

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

ANNUAL FINANCIAL REPORT

JUNE 30, 2005



MORGAN HILL UNIFIED SCHOOL DISTRICT

JUNE 30, 2005

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FINANCIAL SECTION



GOODELL,  
PORTER &  
FREDERICKS, LLP

CERTIFIED  
PUBLIC  
ACCOUNTANTS

RICHARD J. GOODELL, CPA  
JOHN L. GOODELL, CPA  
VIRGINIA K. PORTER, CPA  
BEVERLY A. SANCHEZ, 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, 2005, 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.

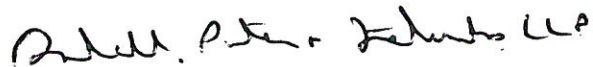
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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, 2005 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 12 and the budgetary comparison information on page 45 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 October 28, 2005 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 agreements and other matters. The purpose of that report is to describe the scope of our testing of internal controls over financial reporting or on compliance, and not to provide an opinion on the internal controls over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Morgan Hill School District's basic financial statements. The accompanying statistical schedules, and combining non-major fund financial statements are presented for additional analysis and are not a required part of the basic financial statements. 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 School District. The statistical schedules, the schedule of expenditures of federal awards and the combining non-major fund financial statements have 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

October 28, 2005

MORGAN HILL UNIFIED SCHOOL DISTRICT  
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2005

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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, 2005. 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 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 average daily attendance for the second consecutive year has increased. For 2002-2003 to 2003-04, ADA increased by 67, or .8%. For 2003-04 to 2004-05, ADA increased by 145, or 1.8%.

The decrease for the general fund revenue for 2002-03 to 2003-04 was \$415,776 or (.8%) compared to an increase of \$1,335,010 or 2.4% for the period 2003-04 to 2004-05. The decrease between 2002-03 to 2003-04 reflects the elimination of the Morgan-Hart program, reduction in Lottery revenue and state funding. The increase between 2003-04 to 2004-05 reflect the increase in ADA and the reduction in the deficit factor.

The decrease in district-wide funding from 2002-03 to 2003-04 was \$13,783,703, or (16%) reflects one-time funds received from the state for Modernization and Construction projects. The decrease in revenue from 2003-04 to 2004-05 was \$3,643,659 or 5% reflecting the changes described above and one-time funds from a lawsuit settlement and one-time revenues for Capital Facilities and the reduction in Developer Fees.

The decrease in general fund expenses from 2002-03 to 2003-04 was \$2,042,853 or (3.6%) compared to an increase of \$1,127,247 or 2%. The decrease between 2002-03 to 2003-04 was due to staff reductions and other cost saving measures. The increase between 2003-04 to 2004-05 was due to increase in staff costs and contractual obligations.

The increase in district-wide expenses from 2002-03 to 2003-04 was \$2,334,683 or 3%, which includes the decrease described above, and reflects the on-going costs of the construction of our new high school and the renovation of several school site campuses. The increase in expenses from 2003-04 to 2004-05 was \$24,255,480 or 37%, reflecting the Work In Progress for several uncompleted building or renovation projects.

General Fund revenues and other sources exceeded expenditures by \$1,200,378, ending the year with a fund balance of \$ 5,154,970, which includes \$1,185,179 that is legally restricted, and available reserves of \$3,427,583, including the mandatory 3% Economic Uncertainty.

The implementation of position control and budget blocking assisted in controlling expenditures.

In complying with GASB 34, fixed assets were valued at historical costs, the total of the District's fixed assets, land, buildings, and equipment, valued on an acquisition cost basis was \$ 194.3 million. After depreciation, the June 30, 2005 book value for fixed assets totaled \$ 159.4 million.



MORGAN HILL UNIFIED SCHOOL DISTRICT  
MANAGEMENT DISCUSSION AND ANALYSIS

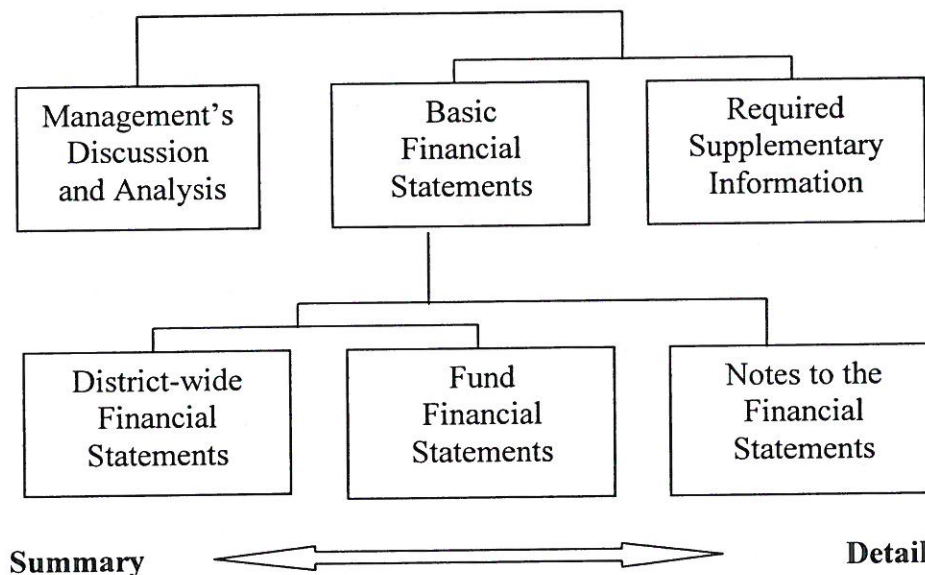
JUNE 30, 2005

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**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, 2005

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**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 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 2004-05?"

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, 2005

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**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 and Bond Interest and Redemption Fund. Governmental funds focus on how money flows into and out of the funds and the balances that remain at the end of the year. They are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the District's operations and services that help determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs.

◆ **Fiduciary Funds**

The District is the trustee, or fiduciary, for 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, 2005

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**FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS**

*The School District as a Whole*

The District's net assets were \$104 million at June 30, 2005. Of this amount \$2.9 million was unrestricted. Investments in capital assets, net of related debt, account for \$88 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	
	2005	2004
<b>Assets</b>		
Cash	\$ 22,468,747	\$ 43,754,230
Receivables	2,461,988	2,612,927
Stores Inventory	160,195	149,679
Prepaid Expenses	376,525	376,877
Capital assets	159,427,747	132,832,127
Total assets	<u>184,895,202</u>	<u>179,725,840</u>
<b>Liabilities</b>		
Accounts payable and other current liabilities	6,494,111	6,609,497
Deferred revenue	1,148,444	577,764
Long-term liabilities	72,607,678	73,181,752
Total liabilities	<u>80,250,233</u>	<u>80,369,013</u>
<b>Net Assets</b>		
Invested in capital assets, net of related debt	88,379,993	60,753,269
Restricted	13,361,403	36,138,126
Unrestricted	2,903,573	2,465,432
Total net assets	<u>\$ 104,644,969</u>	<u>\$ 99,356,827</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2005

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

The District's net asset position increased \$5.2 million this fiscal year (See Table 2). The District's expenses for instructional and pupil services represented 77 percent of total expenses. The purely administrative activities of the District accounted for just 6 percent of total costs. The remaining 17 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	
	2005	2004
<b>Revenues</b>		
Program revenues	\$ 18,161,867	\$ 19,804,999
General revenues		
Taxes levied for general purposes	36,547,360	39,129,156
Taxes levied for other specific purpose	5,055,816	5,542,527
Federal and State Aid not restricted to specific purposes	9,058,799	3,497,986
Interest and investment earnings	274,075	126,670
Miscellaneous	541,487	1,505,145
Total revenues	<u>69,639,404</u>	<u>69,606,483</u>
<b>Expenses</b>		
Instruction	36,083,109	33,550,043
Instruction related services	6,778,127	6,288,377
Pupil support services	7,074,936	6,351,947
General administration	3,610,431	6,557,839
Plant services	4,989,040	4,740,818
Other	5,815,617	7,813,300
Total expenses	<u>64,351,260</u>	<u>65,302,324</u>
Increase in net assets	<u>\$ 5,288,144</u>	<u>\$ 4,304,159</u>



MORGAN HILL UNIFIED SCHOOL DISTRICT  
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2005

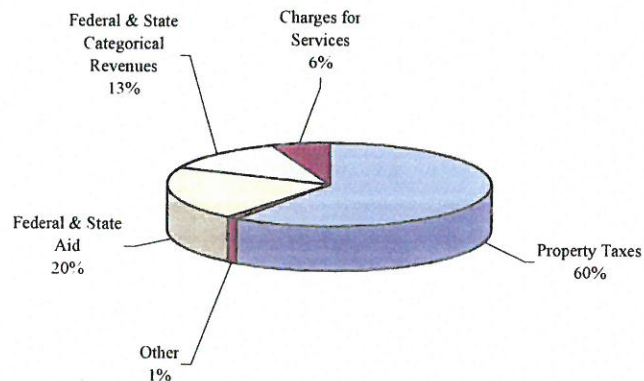
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**FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS  
(CONTINUED)**

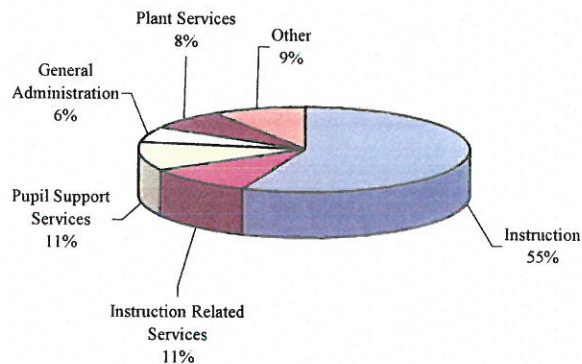
**Governmental Activities**

As reported in the Statement of Activities, the cost of all of the District's governmental activities this year was \$64 million. The amount that our local taxpayers financed for these activities through property taxes was \$41 million. Federal and State aid not restricted to specific purposes totaled \$9.0 million. State and Federal Categorical revenue totaled over \$14 million, or 13% of the revenue of the entire District (See Figure 1).

**Sources of Revenue for the 2004-05 Fiscal Year  
Figure 1**



**Expenses for the Fiscal Year 2004-05  
Figure 2**



MORGAN HILL UNIFIED SCHOOL DISTRICT  
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2005

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**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 \$19 million, a decrease of \$4 million from the previous fiscal year. This decrease is mainly reflected in the Building Fund. The General Fund balance increased \$1.2 million.

**General Fund Budgetary Highlights**

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

- ◆ Budget revisions to the adopted budget required after approval of the State budget.
- ◆ Budget revisions to update revenues to actual enrollment information and to update expenditures for staffing adjustments related to actual 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 \$1,410,193.

The District ended the year adding \$1.2 million to the general fund ending balance. The State recommends an ending reserve for economic uncertainties of 3%. The District's ending reserve was 3.0%.

MORGAN HILL UNIFIED SCHOOL DISTRICT  
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2005

**CAPITAL ASSET AND DEBT ADMINISTRATION**

**Capital Assets**

By the end of the 2004-05 fiscal year, the District had invested \$194 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 \$159 million at June 30, 2005, which is an increase of \$26,595,620 from the previous year due to acquisitions totaling \$31 million and depreciation expenses of \$2.4 million.

**Table 3**  
**Comparative Schedule of Capital Assets**  
**(net of depreciation)**  
**June 30, 2005 and 2004**

	<u>2005</u>	<u>2004</u>	<u>Difference</u>	<u>Total Percent Change</u>
Land	\$ 724,021	\$ 724,021	\$ 0	0%
Buildings and Improvements	79,426,501	78,717,644	708,857	.9%
Machinery & Equipment	784,438	601,327	183,111	30.4%
Work in Progress	78,492,787	52,789,135	25,703,652	48.7%
Total	\$159,427,747	\$132,832,127	\$26,595,620	19.2%

**Long-Term Debt**

At June 30, 2005, the District had \$72 million in long-term debt outstanding.

**Table 4**  
**Comparative Schedule of Outstanding Debt**  
**June 30, 2005 and 2004**

	<u>2005</u>	<u>2004</u>
General Obligation Bonds	\$72,316,144	\$72,942,933
Capital Lease Obligations	0	1,104
Compensated Absences	291,534	237,715
TOTAL	\$72,607,678	\$73,181,752

The long-term debt paid by the District was approximately \$1 million in 2005.

MORGAN HILL UNIFIED SCHOOL DISTRICT  
MANAGEMENT DISCUSSION AND ANALYSIS

JUNE 30, 2005

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**FACTORS BEARING ON THE DISTRICT'S FUTURE**

The District will continue to budget for stability in enrollment and average daily attendance.

Changes at the top management level will provide new direction and enthusiasm. The District has a new Superintendent, Assistant Superintendent of Instructional Services and Assistant Superintendent of Human Resources.

Stabilization of the State's economic environment is desirable and would be beneficial to the District's financial environment. Management will continue to plan carefully and prudently to continue to provide the resources to meet our student's needs.

**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, 2005

		Governmental Activities
<u>ASSETS</u>		
Cash (Note 2)		\$ 22,468,747
Accounts Receivable (Note 4)		2,461,988
Stores Inventory (Note 1H)		160,195
Prepaid Expenditures (Note 1H)		376,525
Capital Assets (Note 6):		
Land	\$ 724,021	
Buildings and Improvements	111,681,875	
Machinery and Equipment	3,381,390	
Work in Progress	78,492,787	
Less Accumulated Depreciation	(34,852,326)	
Total Capital Assets, Net of Depreciation		159,427,747
Total Assets		<u>\$ 184,895,202</u>
<u>LIABILITIES</u>		
Accounts Payable and Other Current Liabilities		\$ 6,494,111
Deferred Revenue (Note 1H)		1,148,444
Long-term Liabilities:		
Due Within One Year:		
General Obligation Bonds Payable (Note 7)	\$ 1,185,000	
Compensated Absences Payable (Note 1H)	291,534	
Total Due Within One Year:		1,476,534
Due After One Year:		
General Obligation Bonds Payable (Note 7)	71,131,144	
Total Due After One Year:		71,131,144
Total Liabilities		<u>\$ 80,250,233</u>
<u>NET ASSETS</u>		
Invested in Capital Assets, Net of Related Debt		\$ 93,992,325
Restricted For:		
Capital Projects		2,320,234
Debt Service		2,975,267
Education Programs		1,185,180
Unrestricted		4,171,963
Total Net Assets		<u>\$ 104,644,969</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MORGAN HILL UNIFIED SCHOOL DISTRICT

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2005

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	\$ 36,083,109	\$ 2,546,996	\$ 6,957,500	\$ 1,606,331	\$ (24,972,282)
Instruction-related services:					
Supervision of instruction	1,684,825	14,256	1,750,329		79,760
Instructional library, media and technology	582,616	2,094	43,859		(536,663)
School site administration	4,510,686	14,915	352,543		(4,143,228)
Pupil Services:					
Home-to school transportation	2,831,427	184,980	1,589,203		(1,057,244)
Food services	2,160,984	1,156,035	859,015		(145,934)
All other pupil services	2,082,525		264,007		(1,818,518)
General administration:					
Data processing	289,851				(289,851)
All other general administration	3,320,580	57,120	376,527		(2,886,933)
Plant services	4,989,040	6,351	360,934		(4,621,755)
Ancillary services	368,309				(368,309)
Community services	35,085				(35,085)
Interest on long-term debt	3,726,492				(3,726,492)
Other Outgo	1,685,731	11,970	6,902		(1,666,859)
Total Governmental Activities	\$ 64,351,260	\$ 3,994,717	\$ 12,560,819	\$ 1,606,331	(46,189,393)

General Revenues:

Property Taxes Levied For:

    General Purposes

36,547,360

    Taxes Levied for Debt Service

4,469,204

    Taxes Levied for Other Specific Purposes

586,612

Federal and State Aid not Restricted  
to Specific Purposes

9,058,799

Interest and Investment Earnings

274,075

Miscellaneous

541,485

Total General Revenue

51,477,535

Change in Net Assets

5,288,142

Net Assets Beginning

99,356,827

Net Assets Ending

\$ 104,644,969

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MORGAN HILL UNIFIED SCHOOL DISTRICT  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
JUNE 30, 2005

	General Fund	Capital Facilities	Building	Bond Interest and Redemption	Other Governmental Funds	Total Governmental Funds
<u>Assets</u>						
Cash in County Treasury (Note 2)	\$ 7,061,456	\$ 1,650,684	\$ 8,004,453	\$ 2,967,496	\$ 2,668,477	\$ 22,352,566
Cash on Hand and in Banks (Note 2)	88,824				6,857	95,681
Cash in Revolving Fund (Note 2)	14,500				6,000	20,500
Accounts Receivable (Note 4)	1,993,108	16,485	58,893	7,771	385,731	2,461,988
Due From Other Funds (Note 5)	41,352		4,266		6,797	52,415
Stores Inventories (Note 1H)	151,183				9,012	160,195
Prepaid Expenses (Note 1H)	376,525					376,525
Total Assets	<u>\$ 9,726,948</u>	<u>\$ 1,667,169</u>	<u>\$ 8,067,612</u>	<u>\$ 2,975,267</u>	<u>\$ 3,082,874</u>	<u>\$ 25,519,870</u>
<u>Liabilities and Fund Balances</u>						
Liabilities:						
Accounts Payable	\$ 3,497,921	\$ 48,234	\$ 1,185,730		\$ 379,576	\$ 5,111,461
Deferred Revenue (Note 1H)	1,067,764				80,680	1,148,444
Due to Other Funds (Note 5)	6,293		1,160		44,962	52,415
Total Liabilities	<u>4,571,978</u>	<u>48,234</u>	<u>1,186,890</u>		<u>505,218</u>	<u>6,312,320</u>
Fund Balances (Note 1H):						
Reserved	1,727,388			\$ 2,975,267	15,012	4,717,667
Designated	3,416,050					3,416,050
Undesignated	11,532	1,618,935	6,880,722		2,562,644	11,073,833
Total Fund Balances	<u>5,154,970</u>	<u>1,618,935</u>	<u>6,880,722</u>	<u>2,975,267</u>	<u>2,577,656</u>	<u>19,207,550</u>
Total Liabilities and Fund Balances	<u>\$ 9,726,948</u>	<u>\$ 1,667,169</u>	<u>\$ 8,067,612</u>	<u>\$ 2,975,267</u>	<u>\$ 3,082,874</u>	<u>\$ 25,519,870</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, 2005

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Total fund balance – governmental funds	\$19,207,550
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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 \$194,280,073 and accumulated depreciation \$34,852,326	159,427,747
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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 unmaturred interest owing at the end of the period was:	(1,382,650)
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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	\$72,316,144	
Compensated absences payable	<u>291,534</u>	
		<u>(72,607,678)</u>

Total net assets-governmental activities	\$ <u>104,644,969</u>
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MORGAN HILL UNIFIED SCHOOL DISTRICT  
STATEMENT OF REVENUES, EXPENDITURES AND  
CHANGES IN FUND BALANCES  
GOVERNMENTAL FUNDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	General Fund	Capital Facilities	Building	Bond Interest and Redemption	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>						
Revenue Limit Sources:						
State Apportionments	\$ 5,310,888				\$ 424,749	\$ 5,735,637
Local Sources	36,547,360					36,547,360
Total Revenue Limit	41,858,248				424,749	42,282,997
Federal Revenue	2,930,334				913,767	3,844,101
Other State Revenue	8,467,088			\$ 39,178	2,687,976	11,194,242
Other Local Revenue	2,767,183	\$ 2,672,399	\$ 275,403	4,449,225	1,954,280	12,118,490
Total Revenues	56,022,853	2,672,399	275,403	4,488,403	5,980,772	69,439,830
<b>EXPENDITURES</b>						
Certificated Salaries	28,982,063				303,510	29,285,573
Classified Salaries	7,746,579	2,099	250,213		785,761	8,784,652
Employee Benefits	9,155,797	207	67,165		375,844	9,599,013
Books and Supplies	2,127,338	250			1,249,940	3,377,528
Services and Other						
Operating Expenditures	5,025,429	124,261	751,507		701,328	6,602,525
Capital Outlay	28,962	9,087,263	18,516,855			27,633,080
Debt Service:						
Principal Retirement	1,104			1,030,000		1,031,104
Interest and Fiscal Charges	42			3,339,750		3,339,792
Other Outgo	1,564,258				120,326	1,684,584
Total Expenditures	54,631,572	9,214,080	19,585,740	4,369,750	3,536,709	91,337,851
Excess of Revenues Over (Under) Expenditures	1,391,281	(6,541,681)	(19,310,337)	118,653	2,444,063	(21,898,021)
Other Financing Sources (Uses):						
Operating Transfers In (Note 5)	136,957		2,200,177		327,861	2,664,995
Operating Transfers Out (Note 5)	(327,861)	(136,957)			(2,200,177)	(2,664,995)
Total Other Financing Sources (Uses)	(190,904)	(136,957)	2,200,177	0	(1,872,316)	0
Excess of Revenues and Other Financing Sources Over (Under) Expenditures and Other Uses	1,200,377	(6,678,638)	(17,110,160)	118,653	571,747	(21,898,021)
Fund Balances - July 1, 2004	3,954,593	8,297,573	23,990,882	2,856,614	2,005,909	41,105,571
Fund Balances - June 30, 2005	\$ 5,154,970	\$ 1,618,935	\$ 6,880,722	\$ 2,975,267	\$ 2,577,656	\$ 19,207,550

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, 2005

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Net change in fund balances – Total governmental funds	\$(21,898,021)
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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:	\$28,822,640	
Depreciation expense:	<u>(2,426,591)</u>	26,396,049

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:

1,031,104

Donated capital assets: In governmental funds, donated capital assets are not reported because they do not affect current financial resources. In the government-wide statements, donated capital assets are reported as revenue and as increases to capital assets, at their fair market value on the date of donation. The fair market value of capital assets donated was:

199,571

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:

(386,741)

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:

(53,819)

Total change in net assets-governmental activities (minor differences may occur due to rounding)	<u>\$5,288,143</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, 2005

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	Expendable <u>Trust</u> Foundation Trust <u>Fund</u>	Student <u>Body</u> Agency <u>Fund</u>
<u>ASSETS</u>		
Cash in Hand and in Bank (Note 2)	\$ 4,239	\$420,101
Total Assets	<u>4,239</u>	<u>420,101</u>
<u>LIABILITIES</u>		
Liabilities:		
Due to Student Groups		<u>420,101</u>
Total Liabilities		<u>420,101</u>
<u>NET ASSETS</u>		
Reserved for scholarships	<u>4,239</u>	<u>0</u>
Total Net Assets	<u>\$ 4,239</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, 2005

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	<u>Expendable Trust Scholarship Fund</u>
<b>Additions</b>	
Interest Income	\$ 145
<b>Deductions</b>	
Disbursements	<u>0</u>
Change in net assets (decrease)	<u>145</u>
Net assets – July 1, 2004	<u>4,094</u>
Net assets – June 30, 2005	<u>\$ 4,239</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS



MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

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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, 2005

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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, 2005

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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, 2005

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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.
4. 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.

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, 2005

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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 for Other Than Capital Outlay 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 two 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.

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.

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.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

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NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2005

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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.

Investments Valuation - In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, highly liquid market investments with maturities of one year or less at time of purchase are stated at amortized cost. All other investments are stated at fair value. Market value is used as fair value for those securities for which market quotations are readily available. However, the District's financial statements do not reflect the fair value of investments as the differences between total investment cost and fair value has been determined to be immaterial.

2. 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.



MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Assets, Liabilities and Equity (Continued)

2. Capital Assets

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

<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, 2005

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NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Assets, Liabilities and Equity (Continued)

3. 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.

4. 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.

5. 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.

6. Net Assets

In the government-wide financial statements, net assets are classified in the following categories:

Invested in Capital Assets, net of Related Debt - This amount consists of capital assets net of accumulated depreciation and reduced by outstanding debt that attributed to the acquisition, construction, or improvement of the assets.

Restricted Net Assets - This amount is restricted by external creditors, grantors, contributors, laws or regulations of other governments.

Unrestricted Net Assets - This amount is all net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted net assets."

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Assets, Liabilities and Equity (Continued)

7. Use of Restricted/Unrestricted Net Assets

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, the District's policy is to apply restricted net assets first.

8. Fund Balance Reserves and Designations

The District's fund balances at June 30, 2005 consisted of the following:

	General Fund	Capital Facilities Fund	Building Fund	Bond Interest and Redemption Fund	Other Governmental Funds	Total
Reserved For:						
Revolving Fund	\$ 14,500				\$ 6,000	\$ 20,500
Stores Inventories	151,183				9,012	160,195
Prepaid Expenditures	376,525					376,525
Legally Restricted Balances	1,185,180					1,185,180
Debt Service				\$2,975,267		2,975,267
Unreserved:						
Designated for:						
Economic Uncertainties	1,648,783					1,648,783
Other Program Carryovers	1,767,267					1,767,267
Undesignated, Reported in:						
General Fund	11,532					11,532
Capital Projects Funds		\$1,618,935	\$6,880,722			8,499,657
Special Revenue Funds					\$2,562,644	2,562,644
Total Fund Balances	<u>\$5,154,970</u>	<u>\$1,618,935</u>	<u>\$6,880,722</u>	<u>\$2,975,267</u>	<u>\$2,577,656</u>	<u>\$19,207,550</u>

Reservations of the ending fund balance indicate the portions of fund balance not appropriate for expenditure or amounts legally segregated for a specific future use. The reserve for revolving fund and stores inventory reflects the portions of fund balances 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, 2005

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NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Assets, Liabilities and Equity (Concluded)

9 . 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 January 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 (January 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, 2005

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NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)

I. Implementation of New GASB Pronouncements

The District adopted new accounting standards in order to conform to the following Governmental Accounting Standards Board Statements:

- Statement No. 40, *Deposit and Investment Risk Disclosures*

GASB Statement No. 40 addresses selected issues and amends GASB Statements No. 3, *Deposits with Financial Institutions, Investments, (including Repurchase Agreements), and Reverse Repurchase Agreements*. The Statement address common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. The Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates.

NOTE 2 - CASH AND INVESTMENTS

A. Cash

The District had the following cash at June 30, 2005:

	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Credit Quality Rating</u>
Cash on Hand and in Bank	\$ 520,021	\$ 520,021	Not Rated
Cash in Revolving Fund	20,500	20,500	Not Rated
Cash in County Treasury	<u>22,303,390</u>	<u>22,352,566</u>	Not Rated
Total Cash	<u>\$22,843,911</u>	<u>\$22,893,087</u>	

Cash on Hand, In Banks and in Revolving Fund

Cash balances 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, 2005, the carrying amount of the District's accounts was \$420,021, of which \$78,589 was not collateralized or insured with securities held by the pledging financial institution in the District's name as discussed in the following:



MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

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NOTE 2 - CASH AND INVESTMENTS (CONTINUED)

A. Cash (Concluded)

Cash on Hand, In Banks and in Revolving Fund (Concluded)

The California Government Code requires California banks and savings and loan associations to secure the District's cash deposits by pledging securities as collateral. This Code states that collateral pledged in this manner shall have the effect of perfecting a security interest in such collateral superior to those of a general creditor. Thus, collateral for cash deposits is considered to be held in the District name.

According to California law, the market value of pledged securities with banking institutions must equal at least 110% of the District cash deposits. California law also allows institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the District's total cash deposits. The District may waive collateral requirements for cash deposits, which are fully insured up to \$100,000 by the Federal Deposit Insurance Corporation. *(The District, however, has not waived the collateralization requirements.)*

The District follows the practice of pooling cash and investments of all funds, except for funds required to be held by fiscal agents under the provisions of bond indentures. Interest income earned on pooled cash and investments is allocated on a quarterly basis to the various funds based on average daily cash and investment balances. Interest income from cash and investments with fiscal agents is credited directly to the related fund.

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 \$22,352,566 as of June 30, 2005. The fair market value of this pool as of that date, as provided by the pool sponsor, was \$22,303,390. 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.



MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

NOTE 2 - CASH AND INVESTMENTS (CONCLUDED)

B. Summary of Cash and Investments

The following is a summary of cash and investments at June 30, 2005:

<u>Governmental Activities</u>	<u>Fiduciary Funds Statement of Net Assets</u>	<u>Total</u>
<u>\$22,468,747</u>	<u>\$ 424,340</u>	<u>\$22,893,087</u>

C. Risk Disclosures

Custodial credit risk is the risk that, in the event of a bank failure, the District's deposits might not be recovered. The District has not adopted a deposit policy for custodial credit risk. As of June 30, 2005, \$78,589 of the \$420,021 were exposed to custodial credit risk as follows:

Uninsured and uncollateralized	<u>\$ 78,589</u>
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D. Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from rising interest rates, the District's investment policy required that at least 30% of the District's investment portfolio mature in less than one year. Additional limitations are that the average maturity of the investment portfolio will not exceed three years, and no investment will have a maturity of more than five years from its date of purchase.

At June 30, 2005, the District had the following investment maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (In Years)</u>			
		<u>Less than 1</u>	<u>1 to 2</u>	<u>2 to 3</u>	<u>3 to 4</u>
County Treasury	<u>\$22,303,390</u>	<u>\$17,918,543</u>	<u>\$2,138,895</u>	<u>\$ 695,866</u>	<u>\$1,550,086</u>

NOTE 3 - EXCESS OF EXPENDITURES OVER APPROPRIATIONS

As of June 30, 2005 there were no excess of expenditures over appropriations in individual funds.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

NOTE 4 - ACCOUNTS RECEIVABLE

Accounts receivable at June 30, 2005 consist of the following:

	General Fund	Capital Facilities	Building Fund	Bond Interest and Redemption Fund	All Other Governmental Funds	Total
Federal Government						
Categorical Aid Program	\$ 514,335				\$ 335,375	\$ 849,710
State Government						
Revenue Limit	7,181					7,181
Categorical Aid Programs	448,642				34,293	482,935
Lottery	566,140					566,140
Other	<u>115,796</u>					<u>115,796</u>
Total State Government	1,137,759				34,293	1,172,052
Local Government	147,559					147,559
Interest	117,195	\$ 16,485	\$ 58,893	\$ 7,771	\$ 16,063	216,407
Miscellaneous	<u>76,260</u>					<u>76,260</u>
Total Accounts Receivable	<u>\$1,993,108</u>	<u>\$ 16,485</u>	<u>\$ 58,893</u>	<u>\$ 7,771</u>	<u>\$ 385,731</u>	<u>\$2,461,988</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, 2005

NOTE 5 - INTERFUND TRANSACTIONS (CONTINUED)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 2004-2005 fiscal year were as follows:

<u>Funds</u>	<u>Transfers In</u>	<u>Transfers Out</u>
General Fund	\$ 136,957	\$ 327,861
Capital Facilities Fund		136,957
Building Fund	2,200,177	
Non-Major Governmental Funds		
County School Facilities		1,610,836
Deferred Maintenance	327,861	
Mello-Roos Fund		589,341
Total	<u>\$ 2,664,995</u>	<u>\$ 2,664,995</u>

Transfer of \$327,861 from the General Fund to the Deferred Maintenance Fund to support State match requirements.

Transfer of \$136,957 from the Capital Facilities Fund to the General Fund reflected \$77,905 for administrative fees and \$59,052 for off-site safety improvements.

Transfer of \$1,610,836 from the County School Facilities Fund to the Building Fund for modernization funds received for the Burnett Elementary, Machado Elementary, San Martin Elementary and Los Paseos Multi-Purpose Room addition.

Transfer of \$589,341 from the Mello-Roos Fund to the Building fund for the Los Paseos Multi-Purpose Room addition.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

NOTE 5 - INTERFUND TRANSACTIONS (CONCLUDED)

Interfund Receivables/Payables (Due From/Due To)

Individual fund interfund receivable and payable balances at June 30, 2005 are as follows:

	<u>Interfund Receivables</u>	<u>Interfund Payables</u>
General Fund	\$ 41,352	\$ 6,293
Building Fund	4,266	1,160
Non-Major Governmental Funds:		
Adult Education Fund		12,284
Child Development Fund		878
Cafeteria Fund	6,797	27,534
Mello-Roos Fund		1,981
County School Facilities Fund		<u>2,285</u>
Totals	<u>\$ 52,415</u>	<u>\$ 52,415</u>

NOTE 6 - CAPITAL ASSETS AND DEPRECIATION

Capital asset activity for the year ended June 30, 2005, is shown below:

	<u>Balance July 1, 2004</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2005</u>
Capital assets, note being depreciated:				
Land	\$ 724,021			\$ 724,021
Work in progress	<u>52,789,135</u>	<u>\$28,672,676</u>	<u>\$ 2,969,024</u>	<u>78,492,787</u>
Total capital assets, not being depreciated	<u>53,513,156</u>	<u>28,672,676</u>	<u>2,969,024</u>	<u>79,216,808</u>
Capital assets being depreciated:				
Buildings	108,689,981	2,991,894		111,681,875
Equipment	<u>3,135,895</u>	<u>326,665</u>	<u>81,170</u>	<u>3,381,390</u>
Total capital assets, being depreciated	<u>111,825,876</u>	<u>3,318,559</u>	<u>81,170</u>	<u>115,063,265</u>
Less accumulated depreciation for:				
Buildings	29,972,337	2,283,037		32,255,374
Equipment	<u>2,534,568</u>	<u>143,554</u>	<u>81,170</u>	<u>2,596,952</u>
Total accumulated depreciated	<u>32,506,905</u>	<u>2,426,591</u>	<u>81,170</u>	<u>34,852,326</u>
Total capital assets, being depreciated, net	<u>79,318,971</u>	<u>891,968</u>	<u>0</u>	<u>80,210,939</u>
Governmental activities capital assets, net	<u>\$132,832,127</u>	<u>\$29,564,644</u>	<u>\$ 2,969,024</u>	<u>\$159,427,747</u>



MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

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NOTE 6 - CAPITAL ASSETS AND DEPRECIATION (CONCLUDED)

Depreciation expense was charged to governmental activities as follows:

Instruction	\$1,897,107
School Site Administration	126,183
Food Services	161,854
All Other General Administration	194,128
Plant Services	<u>47,319</u>
Total	<u>\$2,426,591</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.

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).



MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

NOTE 7 – GENERAL OBLIGATION BONDS (CONCLUDED)

The outstanding general obligation bonded debt of the Morgan Hill Unified School District as of June 30, 2005 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, 2004</u>	<u>Accreted Interest Current Year</u>	<u>Redeemed Current Year</u>	<u>Outstanding June 30, 2005</u>
2000	4.6%-5.5%	2025	\$38,000,000	\$37,580,000		\$ 320,000	\$37,260,000
2002	3.5%-5.25%	2020	28,210,000	28,210,000		710,000	27,500,000
2002	5.5%-5.6%	2026	<u>6,287,754</u>	<u>7,152,933</u>	<u>\$ 403,211</u>		<u>7,556,144</u>
Total			<u>\$72,497,754</u>	<u>\$72,942,933</u>	<u>\$ 403,211</u>	<u>\$1,030,000</u>	<u>\$72,316,144</u>

A. Current Interest Bonds

The annual requirements to amortize the 2000 general obligation bonds payable, outstanding as of June 30, 2005, are as follows:

<u>Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
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	770,000	1,882,167	2,652,167
2011-2015	5,640,000	8,716,698	14,356,698
2016-2020	9,575,000	6,751,367	16,326,367
2021-2025	15,260,000	3,316,500	18,576,500
2026	<u>3,905,000</u>	<u>107,388</u>	<u>4,012,388</u>
Totals	<u>\$37,260,000</u>	<u>\$28,588,448</u>	<u>\$65,848,448</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

NOTE 7 – GENERAL OBLIGATION BONDS (CONTINUED)

A. Current Interest Bonds

The annual requirements to amortize the 2002 General Obligation Bonds payable, outstanding as of June 30, 2005, are as follows:

<u>Year Ended</u> <u>June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
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	1,160,000	1,163,258	2,323,258
2011-2015	7,770,000	4,827,967	12,597,967
2016-2020	11,865,000	2,452,210	14,317,210
2021	<u>3,015,000</u>	<u>79,145</u>	<u>3,094,145</u>
Totals	<u>\$27,500,000</u>	<u>\$13,565,661</u>	<u>\$41,065,661</u>

B. The outstanding Series 2002 Capital Appreciation Bonds at June 30, 2005 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, 2005</u>
2002	5.50%	2022	\$ 1,135,948	\$ 226,087	\$ 1,362,035
2002	5.53%	2023	1,097,428	220,198	1,317,626
2002	5.56%	2024	1,062,031	214,084	1,276,115
2002	5.58%	2025	1,028,614	208,713	1,237,327
2002	5.60%	2026	996,134	202,674	1,198,808
2002	5.60%	2027	<u>967,599</u>	<u>196,634</u>	<u>1,164,233</u>
Totals			<u>\$ 6,287,754</u>	<u>\$ 1,268,390</u>	<u>\$ 7,556,144</u>

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	3,633,639
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>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

NOTE 8 – LONG-TERM DEBT

A schedule of changes in long-term debt for the year ended June 30, 2005 is shown below:

	Balance July 1, 2004	Additions	Deductions	Balance June 30, 2005	Due Within One Year
General Obligation Bonds	\$72,077,754		\$1,030,000	\$71,047,754	\$1,185,000
Accreted Interest on General Obligation Bonds	865,179	\$ 403,211		1,268,390	0
Compensated Absences	237,715	53,819		291,534	291,534
Capital Lease Obligations	<u>1,104</u>	<u></u>	<u>1,104</u>	<u>0</u>	<u>0</u>
Totals	<u>\$73,181,752</u>	<u>\$ 457,030</u>	<u>\$1,031,104</u>	<u>\$72,607,678</u>	<u>\$1,476,534</u>

The District has chosen not to report Other Postemployment Benefits as long-term liabilities (see Note 9). Therefore, this liability is not included in the schedule above.

The accrued vacation 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 9 - 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, 2005, 111 retirees met these eligibility requirements at a cost of \$897,758 for 2004-2005. 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 \$2,445,213. 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 2003-2004. There are currently 34 retirees identified as qualified to receive benefits under this plan.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

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NOTE 10 – 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.

*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 2004-2005 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, 2005, 2004, and 2003 were \$2,586,316, \$2,371,177 and \$2,568,240, 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.



MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

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NOTE 10 – EMPLOYEE RETIREMENT SYSTEMS (CONCLUDED)

B. California Public Employees Retirement System (CalPERS) (Concluded)

*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 2004-2005 was 9.952% 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, 2005, 2004 and 2003 were \$759,441, \$789,176 and \$231,370, 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.

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, 2005. 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 11 - 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.



MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

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NOTE 12 - 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 13 - 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.

NOTE 14 - SUBSEQUENT EVENTS

Tax Revenue Anticipation Notes

On July 6, 2005, the District issued \$7,920,000 in tax revenue anticipation notes at a premium of \$100,109. 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, 2006 and bear interest at 2.60%. Proceeds from the notes can be drawn upon during the year if cash shortages arise.

REQUIRED SUPPLEMENTARY INFORMATION SECTION



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, 2005

	Budgeted Amounts		Actual (Budgetary Basis)	Variance with Final Budget Positive- (Negative)
	Original	Final		
<b>REVENUES</b>				
Revenue Limit Sources:				
State Apportionments	\$ 2,721,433	\$ 5,307,888	\$ 5,310,888	\$ 3,000
Local Sources	37,972,312	36,547,360	36,547,360	
Total Revenue Limit	40,693,745	41,855,248	41,858,248	3,000
Federal Revenue	2,919,267	3,239,665	2,930,334	(309,331)
Other State Revenue	7,504,293	8,809,981	8,467,088	(342,893)
Other Local Revenue	2,902,574	3,812,111	2,767,183	(1,044,928)
Total Revenues	54,019,879	57,717,005	56,022,853	(1,694,152)
<b>EXPENDITURES</b>				
Certificated Salaries	28,468,961	29,130,984	28,982,063	148,921
Classified Salaries	7,733,300	8,015,918	7,746,579	269,339
Employee Benefits	9,019,061	9,245,320	9,155,797	89,523
Books and Supplies	2,417,005	3,939,739	2,127,338	1,812,401
Services and Other				
Operating Expenditures	5,047,932	6,499,249	5,025,429	1,473,820
Capital Outlay	83,290	283,012	28,962	254,050
Debt Service:				
Principal Retirement	1,104	1,104	1,104	
Interest and Fiscal Charges	42	42	42	
Other Outgo	1,488,298	1,683,969	1,564,258	119,711
Total Expenditures	54,258,993	58,799,337	54,631,572	4,167,765
Excess of Revenues Over (Under) Expenditures	(239,114)	(1,082,332)	1,391,281	2,473,613
Other Financing Sources (Uses):				
Operating Transfers In	105,480		136,957	136,957
Operating Transfers Out	(300,000)	(327,861)	(327,861)	0
Total Other Financing Sources (Uses)	(194,520)	(327,861)	(190,904)	136,957
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	(433,634)	(1,410,193)	1,200,377	2,610,570
Fund Balances - July 1, 2004	3,954,593	3,954,593	3,954,593	0
Fund Balances - June 30, 2005	\$ 3,520,959	\$ 2,544,400	\$ 5,154,970	\$ 2,610,570

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS





SUPPLEMENTARY INFORMATION



MORGAN HILL UNIFIED SCHOOL DISTRICT

MORGAN HILL, CALIFORNIA

JUNE 30, 2005

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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 nine elementary school, two middle schools, two regular and one continuation high school, and a community adult education school.

The Board of Trustees for the year ended June 30, 2005, was composed of the following members:

Board of Education

<u>Name</u>	<u>Office</u>	<u>Term expires</u>
Shellé Thomas	President	December 2006
Peter Mandel	Member	December 2008
Michael J. Hickey	Member	December 2006
Amina Khemici	Member	December 2006
Julia Hover-Smoot	Member	December 2008
Donald Moody	Member	December 2006
Kathleen Sullivan	Member	December 2008

ADMINISTRATION

Carolyn McKennan, Ed.D.  
Superintendent

MORGAN HILL UNIFIED SCHOOL DISTRICT  
SCHEDULE OF AVERAGE DAILY ATTENDANCE  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	Second Period <u>Report</u>	Annual <u>Report</u>
<u>Elementary</u>		
Kindergarten	557	557
First through Third	1,900	1,899
Fourth through Sixth	1,880	1,883
Seventh through Eighth	1,314	1,311
Opportunity Schools	6	7
Special Education	116	118
Extended year	1	1
Home & Hospital	<u>1</u>	<u>1</u>
Subtotals	<u>5,775</u>	<u>5,777</u>
<u>High School</u>		
Regular Classes	2,257	2,236
Special Education	89	82
Compulsory Continuation Education	86	83
Home & Hospital	<u>0</u>	<u>2</u>
Subtotals	<u>2,432</u>	<u>2,403</u>
<u>Classes for Adults</u>		
Concurrently Enrolled	6	8
Not concurrently Enrolled	<u>170</u>	<u>166</u>
Totals	<u>8,383</u>	<u>8,354</u>
	Hours of Attendance	
<u>Supplemental Hours</u>		
Elementary	41,849	42,835
High School	<u>31,572</u>	<u>31,944</u>
Totals	<u>73,421</u>	<u>74,779</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, 2005

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<u>Grade Level</u>	<u>1986-87 Minutes Requirement</u>	<u>1982-83 Actual Minutes</u>	<u>2004-2005 Actual Minutes</u>	<u>Number of Days Traditional Calendar</u>	<u>Status</u>
Kindergarten	36,000	31,680	39,600	180	In compliance
Grades 1 through 3	50,400	48,130	57,075	180	In compliance
Grades 4 through 6	54,000	51,920	54,575	180	In compliance
Grades 7 through 8	54,000	55,715	55,730	180	In compliance
Grade 9	64,800	55,715	64,836	180	In compliance
Grades 10 through 12	64,800	60,849	64,836	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, 2005

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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. The Charter was not renewed beyond 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, 2005

<u>Program Name:</u>	<u>Federal Number</u>	<u>Pass-Through Entity Number</u>	<u>Expenditures</u>
US Department of Agriculture: Passed through the California Department of Education (CDE):			
National School Lunch	10.555	13524	\$ 569,634
Especially Needy Breakfast	10.553	13526	155,672
Basic School Breakfast	10.553	13525	<u>59,424</u>
Total US Department of Education			<u>784,730</u>
US Department of Education: Passed through CDE:			
NCLB - Title I	84.010	14329	754,541
NCLB - Title I Even Start	84.213	14331	23,103
NCLB - Title II, Part A Improving Teacher Quality	84.367	14341	212,089
NCLB - Title III, Limited English Proficiency	84.365	10084	72,842
NCLB - Title IV - Drug Free Schools and Communities Act of 1986	84.186	14347	43,013
IDEA Preschool Grant Local Staff Development	84.173	13430	41,490
IDEA Local Staff Development	84.027A	13613	3,266
Local Assistance	84.027	13379	1,390,439
Workability I	84.027	13705	65,332
IDEA - Preschool Local Entitlement	84.027A	13682	59,066
Preschool Staff Development	84.173A	13431	338
Adult Secondary Education	84.002	13978	8,370
English Literacy and Civics Education	84.002A	14109	59,379
Vocational Programs - Voc. & Applied Tech Secondary	84.048	13924	45,569
Vocational Programs - Voc & Applied Tech	84.048	13924	1,315
NCLB - Title V, Innovative Education Strategies	84.298A	14354	22,271
Adult Education - ESL	84.002A	14508	54,890
Child Development - Quality Improvement	N/A	14680	2,040
NCLB - Migrant Education	84.011	14326	156,191
NCLB - Migrant Summer School	84.011	10005	17,024
California Alternative Performance Assessment	N/A	14488	815
English Language Development Test (CELDT)	84.369	14363	<u>8,645</u>
Total US Department of Education			<u>3,042,028</u>
Department of Health and Human Services:			
Medi-Cal Billing Option	93.778	10013	14,301
Child Development - School Age Resource Contracts	93.575	13979	<u>3,042</u>
Total Department of Health and Human Services			<u>17,343</u>
Total Federal Programs			<u>\$ 3,844,101</u>

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, 2005

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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, 2005.

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SEE NOTES TO SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT  
SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	(Budget) 2005-2006	2004-2005	2003-2004	2002-2003
<u>General Fund</u>				
Revenues and Other Financial Sources	\$ 57,732,494	\$ 56,159,810	\$ 54,821,800	\$ 55,390,378
Expenditures	57,092,337	54,631,572	53,176,841	56,027,840
Other Uses and Transfers Out	300,000	327,861	655,345	0
Total Outgo	57,392,337	54,959,433	53,832,186	56,027,840
Change in Fund Balance (Deficit)	340,157	1,200,377	989,614	(637,462)
Ending Fund Balance	\$ 5,495,129	\$ 5,154,970	\$ 3,954,593	\$ 2,964,979
Available Reserves	\$ 2,000,474	\$ 1,660,315	\$ 1,921,790	\$ 1,072,805
Designated for Economic Uncertainties	\$ 1,721,770	\$ 1,648,783	\$ 1,614,966	\$ 1,072,805
Undesignated Fund Balance	\$ 278,704	\$ 11,532	\$ 306,824	\$ 0
Available reserves as a percentage of total outgo	3%	3%	3.6%	1.9%
Total long-term debt	\$ 71,131,144	\$ 72,607,678	\$ 73,181,752	\$ 75,863,911
Average daily attendance at P-2 (excluding Adult Education)	8,156	8,207	8,061	7,995

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 increased by \$1,552,529 over the past three years. The fiscal year 2005-2006 budget projects a increase of \$340,157 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 \$3,256,233 over the past two years. Total average daily attendance has increased 212 over the past two years.

SEE NOTES TO SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT  
COMBINING BALANCE SHEET  
NON-MAJOR FUNDS  
JUNE 30, 2005

	Deferred Maintenance	Cafeteria	Adult Education	Child Development
<b>ASSETS</b>				
Cash in County Treasury	\$ 721,872	\$ 193,952	\$ 229,726	\$ 274,614
Cash on Hand and in Bank		5,907	950	
Cash in Revolving Fund		1,000	5,000	
Accounts Receivable				
Federal Government		242,080	93,295	
State Government			26,334	7,959
Interest	4,306	637		
Due from Other Funds		6,797		
Stores Inventory		9,012		
	<u>726,178</u>	<u>459,385</u>	<u>355,305</u>	<u>282,573</u>
Total Assets	<u>\$ 726,178</u>	<u>\$ 459,385</u>	<u>\$ 355,305</u>	<u>\$ 282,573</u>
<b>LIABILITIES AND FUND BALANCES</b>				
Liabilities:				
Accounts Payable	\$ 24,879	\$ 29,899	\$ 43,103	\$ 281,695
Due to Other Funds		27,534	12,284	878
Deferred Revenue			80,680	
	<u>24,879</u>	<u>57,433</u>	<u>136,067</u>	<u>282,573</u>
Total Liabilities	<u>24,879</u>	<u>57,433</u>	<u>136,067</u>	<u>282,573</u>
Fund Balances:				
Reserved		10,012	5,000	
Unreserved				
Undesignated	<u>701,299</u>	<u>391,940</u>	<u>214,238</u>	
Total Fund Balances	<u>701,299</u>	<u>401,952</u>	<u>219,238</u>	<u>0</u>
Total Liabilities and Fund Balances	<u>\$ 726,178</u>	<u>\$ 459,385</u>	<u>\$ 355,305</u>	<u>\$ 282,573</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS



Special Reserve Fund for Other Than Capital Outlay	Mello Roos	County Schools Facilities	Totals
\$ 1,246,831		\$ 1,482	\$ 2,668,477
			6,857
			6,000
			335,375
8,336	\$ 1,981	803	34,293
			16,063
			6,797
			9,012
<u>\$ 1,255,167</u>	<u>\$ 1,981</u>	<u>\$ 2,285</u>	<u>\$ 3,082,874</u>
	\$ 1,981	\$ 2,285	\$ 379,576
			44,962
			80,680
	<u>1,981</u>	<u>2,285</u>	<u>505,218</u>
			15,012
<u>\$ 1,255,167</u>			<u>2,562,644</u>
<u>1,255,167</u>	<u>0</u>	<u>0</u>	<u>2,577,656</u>
<u>\$ 1,255,167</u>	<u>\$ 1,981</u>	<u>\$ 2,285</u>	<u>\$ 3,082,874</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, 2005

	Deferred Maintenance	Cafeteria	Adult Education	Child Development
<b>REVENUES</b>				
Revenue Limit Sources:				
State Apportionment			\$ 424,749	
Federal Sources:				
Child Nutrition Program		\$ 784,730		
Other			123,955	\$ 5,082
Other State Sources:				
State Nutrition Program		52,726		
Other	\$ 327,861		51,589	649,469
Other Local Sources:				
Food Service Sales		1,259,172		
Interest	8,714	2,853	4,441	6,539
Other			51,783	
Total Revenues	336,575	2,099,481	656,517	661,090
<b>EXPENDITURES</b>				
Certificated Salaries			303,510	
Classified Salaries	59,291	619,696	106,774	
Employee Benefits	23,432	271,936	80,476	
Books and Supplies	25,263	1,054,685	51,180	118,812
Services and Other				
Operating Expenditures	101,336	42,472	35,190	521,804
Other Outgo		83,330	16,522	20,474
Total Expenditures	209,322	2,072,119	593,652	661,090
Excess of Revenues Over (Under) Expenditures	127,253	27,362	62,865	0
Other Financing Sources (Uses):				
Operating Transfers In	327,861			
Operating Transfers Out				
Total Other Financing Sources (Uses)	327,861	0	0	0
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	455,114	27,362	62,865	0
Fund Balances - July 1, 2004	246,185	374,590	156,373	0
Fund Balances - June 30, 2005	\$ 701,299	\$ 401,952	\$ 219,238	\$ 0

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

Special Reserve Fund for Other Than Capital Outlay	Mello Roos	County Schools Facilities	Totals
			\$ 424,749
			784,730
			129,037
		\$ 1,606,331	52,726
			2,635,250
\$ 26,407	\$ 3,255	4,505	1,259,172
	586,611		56,714
			638,394
26,407	589,866	1,610,836	5,980,772
			303,510
			785,761
			375,844
			1,249,940
	526		701,328
			120,326
0	526		3,536,709
26,407	589,340	1,610,836	2,444,063
	(589,341)	(1,610,836)	327,861
			(2,200,177)
0	(589,341)	(1,610,836)	(1,872,316)
26,407	(1)		571,747
1,228,760	1		2,005,909
\$ 1,255,167	\$ 0	\$ 0	\$ 2,577,656

MORGAN HILL UNIFIED SCHOOL DISTRICT  
NOTES TO SUPPLEMENTARY INFORMATION  
FOR THE YEAR ENDED JUNE 30, 2005

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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.

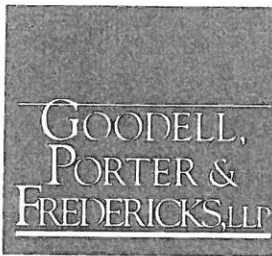
H. Combining Statements and Individual Fund Schedules

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







CERTIFIED  
PUBLIC  
ACCOUNTANTS

RICHARD J. GOODELL, CPA  
JOHN L. GOODELL, CPA  
VIRGINIA K. PORTER, CPA  
BEVERLY A. SANCHEZ, CPA

## REPORT ON STATE COMPLIANCE

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

We have audited the accompanying financial statements of the governmental fund 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, 2005, and have issued our report thereon dated October 28, 2005.

We conducted our audit 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 *Standards and Procedures for Audits of California K-12 Local Education Agencies 2004-05* published by the Education Audit Appeals Panel (Audit Guide). 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:

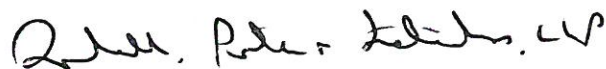
<u>Description</u>	<u>Procedures in the Audit Guide</u>	<u>Procedures Performed</u>
Attendance reporting	8	Yes
Kindergarten continuance	3	Yes
Independent study	22	Yes
Continuation education	10	Yes
Adult education	9	Yes
Regional Occupational Center/Programs	6	Not Applicable
Instructional time and staff development reform program	7	Yes
Instructional Time:		
School Districts	4	Yes
County Offices of Education	3	Not Applicable

<u>Description</u>	<u>Procedures in the Audit Guide</u>	<u>Procedures Performed</u>
Community Day Schools	9	Not Applicable
Class Size Reduction:		
General Requirements	7	Yes
Option One	3	Yes
Option Two	4	Not Applicable
Districts or Charter Schools with only one school serving K-3	4	Not Applicable
Instructional Materials:		
General Requirements	12	Yes
K-8 only	1	Yes
Grades 9-12 only	1	Yes
Ratios of Administrative Employees to Teachers	1	Yes
Early Retirement Incentive Program	4	Not Applicable
GANN Limit calculation	1	Yes
School Construction Funds:		
School District Bonds	3	Yes
State School Facilities Funds	1	Not Applicable
Alternative Pension Plans	2	Yes
Proposition 20 Lottery Funds (Cardenas Textbook Act of 2000)	2	Yes
State Lottery Funds (California State Lottery Act of 1984)	2	Yes
California School Age Families Education (Cal-Safe) Program	3	Not Applicable
School Accountability Report Card	3	No (see below)

We did not apply the audit procedures for the School Accountability Report Card because the most recent School Accountability Report Card obtained from the District was prepared based upon fiscal year 2003-04 data and would not include information from the 2004-05 Quarterly Report of Summarized Complaint Data.

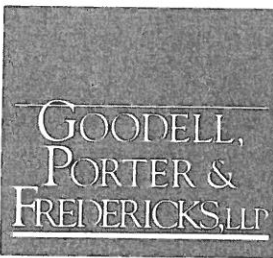
Based on our audit, we found that, for the items tested, the Morgan Hill Unified School District complied with the state laws and regulations referred to above, except as described in the Findings and Recommendations Section of this report. Further, based on the examination, for items not tested, nothing 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

October 28, 2005



CERTIFIED  
PUBLIC  
ACCOUNTANTS

RICHARD J. GOODELL, CPA  
JOHN L. GOODELL, CPA  
VIRGINIA K. PORTER, CPA  
BEVERLY A. SANCHEZ, CPA

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON  
COMPLIANCE AND OTHER MATTERS 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, 2005, and have issued our report thereon dated October 28, 2005. 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*.

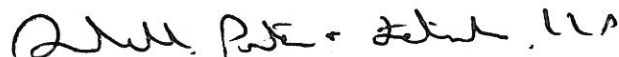


Internal Control over Financial Reporting

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.

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 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 noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

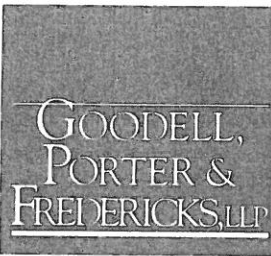
This report is intended solely for the information of the District Board, management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.



GOODELL, PORTER & FREDERICKS, LLP  
Certified Public Accountants

October 28, 2005





CERTIFIED  
PUBLIC  
ACCOUNTANTS

RICHARD J. GOODELL, CPA  
JOHN L. GOODELL, CPA  
VIRGINIA K. PORTER, CPA  
BEVERLY A. SANCHEZ, CPA

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, 2005. 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, 2005.

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

October 28, 2005

## FINDINGS AND RECOMMENDATIONS SECTION



MORGAN HILL UNIFIED SCHOOL DISTRICT  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

JUNE 30, 2005

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**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>
10.553-10.555	NSLP Cluster
84.367	NCLB - Title II, Part A Improving Teacher Quality
84.011	NCLB - Migrant Education

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: Qualified



MORGAN HILL UNIFIED SCHOOL DISTRICT  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

JUNE 30, 2005

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**Section II - Financial Statements Findings**

No matters are reported.

**Section III - Federal Award Findings and Questioned Costs**

No matters are reported.

**Section IV - State Award Findings and Questioned Costs**

2005 - 1 - INDEPENDENT STUDY - 10000

Specific Requirement That Was Not Complied With: Education Code Section 51745.6 (b) states:

Only those units of average daily attendance for independent study that reflect a pupil-teacher ratio that does not exceed the ratio described in subdivision (a) shall be eligible for apportionment pursuant to Section 42238.5, for school districts. Nothing in this section shall prevent a school district from serving additional units of average daily attendance greater than the ratio described in subdivision (a), except that those additional units shall not be funded pursuant to Section 42238.5.

Finding: The District claimed ADA for Independent Study students in excess of the allowed pupil-teacher ratio. The District overstated ADA for Full Time Independent Study by 10.36.

Amount of Questioned Costs and How Computed: Independent Study ADA claimed can not exceed the ratio of pupils to full-time equivalent certificated teachers for all other education programs operated by the District. This ratio is applied to the Independent Study teachers FTE (full time equivalent) to determine the maximum Independent Study ADA that may be claimed.

	<u>Grade Levels</u>		
	<u>K-6</u>	<u>7-12</u>	<u>Total</u>
Teacher to Pupil Ratio for all other programs:	1:21	1:25	-
Independent Study Maximum:	21	25	46
Independent Study ADA as reported on P-2:	23.44	32.92	56.36
Difference (Overstated)	(2.44)	(7.92)	(10.36)

Recommendation: The District should revise the P-2 and annual attendance reports to reduce attendance for K-6 and 7-12 students by 2.44 and 7.92 respectively.

District Response: Disagree: The District does not agree with the auditors calculations of Teacher to pupil ratio for all other programs. The District calculated Teacher FTE by excluding the Teacher's "prep period" as that is not considered instructional time. The District has calculated the District-wide Teacher to Pupil ratio for all other programs as 29 and the independent study Teacher to Pupil ratio as 28. The District believes the average daily attendance originally claimed for Independent study students is allowed per Education Code Section 42238.5.



MORGAN HILL UNIFIED SCHOOL DISTRICT

STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS

JUNE 30, 2005

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<u>Findings/Recommendations</u>	<u>Current Status</u>	<u>Explanation if Not Fully Implemented</u>
1. Funds raised by the student body should not be used to meet obligations of the District.	Accepted Implemented	
2. The District should 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.	Accepted Implemented	

