leave as an operating expense in the period taken, since such benefits do not vest, nor is payment probable; however, unused sick leave is added to the creditable service period for calculation of retirement benefits when the employee retires.

6. Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the Statement of Net Assets. Bond premiums and discounts as well as issuance costs are deferred and amortized over the life of the bonds using the effective-interest method. Bonds payable are reported net of applicable bond premium or discount. Bond issuance costs are reported as prepaid expenditures and amortized over the term of the related debt.

In the fund financial statements, governmental funds recognize bond premiums and discounts as well as bond issuance costs, during the current period. The face amount of the debt issued, premiums, or discounts is reported as other financing sources/uses.

7. Fund Balance Reserves and Designations

Reservations of the ending fund balance indicate the portions of fund balance not appropriable for expenditure or amounts legally segregated for a specific future use. The reserve for revolving fund and reserve for stores inventory reflects the portions of fund balance represented by revolving fund cash and stores inventory, respectively. These amounts are not available for appropriation and expenditure at the balance sheet date.

Designations of the ending fund balance indicate tentative plans for financial resource utilization in a future period.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)

H. Assets, Liabilities and Equity (Concluded)

8. Revenue Limit/Property Tax

The District's revenue limit is received from a combination of local property taxes, state apportionments, and other local sources.

The county is responsible for assessing, collecting, and apportioning property taxes. Taxes are levied for each fiscal year on taxable real and personal property in the county. The levy is based on the assessed values as of the preceding March 1, which is also the lien date. Property taxes on the secured roll are due on November 1 and February 1, and taxes become delinquent after December 10 and April 10, respectively. Property taxes on the unsecured roll are due on the lien date (March 1), and become delinquent if unpaid by August 31.

Secured property taxes are recorded as revenue when apportioned, in the fiscal year of the levy. The county apportions secured property tax revenue in accordance with the alternate method of distribution prescribed by Section 4705 of the California *Revenue and Taxation Code*. This alternate method provides for crediting each applicable fund with its total secured taxes upon completion of the secured tax roll - approximately October 1 of each year.

The County Auditor reports the amount of the District's allocated property tax revenue to the California Department of Education. Property taxes are recorded as local revenue limit sources by the District.

The California Department of Education reduces the District's entitlement by the District local property tax revenue. The balance is paid from the state General Fund, and is known as the State Apportionment.

The District's Base Revenue Limit is the amount of general purpose tax revenue, per average daily attendance (ADA), that the District is entitled to by law. This amount is multiplied by the second period ADA to derive the District's total entitlement.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 2 - CASH AND INVESTMENTS

Cash on Hand, In Banks and in Revolving Fund

Cash balances on hand, in banks, and revolving funds are insured up to \$100,000 by the Federal Deposit Insurance Corporation (FDIC). These amounts are held within various financial institutions. As of June 30, 2004, the carrying amount of the District's accounts was \$370,100.

Cash in County Treasury

In accordance with *Education Code* Section 41001, the District maintains substantially all of its cash with the County Treasury as part of the common investment pool, which totaled \$43,733,730 as of June 30, 2004. The fair market value of this pool as of that date, as provided by the pool sponsor, was \$43,526,284. The District is considered to be an involuntary participant in the external investment pool. Interest is deposited into participating funds. The county is restricted by *Government Code* Section 53635, pursuant to Section 53601, to invest in time deposits, U.S. government securities, state registered warrants, notes or bonds, State Treasurer's investment pool, bankers' acceptances, commercial paper, negotiable certificates of deposit, and repurchase or reverse repurchase agreements.

A summary of deposits as of June 30, 2004, is as follows:

	<u>Fair Market Value</u>	<u>Carrying Amount</u>
Deposits:		
Cash in county treasury	\$43,526,284	\$43,733,730
Cash on hand and in bank -Governmental Funds	20,500	20,500
Cash on hand and in bank - Fiduciary Funds	<u>349,600</u>	<u>349,600</u>
Total	<u>\$43,896,384</u>	<u>\$44,103,830</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 3 - EXCESS OF EXPENDITURES OVER APPROPRIATIONS

As of June 30, 2004 there were no excess of expenditures over appropriations in individual funds.

NOTE 4 - ACCOUNTS RECEIVABLE

Accounts receivable at June 30, 2004 consist of the following:

	General Fund	Capital Facilities	Building Fund	All Other Governmental Funds	Total
Federal Government					
Categorical Aid Program	<u>\$ 867,351</u>			<u>\$192,631</u>	<u>\$1,059,982</u>
State Government					
Revenue Limit	22,013			10,094	32,107
Categorical Aid Programs	401,710			10,168	411,878
Lottery	435,930				435,930
Other	<u>158,526</u>				<u>158,526</u>
Total State Government	1,018,179			20,262	1,038,441
Local Government	176,855			14,903	191,758
Interest	39,469	\$29,460	\$123,462	11,115	203,506
Miscellaneous	<u>116,131</u>			<u>3,109</u>	<u>119,240</u>
Total Accounts Receivable	<u>\$ 2,217,985</u>	<u>\$29,460</u>	<u>\$123,462</u>	<u>\$242,020</u>	<u>\$2,612,927</u>

NOTE 5 - INTERFUND TRANSACTIONS

Interfund transactions are reported as either loans, services provided, reimbursements, or transfers. Loans are reported as interfund receivables and payables, as appropriate, and are subject to elimination upon consolidation. Services provided, deemed to be at market or near market rates, are treated as revenues and expenditures/expenses. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund, and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers among governmental or proprietary funds are netted as part of the reconciliation to the government-wide financial statements.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 5 - INTERFUND TRANSACTIONS (CONCLUDED)

Interfund Transfers

Interfund transfers consist of operating transfers from funds receiving revenue to funds through which the resources are to be expended. Interfund transfers for the 2003-2004 fiscal year were as follows:

<u>Funds</u>	<u>Transfers In</u>	<u>Transfers Out</u>
General Fund	\$ 126,634	\$ 655,345
Capital Facilities Fund		120,790
Building Fund	2,779,263	
Non-Major Governmental Funds		
County School Facilities	646,000	1,122,745
Special Reserve Fund	9,345	5,844
Cafeteria Fund		6,071
Tax Override Fund		9
Roof Replacement Fund		217
Mello-Roos Fund		<u>1,656,292</u>
Total	<u>\$ 3,561,242</u>	<u>\$ 3,561,242</u>

Interfund Receivables/Payables (Due From/Due To)

Individual fund interfund receivable and payable balances at June 30, 2004 are as follows:

	<u>Interfund Receivables</u>	<u>Interfund Payables</u>
General Fund	\$ 236,862	\$132,972
Capital Facilities Fund		103,551
Building Fund	30,702	1,079
Non-Major Governmental Funds:		
Adult Education Fund		3,536
Child Development Fund		5,106
Cafeteria Fund	14,603	123,938
Deferred Maintenance Fund	100,092	
Roof Replacement Fund	147	1
Mello-Roos Fund		10,443
County School Facilities Fund		<u>1,780</u>
Totals	<u>\$ 382,406</u>	<u>\$382,406</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 6 - CAPITAL ASSETS AND DEPRECIATION

Capital asset activity for the year ended June 30, 2004, is shown below:

	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004
Capital assets, not being depreciated:				
Land	\$ 724,021			\$ 724,021
Work in progress	<u>56,737,903</u>	<u>\$ 37,643,447</u>	<u>\$ 41,592,215</u>	<u>52,789,135</u>
Total capital assets, not being depreciated	<u>57,461,924</u>	<u>37,643,447</u>	<u>41,592,215</u>	<u>53,513,156</u>
Capital assets being depreciated:				
Buildings and Improvements	69,824,952	39,170,913	305,884	108,689,981
Equipment	<u>3,160,217</u>		<u>24,322</u>	<u>3,135,895</u>
Total capital assets, being depreciated	<u>72,985,169</u>	<u>39,170,913</u>	<u>330,206</u>	<u>111,825,876</u>
Less accumulated depreciation for:				
Buildings & Improvements	28,802,560	1,418,822	249,045	29,972,337
Equipment	<u>2,376,380</u>	<u>154,188</u>		<u>2,534,568</u>
Total accumulated depreciation	<u>31,178,940</u>	<u>1,573,010</u>	<u>249,045</u>	<u>32,502,905</u>
Total capital assets, being depreciated, net	<u>41,806,229</u>	<u>37,597,903</u>	<u>81,161</u>	<u>79,318,971</u>
Governmental activities capital assets, net	<u>\$99,268,153</u>	<u>\$75,237,350</u>	<u>\$41,673,376</u>	<u>\$132,832,127</u>

NOTE 7 - GENERAL OBLIGATION BONDS

The Morgan Hill Unified School District General Obligation Bonds, Election of 1999, Series 2000 (the "Series 2000 Bonds"), in the aggregate principal amount of \$38,000,000, were issued by the County of Santa Clara on behalf of the District. The Series 2000 Bonds were authorized at a special election of the registered voters of the District held on June 8, 1999, at which more than two-thirds of the persons voting on the proposition voted to authorize the issuance and sale of not to exceed \$72,500,000 principal amount of general obligation bonds to finance the acquisition and construction of school facilities for the District.

The Morgan Hill Unified School District General Obligation Bonds, Series 2002 (the "Series 2002 Bonds"), in the aggregate principal amount of \$34,497,753.80 were issued by the County of Santa Clara on behalf of the District to finance the construction of new high school, renovations to the existing Live Oak High School, and the construction of a new elementary school. This consists of \$28,210,000 in Current Interest Series Bonds and \$6,287,753.80 in Capital Appreciation Bonds.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 7 – GENERAL OBLIGATION BONDS (CONTINUED)

The Bonds are payable solely from ad valorem property taxes levied and collected by the County of Santa Clara. The Board of Supervisors of the County has power and is obligated to annually levy ad valorem taxes for the payment of interest on, and principal of, upon all property subject to taxation by the District without limitation of rate or amount (except certain personal property which is taxable at limited rates).

The outstanding general obligation bonded debt of the Morgan Hill Unified School District as of June 30, 2004 is:

<u>Date of Issue</u>	<u>Interest Rate</u>	<u>Maturity Date (August 1)</u>	<u>Amount of Original Issue</u>	<u>Outstanding July 1, 2003</u>	<u>Issued Current Year</u>	<u>Accreted Interest Current Year</u>	<u>Redeemed Current Year</u>	<u>Outstanding June 30, 2004</u>
2000	4.6%-5.5%	2025	\$38,000,000	\$37,825,000			\$245,000	\$37,580,000
2002	3.5%-5.25%	2020	28,210,000	28,210,000				28,210,000
2002	5.5%-5.6%	2026	<u>6,287,754</u>	<u>6,287,754</u>		<u>\$865,179</u>		<u>7,152,933</u>
			<u>\$72,497,754</u>	<u>\$72,497,754</u>	<u>\$ 0</u>	<u>\$865,179</u>	<u>\$245,000</u>	<u>\$72,942,933</u>

A. Current Interest Bonds

The annual requirements to amortize the 2000 general obligation bonds payable, outstanding as of June 30, 2004, are as follows:

<u>Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 320,000	\$ 2,004,297	\$ 2,324,297
2006	395,000	1,987,852	2,382,852
2007	480,000	1,967,727	2,447,727
2008	570,000	1,943,577	2,513,577
2009	665,000	1,915,172	2,580,172
2010-2014	5,015,000	8,970,978	13,985,978
2015-2019	8,655,000	7,258,623	15,913,623
2020-2024	13,980,000	4,123,494	18,103,494
2025-2026	<u>7,500,000</u>	<u>421,025</u>	<u>7,921,025</u>
Totals	<u>\$37,580,000</u>	<u>\$30,592,744</u>	<u>\$68,172,744</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 7 – GENERAL OBLIGATION BONDS (CONTINUED)

The annual requirements to amortize the 2002 General Obligation Bonds payable, outstanding as of June 30, 2004, are as follows:

<u>Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 710,000	\$ 1,333,833	\$ 2,043,833
2006	790,000	1,307,583	2,097,583
2007	875,000	1,278,445	2,153,445
2008	965,000	1,246,245	2,211,245
2009	1,060,000	1,210,808	2,270,808
2010-2014	7,095,000	5,171,027	12,266,027
2015-2019	10,920,000	3,041,337	13,961,337
2020-2021	<u>5,795,000</u>	<u>310,406</u>	<u>6,105,406</u>
Totals	<u>\$28,210,000</u>	<u>\$14,899,684</u>	<u>\$43,109,684</u>

B. The outstanding Series 2002 Capital Appreciation Bonds at June 30, 2004 is as follows:

<u>Date of Issue</u>	<u>Interest Rate %</u>	<u>Maturity Date</u>	<u>Amount of Original Issue (Principal)</u>	<u>Accreted Interest</u>	<u>Outstanding June 30, 2004</u>
2002	5.50%	2022	\$1,135,947	\$ 154,155	\$ 1,290,102
2002	5.53%	2023	1,097,428	150,248	1,247,676
2002	5.56%	2024	1,062,031	145,985	1,208,016
2002	5.58%	2025	1,028,614	142,456	1,171,070
2002	5.60%	2026	996,135	138,259	1,134,394
2002	5.60%	2027	<u>967,754</u>	<u>134,076</u>	<u>1,101,675</u>
Totals			<u>\$6,287,754</u>	<u>\$ 865,179</u>	<u>\$ 7,152,933</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 7 – GENERAL OBLIGATION BONDS (CONCLUDED)

The 2002 Capital Appreciation Bonds mature through 2027 as follows:

<u>Year Ended</u> <u>June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2022	\$1,135,947	\$ 2,124,053	\$ 3,260,000
2023	1,097,428	2,247,572	3,345,000
2024	1,062,031	2,377,969	3,440,000
2025	1,028,614	2,506,386	3,535,000
2026	996,135	2,637,504	3,603,639
2027	<u>967,599</u>	<u>2,762,401</u>	<u>3,730,000</u>
Totals	<u>\$6,287,754</u>	<u>\$14,655,885</u>	<u>\$20,943,639</u>

NOTE 8 – CAPITAL LEASE OBLIGATIONS

The District leases equipment under agreements which provide for title to pass upon expiration of the lease period. Future minimum lease payments are as follows:

<u>Year Ending</u> <u>June 30.</u>	<u>Lease Payment</u>
2005	\$ 1,147
Less portion representing interest	<u>(43)</u>
Present value of net minimum lease payments	<u>\$ 1,104</u>

The District will receive no sublease rental revenues nor pay any contingent rentals for this equipment.

NOTE 9 – LONG-TERM DEBT

A schedule of changes in long-term debt for the year ended June 30, 2004 is shown below:

	<u>Balance</u> <u>July 1, 2003</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2004</u>	<u>Due</u> <u>Within One</u> <u>Year</u>
General Obligation Bonds	\$72,322,754		\$ 245,000	\$72,077,754	\$ 1,030,000
Accreted Interest on General Obligation Bonds		\$ 865,179		865,179	0
Compensated Absences	298,514		60,799	237,715	237,715
Capital Lease Obligations	<u>10,906</u>	<u> </u>	<u>9,802</u>	<u>1,104</u>	<u>1,104</u>
Totals	<u>\$72,632,174</u>	<u>\$ 865,179</u>	<u>\$ 315,601</u>	<u>\$75,181,752</u>	<u>\$1,268,819</u>

The District has chosen not to report Other Postemployment Benefits as long-term liabilities (see Note 10). Therefore, this liability is not included in the schedule above.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 9 – LONG-TERM DEBT (CONCLUDED)

The accrued vacation and capital lease obligations will be paid by the General Fund. Payments on the general obligation bonds are made by the Bond Interest and Redemption Fund with local revenues.

NOTE 10 - OTHER POST EMPLOYMENT BENEFITS

The District provides an early retirement plan whereby the District will continue retirees' health benefits until age 65 for individuals that qualify. To qualify for the plan, certificated and administrative employees must be at least 55 years old and classified employees must be at least 50 years old and have been an employee of the District for ten continuous years immediately proceeding retirement. Under this plan, the District has agreed to continue to provide these benefits without any additional performance from the retirees. On June 30, 2004, 131 retirees met these eligibility requirements at a cost of \$870,869 for 2003-2004. The District records the cost for postemployment health benefits when there is a cash outlay (the pay-as-you-go method) rather than when they are earned by active employees (the actuarial method). The estimated cost based upon current participants is \$3,342,971. If the costs were recognized by the actuarial method, they would be significantly greater.

In addition to the benefits described above, certain qualified retirees are included in the single premium annuity contract with the Principal Life Insurance Company. The total cost to the District for the contract (\$1,870,785) is payable in five annual payments of \$374,157 beginning in 2002-2003. There are currently 34 retirees identified as qualified to receive benefits under this plan.

NOTE 11 – EMPLOYEE RETIREMENT SYSTEMS

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

A. State Teachers' Retirement System (STRS)

Plan Description. The Morgan Hill Unified School District contributes to the State Teachers' Retirement System (STRS), a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by STRS. The plan provides retirement, disability, 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 STRS annual financial report may be obtained from the STRS, 7667 Folsom Boulevard, Sacramento, California 95826.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 11 – EMPLOYEE RETIREMENT SYSTEMS (CONTINUED)

A. State Teachers' Retirement System (STRS) (Concluded)

Funding Policy. Active plan members are required to contribute 8.0% of their salary and the Morgan Hill Unified School District is required to contribute an actuarially determined rate. The actuarial methods and assumptions used for determining the rate are those adopted by the STRS Teachers' Retirement Board. The required employer contribution rate for fiscal year 2003-2004 was 8.25% of annual payroll. The contribution requirements of the plan members are established by state statute. The Morgan Hill Unified School District's contributions to STRS for the fiscal year ending June 30, 2004, 2003, and 2002 were \$2,371,177, \$2,568,240 and \$2,457,942, respectively, and equal 100% of the required contributions for each year.

B. California Public Employees Retirement System (CalPERS)

Plan Description. The Morgan Hill Unified School 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 Law. 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 95814.

Funding Policy. Active plan members are required to contribute 7.0%, which the District pays for union members, of their salary and the Morgan Hill Unified School 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 required employer contribution rate for fiscal 2003-2004 was 10.42% of annual payroll. The contribution requirements of the plan members are established by State statute. The Morgan Hill Unified School District's contributions to CalPERS for the fiscal year ending June 30, 2004, 2003 and 2002 were \$786,176, \$231,370 and \$518,093, respectively and equal 100% of the required contributions for each year.

C. Social Security

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 11 – EMPLOYEE RETIREMENT SYSTEMS (CONCLUDED)

D. On Behalf Payment

The State of California makes contributions to STRS and PERS on behalf of the District. These payments consist of State General Fund contributions to STRS and contributions to PERS for the year ended June 30, 2004. Under accounting principles generally accepted in the United States of America, these amounts are to be reported as revenues and expenditures, however, guidance received from the California Department of Education advises local education agencies not to record these amounts in the Annual Financial and Budget Report. These amounts also have not been recorded in these financial statements.

NOTE 12 - STUDENT BODY FUND

The Student Body Funds often engage in activities which involve cash transactions. These transactions are not subject to adequate internal accounting control prior to deposits being recorded in the bank accounts. It has been determined on a cost benefit basis that providing increased internal control in this area does not justify the additional costs that would be necessary to control receipts prior to the point of deposit.

NOTE 13 – COMMITMENTS AND CONTINGENCIES

State and Federal Allowance, Award, and Grants

The District has received state and federal funds for specific purposes that are subject to review and audit by the grantor agencies. If the review or audit discloses exceptions, the District may incur a liability to grantor agencies.

NOTE 14 – JOINT VENTURES

The District participates in a joint power authority (“JPA”), the Santa Clara County Schools Insurance Group (“SIG”). The relationship between the District and the JPA is such that the JPA is not a component unit of the Morgan Hill Unified School District for financial reporting purposes.

Santa Clara County Schools Insurance Group – The JPA arranges for and provides workers’ compensation, property and liability, and employee benefits insurance for its thirty member school districts. Each member school district has a representative on the Joint Powers Board which governs the management and financing of JPA activities. Each member District pays a premium commensurate with the level of coverage requested and shares surpluses and deficits proportionate to their participation in the JPA.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

NOTE 14 - JOINT VENTURES (CONCLUDED)

Due to an error in the Experience Modification calculations prepared for the School's Insurance Group for the 1999-2000 fiscal year, some member districts are overpaying their premiums while other member districts are underpaying their premiums. During 1999-2000, it was determined the Morgan Hill Unified District was under-assessed approximately \$84,910. Upon receipt of the final assessment amount, the District will make-up the underpayment over a five-year period. No provision has been made in these financial statements for this obligation.

NOTE 15 - RESTATEMENT OF BEGINNING NET ASSETS

The Net Assets reported at June 30, 2003 have been restated to recognize the effect of not reporting Other Postemployment Benefits as long-term liabilities (see Note 10). The effect of the change is an increase in Net Assets at June 30, 2003 of \$3,231,737.

NOTE 16 - SUBSEQUENT EVENTS

Tax Revenue Anticipation Notes

On July 6, 2004, the District issued \$10,145,000 in tax revenue anticipation notes at a premium of \$129,552. The TRANS are a general obligation of the District and are payable from revenues and cash receipts to be generated by the District. There are no contractual obligations related to the issuance other than the TRANS agreement. The notes mature on July 6, 2005 and bear interest at 1.60%. Proceeds from the notes can be drawn upon during the year if cash shortages arise.

MORGAN HILL UNIFIED SCHOOL DISTRICT
STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES - BUDGET (NON-GAAP) AND ACTUAL
GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	Budgeted Amounts		Actual (Budgetary Basis)	Variance with Final Budget Positive- (Negative)
	Original	Final		
REVENUES				
Revenue Limit Sources:				
State Apportionments	\$ 1,832,959	\$ 251,239	\$ 247,147	\$ (4,092)
Local Sources	37,140,780	39,129,156	39,129,156	
Total Revenue Limit	38,973,739	39,380,395	39,376,303	(4,092)
Federal Revenue	2,392,985	3,103,332	2,925,851	(177,481)
Other State Revenue	6,278,730	8,075,797	7,732,806	(342,991)
Other Local Revenue	3,426,295	4,844,230	4,660,206	(184,024)
Total Revenues	51,071,749	55,403,754	54,695,166	(708,588)
EXPENDITURES				
Certificated Salaries	28,299,240	28,577,578	28,441,909	135,669
Classified Salaries	7,459,691	7,644,567	7,445,531	199,036
Employee Benefits	8,144,814	8,866,061	8,657,087	208,974
Books and Supplies	1,851,408	4,151,129	2,302,407	1,848,722
Services and Other				
Operating Expenditures	4,066,594	5,268,878	4,763,863	505,015
Capital Outlay	24,012	21,730	21,730	
Debt Service:				
Principal Retirement	9,802	9,802	9,802	
Interest and Fiscal Charges	1,062	1,062	1,062	
Other Outgo	1,433,935	1,583,799	1,533,450	50,349
Total Expenditures	51,290,558	56,124,606	53,176,841	2,947,765
Excess of Revenues Over (Under) Expenditures	(218,809)	(720,852)	1,518,325	2,239,177
Other Financing Sources (Uses):				
Operating Transfers In	65,640	175,304	126,634	(48,670)
Operating Transfers Out		(655,345)	(655,345)	
Total Other Financing Sources (Uses)	65,640	(480,041)	(528,711)	(48,670)
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	(153,169)	(1,200,893)	989,614	2,190,507
Fund Balances - July 1, 2003	2,964,979	2,964,979	2,964,979	0
Fund Balances - June 30, 2004	\$ 2,811,810	\$ 1,764,086	\$ 3,954,593	\$ 2,190,507

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

REQUIRED SUPPLEMENTARY INFORMATION SECTION

SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

MORGAN HILL, CALIFORNIA

JUNE 30, 2004

ORGANIZATION

The Morgan Hill Unified School District was founded on July 1, 1966 and is comprised of an area of approximately 296 square miles located in Santa Clara County. There were no changes in the boundaries of the District during the current year. The District operates ten elementary school, two middle schools, one regular and one continuation high school, and a community adult education school.

The Board of Trustees for the year ended June 30, 2004, was composed of the following members:

Board of Education

<u>Name</u>	<u>Office</u>	<u>Term expires</u>
George Panos	President	December 2004
Shellé Thomas	Vice President	December 2006
J.C. Foster	Member	December 2004
Michael J. Hickey	Member	December 2006
Amina Khemici	Member	December 2006
Jan Masuda	Member	December 2004
Donald Moody	Member	December 2006

ADMINISTRATION

Carolyn McKennan, Ed.D.
Superintendent

MORGAN HILL UNIFIED SCHOOL DISTRICT
SCHEDULE OF AVERAGE DAILY ATTENDANCE
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	<u>Second Period Report</u>	<u>Annual Report</u>
<u>Elementary</u>		
Kindergarten	638	640
First through Third	1,880	1,882
Fourth through Sixth	1,842	1,846
Seventh through Eighth	1,278	1,280
Opportunity Schools	6	6
Special Education	121	124
Extended year	<u>9</u>	<u>9</u>
Subtotals	<u>5,774</u>	<u>5,787</u>
<u>High School</u>		
Regular Classes	2,144	2,133
Special Education	55	53
Compulsory Continuation Education	82	82
Opportunity Schools	3	3
Extended Year	<u>3</u>	<u>3</u>
Subtotals	<u>2,287</u>	<u>2,274</u>
<u>Classes for Adults</u>		
Concurrently Enrolled	3	3
Not concurrently Enrolled	<u>167</u>	<u>180</u>
Totals	<u>8,230</u>	<u>8,244</u>
	<u>Hours of Attendance</u>	
<u>Supplemental Hours</u>		
Elementary	43,563	45,226
High School	<u>40,843</u>	<u>43,481</u>
Totals	<u>84,406</u>	<u>88,707</u>

Average daily attendance is a measurement of the numbers 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 the school districts. This schedule provides information regarding the attendance of students at various grade levels and in different programs.

SEE NOTES TO SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT
SCHEDULE OF INSTRUCTIONAL TIME OFFERED
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

<u>Grade Level</u>	<u>1986-87 Minutes Requirement</u>	<u>1982-83 Actual Minutes</u>	<u>2003-2004 Actual Minutes</u>	<u>Number of Days Traditional Calendar</u>	<u>Status</u>
Kindergarten	36,000	31,680	36,000	180	In compliance
Grades 1 through 3	50,400	48,130	50,705	180	In compliance
Grades 4 through 6	54,000	51,920	54,060	180	In compliance
Grades 7 through 8	54,000	55,715	64,575	180	In compliance
Grade 9	64,800	55,715	64,927	180	In compliance
Grades 10 through 12	64,800	60,849	64,927	180	In compliance

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 instruction 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 requirements, whichever is greater, as required by *Education Code* Section 46201.

SEE NOTES TO SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF CHARTER SCHOOLS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

The District has granted and approved two charter schools pursuant to California Education Code Section 47605. The Charter School of Morgan Hill was granted and approved for a term ending June 30, 2005. The Charter of Advent Academy was granted and approved for a term ending June 30, 2005.

For disclosure purposes, the activities of the charter school are not presented in the District's financial statements.

SEE NOTES TO SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

<u>Program Name:</u>	<u>Federal Number</u>	<u>Pass-Through Entity Number</u>	<u>Expenditures</u>
Federal:			
US Department of Agriculture:			
Passed through the California			
Department of Education (CDE):			
National School Lunch	10.555	13524	\$ 539,053
Especially Needy Breakfast	10.553	13526	143,000
Basic School Breakfast	10.553	13525	51,606
Total US Department of Education			733,659
US Department of Education:			
Passed through CDE:			
NCLB- Title I	84.010	14329	887,087
Title I Even Start	84.213	14331	15,513
NCLB - Title II, Part A Improving Teacher Quality	84.367	14341	272,273
NCLB - Title III, Limited English Proficiency	84.365	10084	60,970
NCLB - Title IV - Drug Free Schools and			
Communities Act of 1986	84.186	14347	23,849
NCLB - Title VI - Innovative Strategies	84.298A	14354	27,193
Special Education			
IDEA Preschool Grant Local Staff Development	84.173	13430	49,442
IDEA Local Staff Development	84.027A	13613	3,024
Local Assistance	84.027	13379	1,099,309
Workability I	84.027	13705	32,038
IDEA - Preschool Local Entitlement	84.027A	13682	60,398
Preschool Staff Development	84.173A	13431	708
Adult Education			
Adult Basic Education	84.002A	13978	16,650
Vocational Programs	84.048	03578	2,698
Adult Education: ESL	84.002	14302	15,981
Adult Secondary Education	84.002	13978	8,550
ESL/ESL - Citizenship	84.002	13974	24,975
English Literacy and Civics Education	84.002A	14109	61,848
Vocational Literacy	84.002A	14494	9,000
Vocational Programs: Voc & Applied Tech State Leadership	84.048	13920	2,872
Vocational Education Act	84.048	03577	48,555
NCLB - Migrant Education	84.011	14326	201,604
NCLB - Migrant Summer School	84.011	10005	17,291
School Renovation Classroom Technology	84.352A	14318	111,024
Total US Department of Education			3,052,852
Department of Health and Human Services:			
Medi-Cal Billing Option	93.778	10013	12,701
Child Development - Instructional Materials	93.575	00174	1,990
Total Department of Health and Human Services			14,691
Total Federal Programs			\$ 3,801,202

SEE NOTES TO SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT
RECONCILIATION OF ANNUAL FINANCIAL AND BUDGET
REPORT WITH AUDITED FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	Cafeteria <u>Fund</u>
June 30, 2004 Unaudited Actual Financial Report Fund Balance	<u>\$374,842</u>
Adjustments and Reclassifications Increasing (Decreasing) the Fund Balance:	
Overstatement of State Revenue - Staff Development	
Overstatement of Cash with Fiscal Agent	<u>(252)</u>
Net adjustment and Reclassification	<u>(252)</u>
June 30, 2004 Audited Financial Statement Fund Balance	<u>\$374,590</u>

Auditor's Comments

The audited financial statements of all funds were in agreement with the Annual Financial and Budget Report (J-200) for the year ended June 30, 2004.

SEE NOTES TO SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT
SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	(Budget) 2004-2005	2003-2004	2002-2003	2001-2002
<u>General Fund</u>				
Revenues and Other Financial Sources	\$ 54,125,359	\$ 54,821,800	\$ 55,390,378	\$ 56,115,405
Expenditures	54,258,993	53,176,841	56,027,840	57,236,363
Other Uses and Transfers Out	300,000	655,345	0	152,792
Total Outgo	54,558,993	53,832,186	56,027,840	57,389,155
Change in Fund Balance (Deficit)	(433,634)	989,614	(637,462)	(1,273,750)
Ending Fund Balance	\$ 3,520,959	\$ 3,954,593	\$ 2,964,979	\$ 3,602,441
Available Reserves	\$ 1,488,155	\$ 1,921,790	\$ 1,072,805	\$ 1,726,170
Designated for Economic Uncertainties	\$ 1,363,572	\$ 1,614,966	\$ 1,072,805	\$ 1,716,423
Undesignated Fund Balance	\$ 124,583	\$ 306,824	\$ 0	\$ 9,747
Available reserves as a percentage of total outgo	2.7%	3.6%	1.9%	3%
Total long-term debt	\$ 71,912,933	\$ 73,181,752	\$ 75,863,911	\$ 74,018,616
Average daily attendance at P-2 (excluding Adult Education)	8,062	8,061	7,995	8,177

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.

Available reserves includes General Fund designated for economic uncertainty and General Fund unrestricted, undesignated fund balance. The general fund balance has decreased by \$921,598 over the past three years. The fiscal year 2004-2005 budget projects a decrease of \$433,634 in the general fund balance. For a district this size, the state recommends available reserves of at least 3 percent of total general fund expenditures, transfers out, and other uses.

Total long-term debt has decreased by \$836,864 over the past two years. Total average daily attendance has decreased 116 over the past two years.

SEE NOTES TO SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT
COMBINING BALANCE SHEET
NON-MAJOR FUNDS
JUNE 30, 2004

	Deferred Maintenance	Cafeteria	Adult Education	Child Development
ASSETS				
Cash in County Treasury	\$ 145,069	\$ 358,056	\$ 188,371	\$ 177,993
Cash in Revolving Fund		1,000	5,000	
Accounts Receivable				
Federal Government		119,114	73,517	
State Government		7,939	10,094	2,229
Local Governments				
Interest	753	943	937	268
Miscellaneous	271	1,389	1,449	
Due from Other Funds	100,092	14,603		
Stores Inventory		25,155		
Total Assets	<u>\$ 246,185</u>	<u>\$ 528,199</u>	<u>\$ 279,368</u>	<u>\$ 180,490</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts Payable		\$ 29,671	\$ 38,613	\$ 81,384
Due to Other Funds		123,938	3,536	5,106
Deferred Revenue			80,846	94,000
Total Liabilities		<u>153,609</u>	<u>122,995</u>	<u>180,490</u>
Fund Balances:				
Reserved		25,155	5,000	
Unreserved				
Designated				
Undesignated	\$ 246,185	349,435	151,373	
Total Fund Balances	<u>246,185</u>	<u>374,590</u>	<u>156,373</u>	<u>0</u>
Total Liabilities and Fund Balances	<u>\$ 246,185</u>	<u>\$ 528,199</u>	<u>\$ 279,368</u>	<u>\$ 180,490</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

Special Reserve	Mello Roos	County Schools Facilities	State School Building	Bond Interest and Redemption	Totals
\$ 1,226,102	\$ 9,582	\$ 1,770		\$ 2,837,026	\$ 4,943,969
					6,000
					192,631
					20,262
				14,903	14,903
2,658	861	9	\$ 1	4,685	11,115
					3,109
			147		114,842
					25,155
<u>\$ 1,228,760</u>	<u>\$ 10,443</u>	<u>\$ 1,779</u>	<u>\$ 148</u>	<u>\$ 2,856,614</u>	<u>\$ 5,331,986</u>
			\$ 147		\$ 149,815
	\$ 10,442	\$ 1,779	1		144,802
					174,846
	<u>10,442</u>	<u>1,779</u>	<u>148</u>		<u>469,463</u>
					30,155
\$ 1,228,760	1			\$ 2,856,614	2,856,614
					1,975,754
<u>1,228,760</u>	<u>1</u>	<u>0</u>	<u>0</u>	<u>2,856,614</u>	<u>4,862,523</u>
<u>\$ 1,228,760</u>	<u>\$ 10,443</u>	<u>\$ 1,779</u>	<u>\$ 148</u>	<u>\$ 2,856,614</u>	<u>\$ 5,331,986</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT
COMBINING STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES
NON-MAJOR FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	Deferred Maintenance	Cafeteria	Adult Education	Child Development
REVENUES				
Revenue Limit Sources:				
State Apportionment			\$ 376,892	
Federal Sources:				
Child Nutrition Program		\$ 733,659	139,702	\$ 1,990
Other				
Other State Sources:				
State Nutrition Program		48,704	49,250	434,462
Other	\$ 103,060			
Other Local Sources:				
Food Service Sales		1,175,408		
Interest	4,904	3,575	3,219	2,000
Other			47,401	
Total Revenues	107,964	1,961,346	616,464	438,452
EXPENDITURES				
Certificated Salaries			256,090	
Classified Salaries		577,789	135,424	
Employee Benefits		264,383	78,202	
Books and Supplies	3,420	941,294	42,762	
Services and Other				
Operating Expenditures	170,538	56,496	35,578	415,365
Capital Outlay	183,591			
Debt Service:				
Principal Retirement				
Interest and Fiscal Charges		103,759	15,060	23,087
Other Outgo				
Total Expenditures	357,549	1,943,721	563,116	438,452
Excess of Revenues Over (Under) Expenditures	(249,585)	17,625	53,348	0
Other Financing Sources (Uses):				
Operating Transfers In		9,345		
Operating Transfers Out		(5,844)		
Total Other Financing Sources (Uses)	0	3,501	0	0
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	(249,585)	21,126	53,348	0
Fund Balances - July 1, 2003	495,770	353,464	103,025	0
Fund Balances - June 30, 2004	\$ 246,185	\$ 374,590	\$ 156,373	\$ 0

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

Special Reserve	Mello Roos	County Schools Facilities	State School Building	Tax Override	Bond Interest and Redemption	Totals
						\$ 376,892
						733,659
						141,692
		\$ 1,115,722				48,704
						1,702,494
\$ 9,783	\$ 8,735	7,023	\$ 364		\$ 14,822	1,175,408
	539,916			\$ 9	4,249,906	54,425
						4,837,232
9,783	548,651	1,122,745	364	9	4,264,728	9,070,506
						256,090
						713,213
			147			342,585
						987,623
	2,179					680,156
						183,591
					245,000	245,000
					3,365,170	3,365,170
						141,906
	2,179		147		3,610,170	6,915,334
9,783	546,472	1,122,745	217	9	654,558	2,155,172
646,000						655,345
	(1,656,292)	(1,122,745)	(217)	(9)		(2,785,107)
646,000	(1,656,292)	(1,122,745)	(217)	(9)		(2,129,762)
655,783	(1,109,820)	0	0	0	654,558	25,410
572,977	1,109,821	0	0	0	2,202,056	4,837,113
\$ 1,228,760	\$ 1	\$ 0	\$ 0	\$ 0	\$ 2,856,614	\$ 4,862,523

MORGAN HILL UNIFIED SCHOOL DISTRICT
NOTES TO SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2004

NOTE 1 - PURPOSE OF STATEMENTS AND SCHEDULES

A. Schedule of Revenues, Expenditures, and Changes in Fund Balances - Budget and Actual

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, the District is required to present a Schedule of Revenues, Expenditures, and Changes in Fund Balance budgetary comparison for the General Fund and each Major Special Revenue Fund that has an adopted budget. This schedule presents the original adopted budget, final adopted budget, and the actual revenues and expenditures of each of these funds by object.

B. Schedule of Average Daily Attendance

Average daily attendance 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.

C. 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 and number of days offered by the District and whether the District complied with the provisions of Education Code Sections 46201 through 46206.

D. Schedule of Charter Schools

This schedule is provided to list all charter schools chartered by the District and displays information for each charter school on whether or not the charter school is included in the District audit.

E. Schedule of Expenditures of Federal Awards

OMB Circular A-133 requires a disclosure of the financial activities of all federally funded programs. To comply with Circular A-133 requirements, this schedule was prepared for the District.

F. Reconciliation of Unaudited Actual Financial Report with Audited Financial Statements

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

G. Schedule of Financial Trends and Analysis

This schedule is presented to improve the evaluation and reporting of the going concern status of the District.

H. Combining Statements and Individual Fund Schedules

Combining statements and individual fund schedules are presented for purposes of additional analysis, and are not a required part of the District's basic financial statements. These statements and schedules present more detailed information about the financial position and financial activities of the District's individual funds.

OTHER INDEPENDENT AUDITORS REPORTS SECTION

INDEPENDENT AUDITOR'S REPORT ON STATE COMPLIANCE

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

We have audited the general purpose financial statements of the Morgan Hill Unified School District, as of and for the year ended June 30, 2004, and have issued our report thereon dated November 10, 2004. Our audit was made in accordance with auditing standards generally accepted in the United States of America, the standards for financial and compliance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the State Controller's *Standards and Procedures for Audits of California K-12 Local Educational Agencies*. 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 opinion.

The District's management is responsible for the District's compliance with laws and regulations. In connection with the audit referred to above, we selected and tested transactions and records to determine the District's compliance with the state laws and regulations applicable to the following items:


<u>Description</u>	<u>Procedures in Controller's Audit Guide</u>	<u>Procedures Performed</u>
Attendance reporting	6	Yes
Kindergarten continuance	3	Yes
Independent study	22	No (See Below)
Continuation education	10	Yes
Adult education	9	Yes
Regional Occupational Center/Programs	6	Not Applicable
Instructional time and staff development reform program	7	Yes

<u>Description</u>	<u>Procedures in Controller's Audit Guide</u>	<u>Procedures Performed</u>
Instructional Time for School Districts	4	Yes
Instructional Time for County Offices of Education	3	Not Applicable
Community Day Schools	9	Not Applicable
Class Size Reduction:		
General Requirements	7	Yes
Option One classes	3	Yes
Option Two classes	4	Not Applicable
Districts or Charter Schools with only one school serving K-3	4	Not Applicable
Instructional Materials:		
General Requirements	9	Yes
K-8 only	1	Yes
9-12 only	1	Yes
Ratios of administrative employees to teachers	1	Yes
GANN limit calculation	1	Yes
Early retirement incentive program	4	Not Applicable

We did not perform testing for independent study because the independent study ADA was under the level that requires testing.

Based on our audit, we found that, for the items tested, the Morgan Hill Unified School District complied with the state laws and regulations of the state programs referred to above. Further, based on our examination, for items not tested, nothing came to our attention to indicate that the Morgan Hill Unified School District had not complied with the state laws and regulations.

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


GOODELL, PORTER & FREDERICKS, LLP
Certified Public Accountants

November 10, 2004

GOODELL,
PORTER &
FREDERICKS, LLP

CERTIFIED
PUBLIC
ACCOUNTANTS

RICHARD J. GOODELL, CPA
JOHN L. GOODELL, CPA
VIRGINIA K. PORTER, CPA
PAUL D. FREDERICKS, CPA

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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

We have audited the financial statements of Morgan Hill Unified School District as of and for the year ended June 30, 2004, and have issued our report thereon dated November 10, 2004. 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.

Compliance

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 grants, 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 that are required to be reported under *Government Auditing Standard*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Morgan Hill Unified School District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Morgan Hill Unified School District's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are included in the Findings and Recommendations Section of the report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We believe none of the reportable conditions described above is a material weakness.

This report is intended solely for the information of the District Board, management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.


GOODELL, PORTER & FREDERICKS, LLP
Certified Public Accountants

November 10, 2004

INDEPENDENT AUDITOR'S REPORT
ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE
WITH OMB CIRCULAR A-133

Board of Education
Morgan Hill Unified School District
Morgan Hill, CA

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, 2004. Morgan Hill Unified School District's major federal programs are identified in the summary of the auditor's 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 reasonable basis for our opinion. Our audit does not provide a legal determination of Morgan Hill Unified School District's compliance with those requirements.

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, 2004.

Internal Control Over Compliance

The management of Morgan Hill Unified School District is responsible for establishing and maintaining effective internal control over compliance with 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 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 and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level of risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal controls over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Governing Board, management, federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than the specified parties.


GOODELL, PORTER & FREDERICKS, LLP
Certified Public Accountants

November 10, 2004

FINDINGS AND QUESTIONED COSTS SECTION

MORGAN HILL UNIFIED SCHOOL DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

JUNE 30, 2004

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

Material weakness(es) identified? ☐ Yes ☒ No

Reporting condition(s) identified not considered to be material weaknesses? ☒ Yes ☐ None reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

Federal Awards

Internal control over financial reporting:

Material weakness(es) identified? ☐ Yes ☒ No

Reporting condition(s) identified not considered to be material weaknesses? ☐ Yes ☒ None reported

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

Any audit findings disclosed that are required to be reported in accordance with Circular A-133 ☐ Yes ☒ No

Identification of major programs

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
84.010	NCLB - Title I
84.027	Special Education - Local Assistance
84.367	NCLB - Title II Part A Improving Teacher Quality

Dollar threshold used to distinguish between Type A and Type B programs: 300,000

Auditee qualified as low-risk auditee? ☐ Yes ☒ No

State Awards

Internal control over state programs:

Material weakness(es) identified? ☐ Yes ☒ No

Reporting conditions(s) identified not considered to be material weaknesses? ☐ Yes ☒ None reported

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

MORGAN HILL UNIFIED SCHOOL DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

JUNE 30, 2004

Section II - Financial Statements Findings

2004 - 1 - STUDENT BODY ACCOUNT - MURPHY MIDDLE SCHOOL - 30000

Specific Requirement That Was Not Complied With: Accounting Procedures for Student Organizations require funds raised through student body accounts be allocated to student activities.

Finding: During our testing of the student body account at Murphy Middle School, we tested sixteen (16) disbursements and noted two (2) of them appeared to be improper expenditures. One was for the purchase of T-shirts for teachers at the beginning of the school year and the other one was for repair of equipment in the Home Economics room.

Amount of Questioned Costs and How Computed: The condition referred to above was the result of our test of an attribute of the control system. We considered defining, the dollar amount by extending the error rate to the total population, but determined this type of analysis would likely result in an incorrect conclusion.

Recommendation: We recommend that funds raised by the student body not be used to meet obligations of the District.

District Response: The samplings of the two expenditures of a middle school ASB account reflect extraordinary expenditures not done with ASB funds. New staff at the middle school was not familiar with ASB guidelines. The purchase of the T-shirts for staff was intended to stimulate school spirit. The expenditure for the repair in the Home Economics room was made from funds collected from prior fundraisers conducted by the department. The ASB director has been trained to ensure future compliance.

2004 - 2 - CASH DISBURSEMENT - LIVE OAK HIGH SCHOOL- 30000

Specific Requirement That Was Not Complied With: Sound accounting practices require the use of purchase orders as a management tool to document prior approval and encumbrance of District funds. All District expenditures should be supported by a purchase order completed in advance of the purchase. Before the purchase is approved, the budget should be reviewed for availability of funds and then the expenditure should be encumbered.

Finding: During our audit of Live Oak High School cash disbursements, we determined three of the three warrants tested were not supported by a purchase order completed/approved in advance of the purchase.

Amount of Questioned Costs and How Computed: The condition referred to above was the result of our test of an attribute of the control system. We considered defining the dollar amount by extending the error rate to the total population, but determined this type of analysis would likely result in incorrect conclusion.

MORGAN HILL UNIFIED SCHOOL DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

JUNE 30, 2004

Section II - Financial Statements Findings (Continued)

2004 - 2 - CASH DISBURSEMENT - LIVE OAK HIGH SCHOOL- 30000 (CONCLUDED)

Effect: Lack of adherence to the District's policy requiring adequate supporting documentation for expenditures limits management's control over cash disbursements. The District's payments may inadvertently exceed amounts encumbered resulting in an excess of expenditures over appropriation.

Recommendation: We recommend the District require all employees to obtain purchase orders prior to any purchases. Before the purchase order is approved and items ordered, the budget should be reviewed for availability of funds and then the expenditure should be encumbered.

District Response: Although the sampling indicated that purchase orders were not issued for some expenses, two of the three samples would still typically be treated as direct pays with no purchase orders. One payment was a reimbursement for a teacher for attending a conference and the other was payment to the Tri County Athletic League for membership dues. We anticipate we will continue to pay reimbursements and some dues as direct pays and we will continue to require that prior approval by the department managers or principals for all types of expenditures, direct pays and requisitions.

In reviewing our records we do find that the use of purchase orders should be implemented with greater regularity. In June 2004, we provided a list to each program manager indicating when purchase orders must be issued in the future. In February 2005. We will follow-up with the department managers to ensure compliance has been followed.

Section III - Federal Award Findings and Questioned Costs

No matters are reported

Section IV - State Award Findings and Questioned Costs

No matters are reported

MORGAN HILL UNIFIED SCHOOL DISTRICT

STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS

JUNE 30, 2004

<u>Findings/Recommendations</u>	<u>Current Status</u>	<u>Explanation if Not Fully Implemented</u>
1. The District should implement a position control system in order to more effectively control personnel expenditures and to ensure accurate budget projections. Staff should not be hired without identifying the revenue source that will fund the position. Business services should be notified of all requests for new positions, and should sign off that the budget is in place prior to the hiring of new personnel. Communications between Human Resources and the Business Office should be improved, allowing staffing and budgetary decisions to be made in a coordinated manner.	Accepted Implemented	
2. The District should institute procedures to assure that no funds are spent without budget authorization. Program managers should implement monthly reviews of the approved the budget to actual reports to prevent future deficit spending.	Accepted Implemented	
3. The District should review the instructional minutes currently offered to ensure time is not claimed for passing times of varying lengths.	Accepted Implemented	