

**MORGAN HILL UNIFIED
SCHOOL DISTRICT**

ANNUAL FINANCIAL REPORT

JUNE 30, 2006

MORGAN HILL UNIFIED SCHOOL DISTRICT
OF SANTA CLARA COUNTY
MORGAN HILL, CALIFORNIA
JUNE 30, 2006

GOVERNING BOARD

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Bonnie Tognazzini	Deputy Superintendent

MORGAN HILL UNIFIED SCHOOL DISTRICT

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FINANCIAL SECTION



INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Morgan Hill Unified School District (the "District") as of and for the year ended June 30, 2006, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Standards and Procedures for Audits of California K-12 Local Educational Agencies 2005-06*, issued by the California Education Audit Appeals Panel as regulations. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Morgan Hill Unified School District, as of June 30, 2006, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 20, 2006, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

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

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

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

Vannink Time Day + Co. LLP

Palo Alto, California
October 20, 2006

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

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, 2006. The intent of this discussion and analysis is to look at the District's financial performance as a whole. To provide a complete understanding of the District's financial performance, please read it in conjunction with the Independent Auditor's Report, notes to the basic financial statements and the District's financial statements.

The Management's Discussion and Analysis (MD&A) is an element of the reporting model adopted by the Governmental Accounting Standards Board (GASB) in their Statement No. 34 Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments issued June 1999. Certain comparative information is required to be presented in the MD&A.

FINANCIAL HIGHLIGHTS

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

Enrollment and average daily attendance for the third consecutive year has increased. For 2003-04 to 2004-05, average daily attendance (ADA) increased by 121, or 1.5%. For 2004-05 to 2005-06, ADA increased by 148, or 1.8%.

The increase in general fund revenue reflects the increase in ADA, a 2.43% Cost of Living Adjustment (COLA) and the reduction in the deficit factor resulted in additional revenue limit resources of almost \$3.3 million or 7.8% increase over 2004-05. Total general fund revenue increased by \$6.79 million or 12.1%, excluding the "on-behalf" STRS payment of \$1.4 million. The increase in the total general fund revenue reflects increases in restricted resources due to increased funding due to COLA and growth for state and federal programs, increased funding due to the new block grant funding models and spending more carryover funds compared to prior periods.

The general fund expenditures increased compared to prior due to the increase funding and utilizing carryover funds. With the increase funding, our expenditures increased in the general fund by approximately \$7.3 million.

Salaries and benefits increased by \$2.7 million or 5.9%. The district's expenditures for supplies, services and other outlay increased by approximately \$4.6 million, or 50.7% compared to 2004-05.

At year end, the district's general fund was able to increase its fund balance to \$5.5 million, an increase of \$389,679, a 7.6% increase, over the prior year.

The district-wide revenue reflected on the Statement of Activities increased from \$69.6 million for 2004-05 to \$90.2 million for 2005-06, an increase of \$20.6 million, or 29.5% increase. This increase reflects over \$13 million in state funding for modernization.

The district-wide expenses reflected on the Statement of Activities increased from \$64.3 million for 2004-05 to \$73.0 million for 2005-06, an increase of \$8.7 million, an increase of 13.5%.

The district-wide net assets increased to \$121.9 million, an increase of \$17.2 million or 16.5% compared to 2004-05.

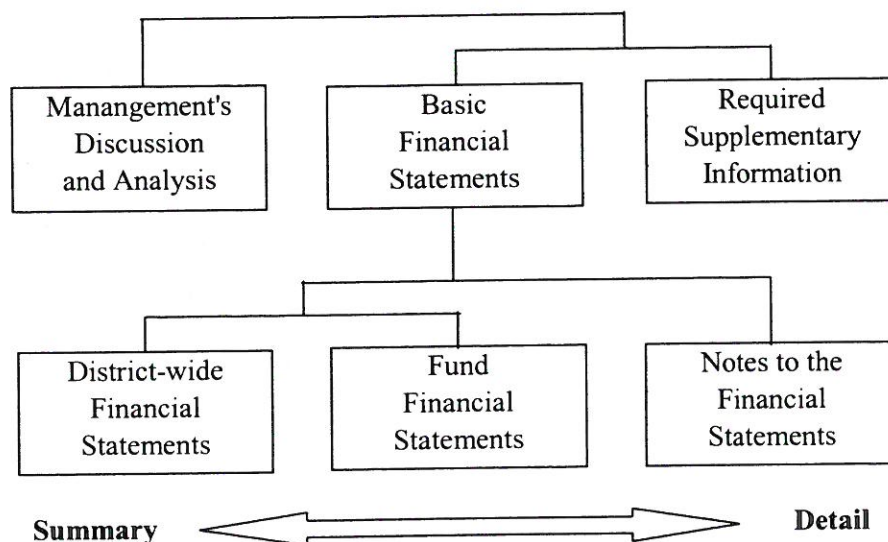
MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of three parts – management's discussion and analysis (this section), the basic financial statements, and required supplementary information. These statements are organized so the reader can understand the Morgan Hill Unified School District as a financial whole, an entire operating entity. These statements then proceed to provide an increasingly detailed look at specific financial activities.

Components of the Financial Section



The first two statements are district-wide financial statements, the Statement of Net Assets and Statement of Activities. These statements provide information about the activities of the whole School District, presenting both an aggregate view of the District's finances and a longer-term view of these finances. Fund financial statements provide the next level of detail. For governmental funds, these statements tell how services were financed in the short-term as well as what remains for future spending. The fund financial statements also look at the School District's more significant funds will all other non-major funds presented in total in one column. A comparison of the District's general fund is included.

The financial statements also include notes that explain some of the information in the statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the financial statements.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2006

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 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 2005-06?"

These two statements report the School District's net assets and changes in those assets. This change in net assets is important because it tells the reader that, for the School District as a whole, the financial position of the School District has improved or diminished. The causes of this change may be the result of many factors, some financial, some not. Over time, the increases or decreases in the District's net assets, as reported in the Statement of Activities, are one indicator of whether its financial health is improving or deteriorating. The relationship between revenues and expenses indicates the District's operating results. However, the District's goal is to provide services to our students, not to generate profits as commercial entities. One must consider many other non-financial factors, such as the quality of education provided and the safety of the schools to assess the overall health of the District.

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

Reporting the School District's Most Significant Funds

Fund Financial Statements

The fund financial statements provide more detailed information about the District's most significant funds – not the District as a whole. Funds are accounting devices the District uses to keep track of specific sources of funding and spending on particular programs. Some funds are required to be established by State law. However, the District establishes other funds to control and manage money for specific purposes.

◆ Governmental Funds

Most of the School District's activities are reported in governmental funds. The major governmental funds of the District are the General Fund, Capital Facilities 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

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

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.

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. For the period ending June 30, 2006, the District's net assets increased to \$121.9 million, or a 16% increase. Of this amount \$4.2 million was unrestricted.

(Table 1)
Comparative Statement of Net Assets

	Governmental Activities	
	2006	2005
Deposits and investments	\$ 26,085,639	\$ 22,468,747
Receivables	2,883,604	2,461,988
Prepaid expenses	772,272	376,525
Stores inventory	157,186	160,195
Capital assets	169,385,052	159,427,747
Total Assets	199,283,753	184,895,202
Accounts payable and other current liabilities	3,963,947	6,494,111
Deferred revenue	1,621,284	1,148,444
Long-term liabilities	71,833,225	72,607,678
Total Liabilities	77,418,456	80,250,233
Net assets		
Invested in capital assets, net of related debt	108,688,148	88,379,993
Restricted	8,970,214	13,361,403
Unrestricted	4,206,935	2,903,573
Total Net Assets	\$ 121,865,297	\$ 104,644,969

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

The District's net asset position increased \$17.2 million for this fiscal year (See Table 2). The District's expenses for instruction and pupil services represented 76.3 percent of total expenses. The purely administrative activities of the District account for just 5.9 percent of total costs. The remaining 17.8 percent was spent in the areas of plant services and other expenses, interest on long-term debt, depreciation of capital assets and other outgo.

(Table 2)
Comparative Statement of Change in Net Assets

	Governmental Activities	
	2006	2005
Revenues		
Program revenues:	\$ 29,236,736	\$ 18,161,867
General revenues:		
Taxes levied for general purposes	38,994,271	36,547,360
Taxes levied for other specific purpose	5,531,440	5,055,816
Federal and State Aid not restricted to specific purposes	9,906,638	9,058,799
Interest and investment earnings	432,416	274,075
Miscellaneous	6,127,179	541,487
Total Revenues	90,228,680	69,639,404
Expenses		
Instruction	40,627,500	36,083,109
Instruction related services	7,729,720	6,778,127
Pupil support services	7,354,640	7,074,936
General administration	4,299,197	3,610,431
Plant services	4,470,660	4,989,040
Other	8,526,635	5,815,617
Total Expenses	73,008,352	64,351,260
Increase In Net Assets	\$ 17,220,328	\$ 5,288,144

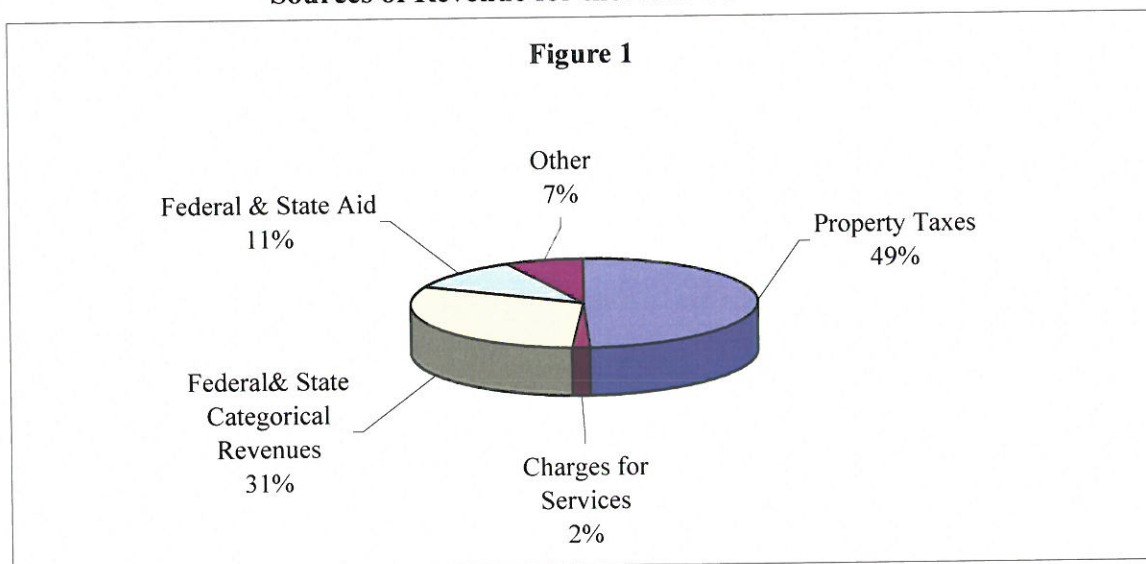
MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

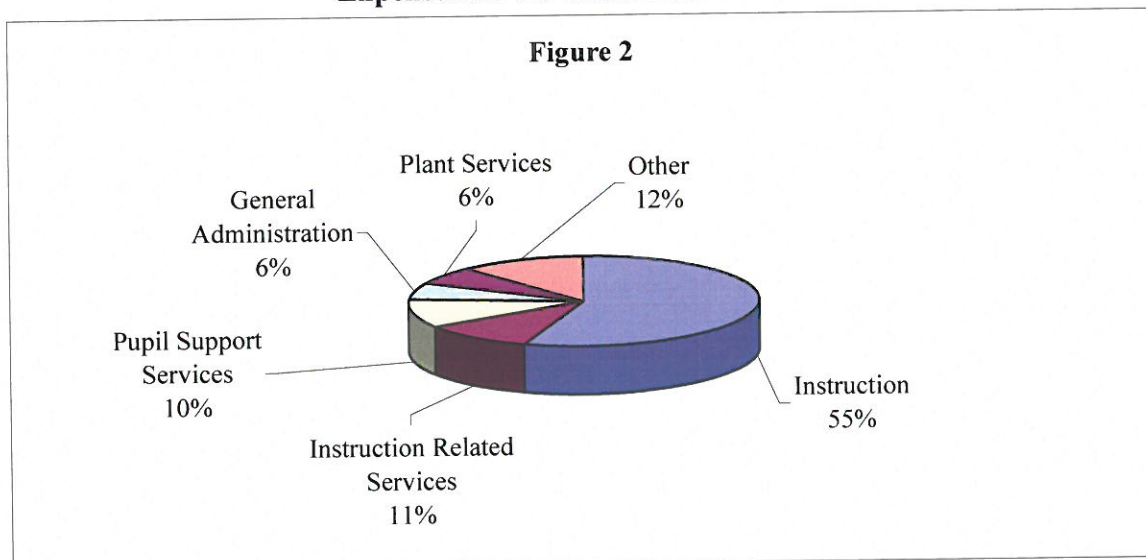
Governmental Activities

As reported in the Statement of Activities, the cost of all the District's governmental activities this year was \$73 million. The amount that our local taxpayers financed for these activities through property taxes was \$43.8 million. Federal and State aid not restricted to specific purposes total \$ 9.9 million. State and Federal Categorical revenue totaled over \$29.1 million, or 40% of the revenue of the entire District (See Figure 1).

Sources of Revenue for the 2005-06 Fiscal Year



Expenses for the Fiscal Year 2005-06



MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

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 \$25 million, an increase of \$ 6 million from the previous fiscal year. This increase is mainly reflected in the Building Fund and Capital Facilities Fund. The General Fund balance increased \$389,679.

General Fund Budgetary Highlights

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

- ◆ Budget revisions to the adopted budget required after approval of the State budget.
- ◆ Budget revisions to update revenues to actual enrollment information and to update expenditures for staffing adjustments related to actual enrollments.
- ◆ Budget revisions to update revenues and expenses in compliance with current education code requirements.
- ◆ Other budget revisions are routine in nature, including adjustments to categorical revenues and expenditures based on final awards, and adjustments between expenditure categories for school and department budgets.

The final revised budget for the General fund reflected a net decrease to the ending balance of \$3,942,379.

The District ended the year adding \$389,679 to the general fund ending balance. The State recommends an ending reserve for economic uncertainties of 3%. The District's ending reserve for economic uncertainty was 3%.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2006

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

By the end of the 2005-06 fiscal year, the District had invested \$207 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 \$169 million at June 30, 2006, which is an increase of \$10 million from the previous year due to acquisitions totaling \$13 million and depreciation expense of \$3 million.

Table 3

Comparative Schedule of Capital Assets (net of depreciation) June 30, 2006 and 2005				
	2006	2005	Difference	Percent Change
Land	\$ 724,021	\$ 724,021	\$ -	0.0%
Buildings and improvements	76,357,457	79,426,501	(3,069,044)	-3.9%
Machinery & Equipment	2,318,008	784,438	1,533,570	195.5%
Work in Progress	89,985,566	78,492,787	11,492,779	14.6%
Totals	\$ 169,385,052	\$ 159,427,747	\$ 9,957,305	6.2%

Long-Term Debt

As June 30, 2006, the District has \$71.8 million in long-term debt outstanding.

Table 4

Comparative Schedule of Outstanding Debt June 30, 2006 and 2005		
	2006	2005
General obligation bonds	\$ 71,488,366	\$ 72,316,144
Compensated absences	344,859	291,534
Totals	\$ 71,833,225	\$ 72,607,678

The long-term debt paid by the District was \$ 1,185,000.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

FACTORS BEARING ON THE DISTRICT'S FUTURE

During the past year, Morgan Hill Unified School District has completed its first year under a new superintendent, Alan Nishino, Ed.D.. Under his direction the district has focused on improving our student's test scores and enhance our ability to identify those students to meet their individual needs. The Morgan Hill Unified School District has set the following goals:

- Student Achievement, increase overall academic achievement for all students while aggressively closing the achievement gap between all numerically significant subgroups. A safe, orderly and supportive environment shall be the foundation for student learning and achievement.
- Fiscal Responsibility. In a dynamic financial environment, the district will continue to ensure students' academic success. By applying sound financial principles and practices, the district will maintain fiscal solvency and align priorities to expenses to support critical educational programs.
- Value, Respect, and Support our Employees. The district values highly qualified and dedicated employees who are committed to overall student academic achievement.
- District and Board Communication. The District values the partnership among home, school, and community to support student academic achievement.

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

During July 2006, the district was able to refinance the general bonds issued in 2002 and 2003. The result of this refinancing was an additional \$10 million that will upgrade the facilities at Live Oak High School.

The Morgan Hill Unified School District has been notified that three of the elementary schools are subject to Program Improvement. There will be a focus on assisting the students, parents and staff to ensure appropriate support to close this achievement gap.

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

Stabilization of the state's economic environment is desirable and would be beneficial to the district's financial environment. The Morgan Hill Board of Education and management will continue to plan carefully and prudently to continue to provide the resources to ensure the growth of our student's needs and capabilities.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, parents, investors, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact 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, 2006

	Governmental Activities
ASSETS	
Deposits and investments	\$ 26,085,639
Receivables	2,883,604
Prepaid expenses	772,272
Stores inventories	157,186
Capital assets not depreciated	90,709,587
Capital assets, net of accumulated depreciation	78,675,465
Total Assets	199,283,753
LIABILITIES	
Accounts payable	2,600,394
Interest payable	1,363,553
Deferred revenue	1,621,284
Current portion of long-term obligations	1,355,000
Noncurrent portion of long-term obligations	70,478,225
Total Liabilities	77,418,456
NET ASSETS	
Invested in capital assets, net of related debt	108,688,148
Restricted for:	
Legally restricted	2,515,622
Debt service	1,832,693
Capital projects	3,119,777
Special revenue	1,502,122
Unrestricted	4,206,935
Total Net Assets	\$ 121,865,297

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2006

Functions/Programs	Expenses	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets
		Charges for Services and Sales	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
Governmental Activities:					
Instruction	\$ 40,627,500	\$ 63,888	\$ 7,798,843	\$ 12,680,336	\$ (20,084,433)
Instruction-related activities:					
Supervision of instruction	1,786,845	29,569	1,234,207	-	(523,069)
Instructional library and technology	374,692	9,789	51,353	-	(313,550)
School site administration	5,568,183	23,744	390,182	-	(5,154,257)
Pupil services:					
Home-to-school transportation	2,921,762	191,339	1,643,772	-	(1,086,651)
Food services	2,261,859	1,141,109	933,350	-	(187,400)
All other pupil services	2,171,019	-	456,023	-	(1,714,996)
General administration:					
Data processing	675,978	-	-	-	(675,978)
All other general administration	3,623,219	71,148	898,268	-	(2,653,803)
Plant services	4,470,660	67,492	391,276	-	(4,011,892)
Ancillary services	494,236	-	-	-	(494,236)
Community services	42,362	-	-	-	(42,362)
Interest on long-term debt	3,635,180	-	-	-	(3,635,180)
Other outgo	4,354,857	44,759	1,116,289	-	(3,193,809)
Total Governmental-Type Activities	\$ 73,008,352	\$ 1,642,837	\$ 14,913,563	\$ 12,680,336	(43,771,616)
General revenues and subventions:					
Property taxes, levied for general purposes					38,994,271
Property taxes, levied for debt service					4,668,278
Taxes levied for other specific purposes					863,162
Federal and State aid not restricted to specific purposes					9,906,638
Interest and investment earnings					432,416
Miscellaneous					6,127,179
					<u>60,991,944</u>
Change in Net Assets					<u>17,220,328</u>
Net Assets - Beginning					<u>104,644,969</u>
Net Assets - Ending					<u>\$ 121,865,297</u>

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

GOVERNMENTAL FUNDS BALANCE SHEET JUNE 30, 2006

	General Fund	Building Fund	Capital Facilities Fund
ASSETS			
Deposits and investments	\$ 6,176,066	\$ 10,701,988	\$ 3,103,431
Receivables	2,058,927	118,941	29,221
Due from other funds	164,464	193,497	-
Prepaid expenses	772,272	-	-
Stores inventories	138,594	-	-
Total Assets	\$ 9,310,323	\$ 11,014,426	\$ 3,132,652
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 2,224,436	\$ 222,904	\$ 10,368
Due to other funds	-	60	2,507
Deferred revenue	1,541,238	-	-
Total Liabilities	3,765,674	222,964	12,875
Fund Balances:			
Reserved for:			
Stores inventories	138,594	-	-
Other reservations	2,352,436	-	-
Unreserved:			
Designated	2,805,993	-	-
Undesignated, reported in:			
General fund	247,626	-	-
Special revenue funds	-	-	-
Debt service funds	-	-	-
Capital projects funds	-	10,791,462	3,119,777
Total Fund Balance	5,544,649	10,791,462	3,119,777
Total Liabilities and Fund Balances	\$ 9,310,323	\$ 11,014,426	\$ 3,132,652

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

County School Facilities Fund	Bond Interest and Redemption Fund	Non Major Governmental Funds	Total Governmental Funds
\$ -	\$ 3,182,248	\$ 2,921,906	\$ 26,085,639
345	13,998	467,197	2,688,629
-	-	-	357,961
-	-	-	772,272
-	-	18,592	157,186
<u>\$ 345</u>	<u>\$ 3,196,246</u>	<u>\$ 3,407,695</u>	<u>\$ 30,061,687</u>

\$ -	\$ -	\$ 142,686	\$ 2,600,394
345	-	355,049	357,961
-	-	80,046	1,621,284
<u>345</u>	<u>-</u>	<u>577,781</u>	<u>4,579,639</u>

-	-	18,592	157,186
-	-	6,000	2,358,436
-	-	731,855	3,537,848
-	-	-	247,626
-	-	2,073,467	2,073,467
-	3,196,246	-	3,196,246
-	-	-	13,911,239
<u>-</u>	<u>3,196,246</u>	<u>2,829,914</u>	<u>25,482,048</u>
<u>\$ 345</u>	<u>\$ 3,196,246</u>	<u>\$ 3,407,695</u>	<u>\$ 30,061,687</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET ASSETS JUNE 30, 2006

Total Fund Balance - Governmental Funds **\$ 25,482,048**

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

Capital assets used in governmental activities are not financial resources
and, therefore, are not reported as assets in governmental funds.

The cost of capital assets is	\$207,408,834	
Accumulated depreciation is	<u>(38,023,782)</u>	
Net Capital Assets		169,385,052

In governmental funds, unmatured interest on long-term debt is recognized
in the period when it is due. On the government-wide statements,
unmatured interest on long-term debt is recognized when it is incurred. (1,363,553)

In governmental funds, the receipt of the special education mandated
settlement is reported as revenue in the year received. On the statement of
net assets, the settlement amount is recorded as a receivable and payments
received in the current year reduce the receivable amount. 194,975

Long-term liabilities, including bonds payable, are not due and payable in the
current period and, therefore, are not reported as liabilities in the funds.

Long-term liabilities at year end consist of:

Bonds payable	\$ 69,862,754	
Accreted interest on the bonds	1,625,612	
Compensated absences (vacations)	<u>344,859</u>	
Total Long-Term Liabilities		<u>(71,833,225)</u>
Total Net Assets - Governmental Activities		<u>\$ 121,865,297</u>

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

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MORGAN HILL UNIFIED SCHOOL DISTRICT

GOVERNMENTAL FUNDS

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE FOR THE YEAR ENDED JUNE 30, 2006

	General Fund	Building Fund	Capital Facilities Fund
REVENUES			
Revenue limit sources	\$ 45,157,760	\$ -	\$ -
Federal sources	3,155,725	-	-
Other State sources	10,792,568	-	-
Other local sources	5,088,594	328,665	3,386,075
Total Revenues	64,194,647	328,665	3,386,075
EXPENDITURES			
Current			
Instruction	37,445,323	-	-
Instruction-related activities:			
Supervision of instruction	1,682,157	-	-
Instructional library, media and technology	352,740	-	-
School site administration	4,970,760	-	-
Pupil services:			
Home-to-school transportation	2,750,581	-	-
Food services	-	-	-
All other pupil services	2,043,823	-	-
General administration:			
Data processing	636,374	-	-
All other general administration	3,233,001	-	-
Plant services	5,654,930	1,922	242,948
Facility acquisition and construction	-	10,009,300	1,483,479
Ancillary services	465,280	-	-
Community services	39,881	-	-
Other outgo	4,354,857	-	-
Debt service			
Principal	-	-	-
Interest and other	-	-	-
Total Expenditures	63,629,707	10,011,222	1,726,427
Excess (Deficiency) of			
Revenues Over Expenditures	564,940	(9,682,557)	1,659,648
Other Financing Sources (Uses):			
Transfers in	158,806	13,593,297	-
Transfers out	(334,067)	-	(158,806)
Net Financing Sources (Uses)	(175,261)	13,593,297	(158,806)
NET CHANGE IN FUND BALANCES	389,679	3,910,740	1,500,842
Fund Balance - Beginning	5,154,970	6,880,722	1,618,935
Fund Balance - Ending	\$ 5,544,649	\$ 10,791,462	\$ 3,119,777

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

County School Facilities Fund	Bond Interest and Redemption Fund	Nonmajor Governmental Funds	Total Governmental Funds
\$ -	\$ -	\$ 411,441	\$ 45,569,201
-	-	1,009,429	4,165,154
12,680,336	36,439	973,880	24,483,223
43,699	4,666,595	2,302,499	15,816,127
12,724,035	4,703,034	4,697,249	90,033,705
-	-	818,112	38,263,435
-	-	-	1,682,157
-	-	-	352,740
-	-	271,193	5,241,953
-	-	-	2,750,581
-	-	2,129,341	2,129,341
-	-	-	2,043,823
-	-	-	636,374
-	-	165,061	3,398,062
-	-	526,089	6,425,889
-	-	-	11,492,779
-	-	-	465,280
-	-	-	39,881
-	-	-	4,354,857
-	1,185,000	-	1,185,000
-	3,297,055	-	3,297,055
-	4,482,055	3,909,796	83,759,207
12,724,035	220,979	787,453	6,274,498
-	-	334,067	14,086,170
(12,724,035)	-	(869,262)	(14,086,170)
(12,724,035)	-	(535,195)	-
-	220,979	252,258	6,274,498
-	2,975,267	2,577,656	19,207,550
\$ -	\$ 3,196,246	\$ 2,829,914	\$ 25,482,048

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES TO THE DISTRICT-WIDE STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2006

Total Net Change in Fund Balances - Governmental Funds	\$ 6,274,498
Amounts Reported for Governmental Activities in the Statement of Activities are Different Because:	
Capital outlays to purchase or build capital assets are reported in governmental funds as expenditures; however, for governmental activities, those costs are shown in the statement of net assets and allocated over their estimated useful lives as annual depreciation expenses in the statement of activities.	
This is the amount by which capital outlays exceed depreciation in the period.	
Depreciation expense	\$ (3,477,022)
Capital outlays	<u>13,448,008</u>
Net Expense Adjustment	9,970,986
Loss on disposal of capital assets is reported in the government-wide statement of net assets, but is not recorded in the governmental funds.	(13,681)
In the statement of activities, certain operating expenses, such as compensated absences (vacations) are measured by the amounts earned during the year. In the governmental funds, however, expenditures for these items are measured by the amount of financial resources used (essentially, the amounts actually paid).	
Vacation used was less than the amounts earned by \$53,325.	(53,325)
Accreted interest on capital appreciation bonds does not require the use of current financial resources, and thus is not recorded in the governmental funds. In the statement of activities, however, accreted interest expense is recognized in the entity-wide statements as the long-term liabilities.	(357,222)
Payment of principal on long-term liabilities is an expenditure in the governmental funds, but it reduces long-term liabilities in the statement of net assets and does not affect the statement of activities.	1,185,000
Interest on long-term debt is recorded as an expenditure in the funds when it is due; however, in the statement of activities, interest expense is recognized as the interest accrues, regardless of when it is due.	19,097
In the governmental funds, the receipt of the special education mandated settlement is reported as revenue in the year received. On the statement of net assets, the settlement amount is recorded as a receivable and payments received in the current year reduce the receivable amount.	<u>194,975</u>
Change in Net Assets of Governmental Activities	<u>\$ 17,220,328</u>

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

FIDUCIARY FUNDS

STATEMENT OF FIDUCIARY NET ASSETS

JUNE 30, 2006

	Agency Funds
ASSETS	
Deposits and investments	\$ 397,856
Total Assets	<u>\$ 397,856</u>
LIABILITIES	
Due to student groups	\$ 397,856
Total Liabilities	<u>\$ 397,856</u>

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity

The Morgan Hill Unified School District was unified on July 1, 1966 under the laws of the State of California. The District operates under a locally elected seven member Board form of government and provides educational services to grades K-12 as mandated by the State and/or Federal agencies. The District operates nine elementary, two middle, two high schools, a continuation high school and a community adult school as well as a home-schooling program.

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

Component Units

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

Other Related Entities

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

Basis of Presentation - Fund Accounting

The accounting system is organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. The District's funds are grouped into two broad fund categories: governmental and fiduciary.

Governmental Funds Governmental funds are those through which most governmental functions typically are financed. Governmental fund reporting focuses on the sources, uses, and balances of current financial resources. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used. Current liabilities are assigned to the fund from which they will be paid. The difference between governmental fund assets and liabilities is reported as fund balance. The following are the District's major and non-major governmental funds:

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

Major Governmental Funds

General Fund The General Fund accounts for all financial resources except those required to be accounted for in another fund. The General Fund balance is available to the District for any purpose provided it is expended or transferred according to the general laws of California.

Building Fund The Building Fund exists primarily to account separately for proceeds from sale of bonds and acquisition of major governmental capital facilities and buildings.

Capital Facilities Fund The Capital Facilities Fund is used to account for resources received from developer impact fees assessed under provisions of the California Environmental Quality Act (CEQA).

County School Facilities Fund The County School Facilities Fund is used primarily to account separately for State apportionments provided for construction and reconstruction of school facilities (Education Code Sections 17010.10-17076.10).

Bond Interest and Redemption Fund The 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 The 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 the following special revenue funds:

Adult Education Fund The Adult Education Fund is used to account for resources committed to adult education programs maintained by the District.

Child Development Fund The Child Development Fund is used to account for resources committed to child development programs maintained by the District.

Cafeteria Fund/Account The Cafeteria Fund/Account is used to account for the financial transactions related to the food service operations of the District.

Deferred Maintenance Fund The Deferred Maintenance Fund is used for the purpose of major repair or replacement of District property.

Special Reserve Fund for Other than Capital Outlay The Special Reserve Fund for Other than Capital Outlay is used to provide for the accumulation of General Fund monies for general operating purposes.

Debt Service Funds The Debt Service Funds are used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interest, and related costs. In addition to the one that presented in the major funds, the District maintains another debt service fund:

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

Fiduciary Funds Fiduciary fund reporting focuses on net assets and changes in net assets. The District has only one Fiduciary Fund, which is an agency fund.

Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. The District's agency fund accounts for student body activities (ASB) and scholarship activities.

Basis of Accounting - Measurement Focus

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

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

Net assets should be reported as restricted when constraints placed on net asset use are either externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. The net assets restricted for other activities result from special revenue funds and the restrictions on their net asset use.

Fund Financial Statements Fund financial statements report detailed information about the District. The focus of governmental and proprietary fund financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Non-major funds are aggregated and presented in a single column. The internal service fund is presented in a single column on the face of the proprietary fund statements.

Governmental Funds All governmental funds are accounted for using the flow of current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. The statement of revenues, expenditures, and changes in fund balance reports on the sources (revenues and other financing sources) and uses (expenditures and other financing uses) of current financial resources. This approach differs from the manner in which the governmental activities of the government-wide financial statements are prepared. Governmental fund financial statements, therefore, include reconciliations with brief explanations to better identify the relationship between the government-wide financial statements, prepared using the economic resources measurement focus and the accrual basis of accounting, and the governmental fund financial statements, prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting.

Fiduciary Funds Fiduciary funds are accounted for using the flow of economic resources measurement focus and the accrual basis of accounting. Fiduciary funds are excluded from the government-wide financial statements because they do not represent resources of the District.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

Revenues – Exchange and Non-Exchange Transactions Revenue resulting from exchange transactions, in which each party gives and receives essentially equal value, is recorded on the accrual basis when the exchange takes place. On a modified accrual basis, revenue is recorded in the fiscal year in which the resources are measurable and become available. Available means that the resources will be collected within the current fiscal year or are expected to be collected soon enough thereafter, to be used to pay liabilities of the current fiscal year. For the District, available means expected to be received within 90 days of fiscal year-end.

Non-exchange transactions, in which the District receives value without directly giving equal value in return, include property taxes, certain grants, entitlements, and donations. Revenue from property taxes is recognized in the fiscal year in which the taxes are received. Revenue from certain grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include time and purpose restrictions. On a modified accrual basis, revenue from non-exchange transactions must also be available before it can be recognized.

Under the modified accrual basis, the following revenue sources are considered to be both measurable and available at fiscal year-end: State apportionments, interest, certain grants, and other local sources.

Deferred Revenue Deferred revenue arises when potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period or when resources are received by the District prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the District has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and revenue is recognized.

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

Expenses/Expenditures On the accrual basis of accounting, expenses are recognized at the time they are incurred. The measurement focus of governmental fund accounting is on decreases in net financial resources (expenditures) rather than expenses. Expenditures are generally recognized in the accounting period in which the related fund liability is incurred, if measurable. Principal and interest on long-term obligations, which has not matured, are recognized when paid in the governmental funds. Allocations of costs, such as depreciation and amortization, are not recognized in the governmental funds.

Cash and Cash Equivalents

The District's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. Cash equivalents also include cash with county treasury balances.

Investments

Investments held at June 30, 2006 with original maturities greater than one year are stated at fair value. Fair value is estimated based on quoted market prices at year-end. All investments not required to be reported at fair value are stated at cost or amortized cost. Fair values of investments in county and state investment pools are determined by the program sponsor.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

Restricted Assets

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

Prepaid Expenditures

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

Stores Inventories

Inventories consist of expendable food and supplies held for consumption. Inventories are stated at cost, on the weighted average basis. The costs of inventory items are recorded as expenditures in the governmental type funds and expenses in the proprietary type funds when used.

Capital Assets and Depreciation

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

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

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

Depreciation is computed using the straight-line method. Estimated useful lives of the various classes of depreciable capital assets are as follows: buildings, 20 to 50 years; improvements/infrastructure, 5 to 50 years; equipment, 2 to 15 years.

Interfund Balances

On fund financial statements, receivables and payables resulting from short-term interfund loans are classified as "interfund receivables/payables". These amounts are eliminated in the governmental columns of the statement of net assets.

Compensated Absences

Accumulated unpaid vacation benefits are accrued as a liability as the benefits are earned. The entire compensated absence liability is reported on the government-wide financial statements. For governmental funds, the current portion of unpaid compensated absences is recognized upon the occurrence of relevant events such as

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

employee resignations and retirements that occur prior to year-end that have not yet been paid with expendable available financial resources. These amounts are reported in the fund from which the employees who have accumulated leave are paid.

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

Accrued Liabilities and Long-Term Obligations

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

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

Fund Balance Reserves and Designations

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

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

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. The District first applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

Interfund Activity

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures in the purchaser funds. Flows of cash or goods from one fund to another without a requirement for repayment are reported as interfund transfers. Interfund transfers are reported as other financing sources/uses in governmental funds. Repayments from funds responsible for particular expenditures to the funds that initially paid for them are not presented in the financial statements.

Estimates

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

Budgetary Data

The budgetary process is prescribed by provisions of the California Education Code and requires the governing board to hold a public hearing and adopt an operating budget no later than July 1st of each year. The District governing board satisfied these requirements. The adopted budget is subject to amendment throughout the year to give consideration to unanticipated revenue and expenditures primarily resulting from events unknown at the time of budget adoption with the legal restriction that expenditures cannot exceed appropriations by major object account.

The amounts reported as the original budgeted amounts in the budgetary statements reflect the amounts when the original appropriations were adopted. The amounts reported as the final budgeted amounts in the budgetary statements reflect the amounts after all budget amendments have been accounted for. For purposes of the budget, on-behalf payments have not been included as revenue and expenditures as required under generally accepted accounting principles.

Property Tax

Secured property taxes attach as an enforceable lien on property as of January 1. Taxes are payable in two installments on November 1 and February 1 and become delinquent on December 10 and April 10, respectively. Unsecured property taxes are payable in one installment on or before August 31. The County of Santa Clara bills and collects the taxes on behalf of the District. Local property tax revenues are recorded when received.

New Accounting Pronouncements

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

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

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

In June 2005, the GASB issued GASBS No. 47, *Accounting for Termination Benefits*. GASBS No. 47 addresses accounting for both voluntary and involuntary termination benefits. For termination benefits that affect an employer's obligations for defined benefit OPEB, the provisions of GASBS No. 47 should be applied simultaneously with the requirements of GASBS No. 45 [GASBS No. 45 is effective in three phases, with implementation required for Phase 1 governments in periods beginning after December 15, 2006.] For all other termination benefits, including those that affect an employer's obligations for defined benefit pension benefits, GASBS No. 47 is effective for financial statements for periods beginning after June 15, 2005. Earlier application of GASBS No. 47 is encouraged. There was no impact on the financial statements as a result of implementation of this standard.

NOTE 2 – DEPOSITS AND INVESTMENTS

Summary of Deposits and Investments

Deposits and investments as of June 30, 2006, are classified in the accompanying financial statements as follows:

Governmental activities	\$26,085,639
Fiduciary funds	397,856
Total Deposits and Investments	<u>\$26,483,495</u>

Deposits and investments as of June 30, 2006, consist of the following:

Cash on hand and in banks	\$ 482,362
Investments	26,001,133
Total Deposits and Investments	<u>\$26,483,495</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

Policies and Practices

The District is authorized under California Government Code to make direct investments in local agency bonds, notes, or warrants within the State; U.S. Treasury instruments; registered State warrants or treasury notes; securities of the U.S. Government, or its agencies; bankers acceptances; commercial paper; certificates of deposit placed with commercial banks and/or savings and loan companies; repurchase or reverse repurchase agreements; medium term corporate notes; shares of beneficial interest issued by diversified management companies, certificates of participation, obligations with first priority security; and collateralized mortgage obligations.

Investment in County Treasury - The District is considered to be an involuntary participant in an external investment pool as the District is required to deposit all receipts and collections of monies with their County Treasurer (Education Code Section 41001). The fair value of the District's investment in the pool is reported in the accounting financial statements at amounts based upon the District's pro-rata share of the fair value provided by the County Treasurer for the entire portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by the County Treasurer, which is recorded on the amortized cost basis.

General Authorizations

Limitations as they relate to interest rate risk, credit risk, and concentration of credit risk are indicated in the schedules below:

Authorized Investment Type	Maximum Remaining Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Local Agency Bonds, Notes, Warrants	5 years	None	None
Registered State Bonds, Notes, Warrants	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptance	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base	None
Medium-Term Corporate Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None
Joint Powers Authority Pools	N/A	None	None

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. The District manages its exposure to interest rate risk by investing in the county treasury pool. The fair value of the deposits with county treasurer at June 30, 2006 was \$25,770,896 and the weighted average maturity of the pool was 478 days.

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The District's investments in the county pool is not required to be rated, nor has it been rated as of June 30, 2006.

Custodial Credit Risk - Deposits

This is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a policy for custodial credit risk for deposits. However, the California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110 percent of the total amount deposited by the public agencies. California law also allows financial institutions to secure public deposits by pledging first trust deed mortgage notes having a value of 150 percent of the secured public deposits and letters of credit issued by the Federal Home Loan Bank of San Francisco having a value of 105 percent of the secured deposits. The District believes it has no significant custodial credit risk with respect to any of its bank deposits.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

NOTE 3 - RECEIVABLES

Receivables at June 30, 2006, consisted of intergovernmental grants, entitlements, interest and other local sources. All receivables are considered collectible in full.

	General Fund	Building Fund	Capital Facility Fund	County School Facilities Fund	Bond Interest and Redemption Fund	Non-Major Governmental Funds	Total
Federal Government							
Categorical aid	\$ 716,064	\$ -	\$ -	\$ -	\$ -	\$ 300,747	\$ 1,016,811
State Government							
Apportionment	88,260	-	-	-	-	40,581	128,841
Categorical aid	738,814	-	-	-	-	28,379	767,193
Lottery	264,316	-	-	-	-	-	264,316
Local Government							
Interest	98,674	118,941	-	345	-	77,798	295,758
Other Local Sources	152,799	-	29,221	-	13,998	19,692	215,710
Total	<u>\$ 2,058,927</u>	<u>\$ 118,941</u>	<u>\$ 29,221</u>	<u>\$ 345</u>	<u>\$ 13,998</u>	<u>\$ 467,197</u>	<u>\$ 2,688,629</u>

Long-term receivables of \$194,975 consist of the special education mandated settlement which will be received at a rate of approximately \$38,995 each year for the next five (5) years.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2006, was as follows:

	Balance July 1, 2005	Additions	Deductions	Balance June 30, 2006
Governmental Activities				
Capital Assets Not Being Depreciated:				
Land	\$ 724,021	\$ -	\$ -	\$ 724,021
Construction in Progress	78,492,787	11,492,779	-	89,985,566
Total Capital Assets Not Being Depreciated	79,216,808	11,492,779	-	90,709,587
Capital Assets Being Depreciated:				
Buildings and Improvements	111,681,875	-	-	111,681,875
Furniture and Equipment	3,381,390	1,955,229	319,247	5,017,372
Total Capital Assets Being Depreciated	115,063,265	1,955,229	319,247	116,699,247
Total Capital Assets	194,280,073	13,448,008	319,247	207,408,834
Less Accumulated Depreciation:				
Buildings and Improvements	32,255,374	3,069,044	-	35,324,418
Furniture and Equipment	2,596,952	407,978	305,566	2,699,364
Total Accumulated Depreciation	34,852,326	3,477,022	305,566	38,023,782
Governmental Activities Capital Assets, Net	<u>\$ 159,427,747</u>	<u>\$ 9,970,986</u>	<u>\$ 13,681</u>	<u>\$ 169,385,052</u>

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

Governmental Activities	
Instruction	\$ 2,328,356
Supervision of instruction	103,107
Instructional library, media, and technology	21,620
School site administration	321,302
Home-to-school transportation	168,595
Food services	130,516
All other pupil services	153,794
Community service	2,444.00
Data processing	39,006
All other general administration	208,282
Total Depreciation Expense All Activities	<u>\$ 3,477,022</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

NOTE 5 – INTERFUND TRANSACTIONS

Interfund Receivables/Payables (Due To/Due From)

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

Due To	Due From		
	General Fund	Building Fund	Total
Building	\$ 60	\$ -	\$ 60
Capital Facility Fund	2,507	-	2,507
County School Facilities Fund	-	345	345
Non-Major Governmental funds	161,897	193,152	355,049
Total	<u>\$ 164,464</u>	<u>\$ 193,497</u>	<u>\$ 357,961</u>

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

Operating Transfers

Interfund transfers for the year ended June 30, 2006, consisted of the following:

Transfer Out	Transfer In		
	General Fund	Building Fund	None-Major Governmental Fund
General Fund	\$ -	\$ -	\$ 334,067
Capital Facility Fund	158,806	-	-
County School Facilities Fund	-	12,724,035	-
Non-Major Governmental funds	-	869,262	-
Total	<u>\$ 158,806</u>	<u>\$ 13,593,297</u>	<u>\$ 334,067</u>

County School Facilities Fund transferred to Building Fund for costs reimbursement.	\$ 12,724,035
Capital Facility Fund transferred to General Fund for the administration support.	158,806
General Fund transferred to Deferred Maintenance Fund for District match.	334,067
Mello-Roos fund transferred to Building fund for construction project costs.	869,262
Total	<u>\$ 14,086,170</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

NOTE 6 - ACCOUNTS PAYABLE

Accounts payable at June 30, 2006, consisted of the following:

	General Fund	Building Fund	Capital Facility Fund	Non-Major Governmental Funds	Total
Vendor payables	\$ 1,325,478	\$ 221,351	\$ 10,368	\$ 84,744	\$1,641,941
State apportionment	34,538	-	-	-	34,538
Salaries and benefits	864,420	1,553	-	57,942	923,915
Total	<u>\$ 2,224,436</u>	<u>\$ 222,904</u>	<u>\$ 10,368</u>	<u>\$ 142,686</u>	<u>\$2,600,394</u>

NOTE 7 - DEFERRED REVENUE

Deferred revenue at June 30, 2006, consists of the following:

	General Fund	Non-Major Governmental Funds	Total
Federal financial assistance	\$ 81,365	\$ -	\$ 81,365
State categorical aid	2,081	80,046	82,127
Other local	1,457,792	-	1,457,792
Total	<u>\$ 1,541,238</u>	<u>\$ 80,046</u>	<u>\$ 1,621,284</u>

NOTE 8 - TAX AND REVENUE ANTICIPATION NOTES (TRANS)

On July 6, 2005, the District issued \$7,920,000 Tax and Revenue Anticipation Notes bearing interest at 2.6 percent. The notes were issued to supplement cash flows. Interest and principal were due and payable on July 6, 2006. By January 20, 2006, the District had paid 100 percent of principal and interest for the sole purpose of satisfying the notes. The District was not required to make any additional payments on the notes.

Changes in the outstanding liability for the Tax and Revenue Anticipation Note are as follows:

Issue Date	Rate	Maturity Date	Outstanding July 1, 2005	Additions	Payments	Outstanding June 30, 2006
7/6/2005	2.60%	07/06/2006	\$ -	\$ 7,920,000	\$ 7,920,000	\$ -

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

NOTE 9 - LONG-TERM OBLIGATIONS

Summary

The changes in the District's long-term obligations during the year consisted of the following:

	Balance July 1, 2005	Additions	Deductions	Balance June 30, 2006	Due in One Year
General obligation bonds	\$ 71,047,754	\$ -	\$ 1,185,000	\$ 69,862,754	\$ 1,355,000
Accretions on general obligation bonds	1,268,390	357,222	-	1,625,612	-
Accumulated vacation - net	291,534	53,325	-	344,859	-
	<u>\$ 72,607,678</u>	<u>\$ 410,547</u>	<u>\$ 1,185,000</u>	<u>\$ 71,833,225</u>	<u>\$ 1,355,000</u>

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

Bonded Debt

The outstanding general obligation bonded debt is as follows:

Issue Date	Maturity Date (August 1)	Interest Rate	Original Issue	Bonds Outstanding July 1, 2005	Accreted	Redeemed	Bonds Outstanding June 30, 2006
2000	2025	4.6%-5.5%	\$ 38,000,000	\$ 37,260,000	\$ -	\$ 395,000	\$ 36,865,000
2002	2020	3.5%-5.25%	28,210,000	27,500,000	-	790,000	26,710,000
2002	2026	5.5%-5.6%	6,287,754	7,556,144	357,222	-	7,913,366
				<u>\$ 72,316,144</u>	<u>\$ 357,222</u>	<u>\$ 1,185,000</u>	<u>\$ 71,488,366</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

Debt Service Requirements to Maturity

The bonds mature through 2027 as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest to Maturity</u>	<u>Total</u>
2007	\$ 1,355,000	\$ 3,246,173	\$ 4,601,173
2008	1,535,000	3,189,823	4,724,823
2009	1,725,000	3,125,981	4,850,981
2010	1,930,000	3,045,426	4,975,426
2011	2,165,000	2,949,563	5,114,563
2012-2016	14,785,000	12,878,324	27,663,324
2017-2021	23,460,000	7,983,785	31,443,785
2022-2026	21,940,155	14,333,286	36,273,441
2027	967,599	2,762,401	3,730,000
Total	69,862,754	<u>\$ 53,514,762</u>	<u>\$ 123,377,516</u>
Accretion to Date	<u>1,625,612</u>		
	<u>\$ 71,488,366</u>		

Accumulated Unpaid Employee Vacation

The long-term portion of accumulated unpaid employee vacation for the District at June 30, 2006, amounted to \$344,859.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

NOTE 10 - FUND BALANCES

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

	General Fund	Building Fund	Capital Facilities Fund	Bond Interest and Redemption Fund	Non-Major Governmental Funds	Total
Reserved						
Revolving cash	\$ 14,500	\$ -	\$ -	\$ -	\$ 6,000	\$ 20,500
Stores inventory	138,594	-	-	-	18,592	157,186
Prepaid expenditures	772,272	-	-	-	-	772,272
Restricted programs	1,565,664	-	-	-	-	1,565,664
Total Reserved	2,491,030	-	-	-	24,592	2,515,622
Unreserved						
Designated						
Economic uncertainties	1,868,553	-	-	-	85,855	1,954,408
Other designation	937,440	-	-	-	646,000	1,583,440
Total Designated	2,805,993	-	-	-	731,855	3,537,848
Undesignated	247,626	10,791,462	3,119,777	3,196,246	2,073,467	19,428,578
Total Unreserved	3,053,619	10,791,462	3,119,777	3,196,246	2,805,322	22,966,426
Total	\$ 5,544,649	\$ 10,791,462	\$ 3,119,777	\$ 3,196,246	\$ 2,829,914	\$ 25,482,048

NOTE 11 - POSTEMPLOYMENT BENEFITS

Regular Postemployment Benefits

The District provides post-employment health care benefits in accordance with District employment contracts. Administrative and certificated retirees who retire from the district on or after attaining age 55 receive post-employment health care benefits until the age of 65. Classified retirees receive the same-post employment health care benefits after attaining age 50 for a specified period of no more than 5 years. Currently 119 employees meet these eligibility requirements. During the year, expenditures of \$430,679 were recognized for retiree's health care benefits.

The approximate accumulated future liability for the District at June 30, 2006, amounts to \$1,975,966. This amount was calculated based upon the number of retirees receiving benefits multiplied by the yearly district payment per employee in effect at June 30, 2006, multiplied by the number of years of payments remaining.

Supplemental Early Retirement Plan (SERP)

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

NOTE 12 - RISK MANAGEMENT

Property and Liability

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees and natural disasters. During fiscal year ending June 30, 2006, the District contracted with Santa Clara County Schools Insurance Group for property and liability insurance coverage. Settled claims have not exceeded this commercial coverage in any of the past three years. There has not been a significant reduction in coverage from the prior year.

Workers' Compensation

For fiscal year 2006, the District participated in the Santa Clara County Schools Insurance Group, an insurance purchasing pool. The intent of the Santa Clara County Schools Insurance Group is to achieve the benefit of a reduced premium for the District by virtue of its grouping and representation with other participants in the Santa Clara County Schools Insurance Group. The workers' compensation experience of the participating districts is calculated as one experience and a common premium rate is applied to all districts in the Santa Clara County Schools Insurance Group. Each participant pays its workers' compensation premium based on its individual rate. A participant will then either receive money from or be required to contribute to the "equity-pooling fund". This "equity pooling" arrangement insures that each participant shares equally in the overall performance of the Santa Clara County Schools Insurance Group. Participation in the Santa Clara County Schools Insurance Group is limited to districts that can meet the Santa Clara County Schools Insurance Group selection criteria.

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

Insurance Program / Company Name	Type of Coverage	Limits
<u>Workers' Compensation Program</u>		
Santa Clara County Schools Insurance Group	Workers' Compensation	State Statutory Limit
<u>Property and Liability</u>		
Santa Clara County Schools Insurance Group	Property	\$ 250,000,000
	Liability	\$ 1,000,000
	Excess Liability	\$ 4,000,000

Employee Medical Benefits

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

NOTE 13 - EMPLOYEE RETIREMENT SYSTEMS

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

STRS

Plan Description

The District contributes to the California 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 and disability benefits and survivor benefits to beneficiaries. Benefit provisions are established by State statutes, as legislatively amended, within the State Teachers' Retirement Law. STRS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the STRS annual financial report may be obtained from STRS, 7667 Folsom Blvd., Sacramento, CA 95826.

Funding Policy

Active plan members are required to contribute 8.0 percent of their salary and the District is required to contribute an actuarially determined rate. The actuarial methods and assumptions used for determining the rate are those adopted by STRS Teachers' Retirement Board. The required employer contribution rate for fiscal year 2005-2006 was 8.25 percent of annual payroll. The contribution requirements of the plan members are established by State statute. The District's contributions to STRS for the fiscal years ending June 30, 2006, 2005, and 2004, were \$2,632,560, \$2,586,316, and \$2,371,177, respectively, and equal 100 percent of the required contributions for each year.

PERS

Plan Description

The District contributes to the School Employer Pool under the California Public Employees' Retirement System (CalPERS), a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by CalPERS. The plan provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit provisions are established by State statutes, as legislatively amended, within the Public Employees' Retirement Laws. CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalPERS' annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, CA 95814.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

Funding Policy

Active plan members are required to contribute 7.0 percent of their salary and the District is required to contribute an actuarially determined rate. The actuarial methods and assumptions used for determining the rate are those adopted by the CalPERS Board of Administration. The Morgan Hill Unified School District pays the employee's portion of the CalPERS. The required employer contribution rate for fiscal year 2005-2006 was 9.116 percent of annual payroll. The contribution requirements of the plan members are established by State statute. The District's contributions of the employer's portion to CalPERS for the fiscal years ending June 30, 2006, 2005, and 2004, were \$760,982, \$759,441, and \$789,176, respectively, and equal 100 percent of the required contributions for each year.

Social Security

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

On Behalf Payments

The State of California makes contributions to STRS and PERS on behalf of the District. These payments consist of State General Fund contributions to STRS in the amount of \$1,441,366 (4.517 percent of salaries subject to STRS). This amount has been allocated in General Fund, Adult Fund and Child Development Fund for the amounts of \$1,408,215, \$21,620 and \$11,531, respectively. No contributions were made for PERS for the year ended June 30, 2006. 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 educational agencies not to record these amounts in the Annual Financial and Budget Report. These amounts have not been included in the budget amounts reported in the General Fund Budgetary Schedule. These amounts have been recorded in these financial statements. On behalf payments have been excluded from the calculation of the available reserves percentage.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

Grants

The District received financial assistance from Federal and State agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the General Fund or other applicable funds. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of the District at June 30, 2006.

Litigation

The District is involved in various litigations arising from the normal course of business. In the opinion of management and legal counsel, the disposition of all litigation pending is not expected to have a material adverse effect on the overall financial position of the District at June 30, 2006.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

Construction Commitments

As of June 30, 2006, the District had the following commitments with respect to the unfinished capital projects:

Capital Project	Remaining Construction Commitment	Expected Date of Completion
Various modernizations in Live Oak High School	\$ 15,000,000	September, 2007

NOTE 15 - PARTICIPATION IN PUBLIC ENTITY RISK POOLS

The District is a member of the Santa Clara County Schools Insurance Group public entity risk pool (the pool). The District pays an annual premium to the applicable entity for its health, workers' compensation, and property liability coverage. The relationship between the District and the pool is such that it is not component unit of the District for financial reporting purposes.

This entity has budgeting and financial reporting requirements independent of member units and their financial statements are not presented in these financial statements; however, fund transactions between the entities and the District are included in these statements. Audited financial statements are generally available from the entity.

The District has appointed one board member to the Governing Board of the Santa Clara County Schools Insurance Group.

During the year ended June 30, 2006, the District made payment of \$1,785,133 to the Santa Clara County Schools Insurance Group.

NOTE 16 - SUBSEQUENT EVENTS

The District issued \$8,370,000 of Tax and Revenue Anticipation Notes at dated July 6, 2006. The notes mature on July 6, 2007, and yield 3.5 percent interest. The notes were sold to supplement cash flow. Repayment requirements are that a percentage of principal and interest be deposited with the Fiscal Agent each month beginning February, 2007, until 100 percent of principal and interest due is on account in May 2007.

REQUIRED SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

GENERAL FUND BUDGETARY COMPARISON SCHEDULE FOR THE YEAR ENDED JUNE 30, 2006

	Budgeted Amounts (GAAP Basis)		Actual (GAAP Basis)	Variances - Favorable (Unfavorable)
	Original	Final		Final to Actual
REVENUES				
Revenue limit sources	\$ 43,775,081	\$ 45,157,759	\$ 45,157,760	\$ 1
Federal sources	3,297,180	3,402,115	3,155,725	(246,390)
Other State sources	7,726,004	9,176,451	10,792,568	1,616,117
Other local sources	2,766,979	4,127,786	5,088,594	960,808
Total Revenues¹	57,565,244	61,864,111	64,194,647	2,330,536
EXPENDITURES				
Current				
Instruction	34,381,195	38,082,454	37,445,323	637,131
Instruction-related activities:				
Supervision of instruction	1,723,383	1,734,538	1,682,157	52,381
Instructional library, media, and technology	272,993	364,720	352,740	11,980
School site administration	5,071,021	5,174,004	4,970,760	203,244
Pupil services:				
Home-to-school transportation	2,944,305	3,144,617	2,750,581	394,036
Food services	-	48	-	48
All other pupil services	1,840,139	2,152,712	2,043,823	108,889
General administration:				
Data processing	388,231	657,794	636,374	21,420
All other general administration	2,770,606	3,017,523	3,233,001	(215,478)
Plant services	5,516,542	6,331,563	5,654,930	676,633
Facility acquisition and construction		2,262	-	2,262
Ancillary services	434,510	529,451	465,280	64,171
Community services	-	49,885	39,881	10,004
Other outgo	1,749,412	4,385,857	4,354,857	31,000
Total Expenditures¹	57,092,337	65,627,427	63,629,707	1,997,720
Excess (Deficiency) of Revenues Over Expenditures	472,907	(3,763,316)	564,940	4,328,256
Other Financing Sources (Uses):				
Transfers in	167,250	161,438	158,806	(2,632)
Transfers out	(300,000)	(340,501)	(334,067)	6,434
Net Financing Sources (Uses)	(132,750)	(179,063)	(175,261)	3,802
NET CHANGE IN FUND BALANCES	340,157	(3,942,379)	389,679	4,332,058
Fund Balance - Beginning	5,154,970	5,154,970	5,154,970	-
Fund Balance - Ending	\$ 5,495,127	\$ 1,212,591	\$ 5,544,649	\$ 4,332,058

¹ On behalf payments of \$1,408,215 are included in the actual revenues and expenditures for General Fund, but have not been included in the budget amounts.

SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED JUNE 30, 2006

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF EDUCATION			
Passed through California Department of Education (CDE):			
No Child Left Behind Act:			
Title I, Part A, Basic Grants	84.010	13797	\$ 767,624
Title I, Part C, Migrant Ed	84.011	13174	176,895
Title I, Part C, Migrant Ed Summer Program	84.011	10005	21,813
Title I, Even Start Migrant Ed (MEES)	84.214	10030	26,237
Title II, Part A, Teacher Quality	84.367	14341	231,939
Title II, Part D, Education Technology	84.318	14368	25,952
Title III, Limited English Proficiency Student Program	84.365	10084	164,165
Title IV, Part A, Drug-Free Schools	84.186	14347	37,446
Title V, Part A, Innovative Education Strategies	84.298A	14354	40,386
Title VI, Flexibility and Accountability	84.358	14359	6,506
Advanced Placement Test Fee	²	14504	578
Individuals with Disabilities Act: ¹			
Basic Local Assistance Entitlement, Part B	84.027	13379	1,481,328
Preschool Grants, Part B	84.173	13430	44,277
Preschool Local Entitlement, Part B	84.027A	13682	67,932
Local Staff Development Grant, Part B	84.027A	13613	3,288
Preschool Staff Development, Part B	84.173A	13431	384
Carl Perkins Act:			
Vocational and Applied Technology, Secondary	84.048	13577	50,879
Adult Education Act:			
Adult Basic Education	84.002A	13973	56,700
Priority 5, Adult Secondary Education	84.002A	13978	8,775
English Literacy & Civics Education	84.002A	14109	35,550
California Alternative Performance Assessment (CAPA)	²	14488	290
Subtotal			<u>3,248,944</u>

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - CONTINUED FOR THE YEAR ENDED JUNE 30, 2006

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Passed though CDE:

Child Development Act:

Quality Improvement Activities	93.575	13942	5,413
School-Age Child Care Resource Contracts	93.575	13941	5,650
Medi-Cal Billing Option	93.778	10013	10,722
Subtotal			<u>21,785</u>

U.S. DEPARTMENT OF AGRICULTURE

Passed though CDE:

Child Nutrition Act:

National School Lunch Program	10.555	13524	645,212
Especially Needy Breakfast	10.553	13526	181,516
Basic School Breakfast Program	10.553	13390	67,697
Subtotal			<u>894,425</u>

Total Expenditures of Federal Awards			<u><u>\$ 4,165,154</u></u>
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¹ Tested as a major program

² Catalog number not available

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF AVERAGE DAILY ATTENDANCE FOR THE YEAR ENDED JUNE 30, 2006

	Second Period Report	Annual Report
ELEMENTARY		
Kindergarten	586	587
First through third	1,829	1,830
Fourth through sixth	1,948	1,948
Seventh and eighth	1,212	1,211
Opportunity schools	7	7
Home and hospital	2	2
Special education	141	139
Total Elementary	5,725	5,724
SECONDARY		
Regular classes	2,445	2,463
Continuation education	95	91
Home and hospital	2	3
Special education	65	68
Total Secondary	2,607	2,625
Total K-12	8,332	8,349
CLASSES FOR ADULTS		
Concurrently enrolled	10	14
Not concurrently enrolled	166	174
Total Classes for Adults	176	188
Grand Total	8,508	8,537
		Hours of Attendance
SUMMER SCHOOL		
Elementary		83,077
High school		22,160
Total Hours		105,237

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF INSTRUCTIONAL TIME FOR THE YEAR ENDED JUNE 30, 2006

Grade Level	1982-83	1986-87	2005-2006	Number of Days	Status
	Actual Minutes	Minutes Requirement	Actual Minutes	Traditional Calendar	
Kindergarten	31,680	36,000	36,000	180	Complied
Grades 1 - 3	47,480	50,400	51,000	180	Complied
Grades 4 - 6	52,740	54,000	54,550	180	Complied
Grades 7 - 8	54,560	54,000	55,010	180	Complied
Grades 9 - 12	57,726	64,800	65,206	180	Complied

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF ANNUAL FINANCIAL AND BUDGET REPORT WITH AUDITED FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 2006

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

	General Fund	Cafeteria Fund
FUND BALANCE		
Balance, June 30, 2006, Unaudited Actuals	\$ 5,821,540	\$ 344,318
Increase in deposits	-	64,006
Increase in prepaid expenditures	101,000	-
Increase in accounts payable	(377,891)	-
Balance, June 30, 2006, Audited Financial Statement	<u>\$ 5,544,649</u>	<u>\$ 408,324</u>

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2006

	(Budget) 2007 ¹	2006	2005	2004
GENERAL FUND				
Revenues	\$ 65,619,436	\$ 64,194,647	\$ 56,022,853	\$ 54,821,800
Other sources	193,955	158,806	136,957	-
Total Revenues and Other Sources	65,813,391	64,353,453	56,159,810	54,821,800
Expenditures	64,306,243	63,629,707	54,631,572	53,176,841
Other uses and transfers out	310,000	334,067	327,861	655,345
Total Expenditures and Other Uses	64,616,243	63,963,774	54,959,433	53,832,186
INCREASE (DECREASE) IN FUND BALANCE	\$ 1,197,148	\$ 389,679	\$ 1,200,377	\$ 989,614
ENDING FUND BALANCE	\$ 6,741,797	\$ 5,544,649	\$ 5,154,970	\$ 3,954,593
AVAILABLE RESERVES ²	\$ 3,255,918	\$ 2,773,379	\$ 3,309,098	\$ 3,536,756
AVAILABLE RESERVES AS A PERCENTAGE OF TOTAL OUTGO ³	5.04%	4.43%	6.02%	6.57%
LONG-TERM DEBT	\$ 70,478,225	\$ 71,833,225	\$ 72,607,678	\$ 73,181,752
K-12 AVERAGE DAILY ATTENDANCE AT P-2	8,361	8,332	8,207	8,061

The General Fund balance has increased by \$1,590,056, over the past two years. The fiscal year 2006-2007 budget projects a further increase of \$1,197,148 (21 percent). For a district this size, the State recommends available reserves of at least 3 percent of total General Fund expenditures, transfers out, and other uses (total outgo).

The District has incurred operating surpluses in the past three years and anticipates incurring an operating surplus during the 2006-2007 fiscal year. Total long-term obligations have decreased by \$1,348,527 over the past two years.

Average daily attendance has increased by 271 over the past two years. Additional growth of 29 ADA is anticipated during fiscal year 2006-2007.

¹ Budget 2007 is included for analytical purposes only and has not been subjected to audit.

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

³ On-behalf payments of \$1,408,215 have been excluded from the calculation of the available reserves percentage for fiscal year ending June 30, 2006.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF CHARTER SCHOOLS
FOR THE YEAR ENDED JUNE 30, 2006**

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

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION

JUNE 30, 2006

NOTE 1 - PURPOSE OF SCHEDULES

Schedule of Expenditures of Federal Awards

The accompanying schedule of expenditures of Federal awards includes the Federal grant activity of the District and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of the United States Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Schedule of Average Daily Attendance (ADA)

Average daily attendance (ADA) is a measurement of the number of pupils attending classes of the District. The purpose of attendance accounting from a fiscal standpoint is to provide the basis on which apportionments of State funds are made to school districts. This schedule provides information regarding the attendance of students at various grade levels and in different programs.

Schedule of Instructional Time

The District has received incentive funding for increasing instructional time as provided by the Incentives for Longer Instructional Day. This schedule presents information on the amount of instructional time offered by the District and whether the District complied with the provisions of Education Code Sections 46200 through 46206.

Districts must maintain their instructional minutes at either the 1982-83 actual minutes or the 1986-87 requirement, whichever is greater, as required by Education Code Section 46201.

Reconciliation of Annual Financial and Budget Report with Audited Financial Statements

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

Schedule of Financial Trends and Analysis

This schedule discloses the District's financial trends by displaying past years' data along with current year budget information. These financial trend disclosures are used to evaluate the District's ability to continue as a going concern for a reasonable period of time.

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SUPPLEMENTARY INFORMATION - UNAUDITED

MORGAN HILL UNIFIED SCHOOL DISTRICT

**NON-MAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET - UNAUDITED
JUNE 30, 2006**

	Adult Education Fund	Child Development Fund	Cafeteria Fund
ASSETS			
Deposits and investments	\$ 272,695	\$ 66,649	\$ 223,053
Receivables	88,250	27,868	321,307
Stores inventories	-	-	18,592
Total Assets	\$ 360,945	\$ 94,517	\$ 562,952
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 28,146	\$ 78,866	\$ 32,579
Due to other funds	24,197	15,651	122,049
Deferred revenue	80,046	-	-
Total Liabilities	132,389	94,517	154,628
Fund Balances:			
Reserved for:			
Stores inventories	-	-	18,592
Other reservations	5,000	-	1,000
Unreserved:			
Designated	18,771	-	67,084
Undesignated, reported in:			
Special revenue funds	204,785	-	321,648
Total Fund Balance	228,556	-	408,324
Total Liabilities and Fund Balances	\$ 360,945	\$ 94,517	\$ 562,952

See accompanying note to supplementary information - unaudited.

Deferred Maintenance Fund	Special Reserve Non-Capital Fund	Mello Roos Fund	Total Non-Major Governmental Funds
\$ 883,050	\$ 1,288,842	\$ 187,617	\$ 2,921,906
10,187	14,358	5,227	467,197
-	-	-	18,592
<u>\$ 893,237</u>	<u>\$ 1,303,200</u>	<u>\$ 192,844</u>	<u>\$ 3,407,695</u>
\$ 3,095	\$ -	\$ -	\$ 142,686
308	-	192,844	355,049
-	-	-	80,046
<u>3,403</u>	<u>-</u>	<u>192,844</u>	<u>577,781</u>
-	-	-	18,592
-	-	-	6,000
-	646,000	-	731,855
889,834	657,200	-	2,073,467
889,834	1,303,200	-	2,829,914
<u>\$ 893,237</u>	<u>\$ 1,303,200</u>	<u>\$ 192,844</u>	<u>\$ 3,407,695</u>

MORGAN HILL UNIFIED SCHOOL DISTRICT

NON-MAJOR GOVERNMENTAL FUNDS COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - UNAUDITED FOR THE YEAR ENDED JUNE 30, 2006

	Adult Education Fund	Child Development Fund	Cafeteria Fund
REVENUES			
Revenue limit sources	\$ 411,441	\$ -	\$ -
Federal sources	103,942	11,063	894,424
Other state sources	66,977	511,907	60,929
Other local sources	64,179	5,692	1,287,141
Total Revenues	646,539	528,662	2,242,494
EXPENDITURES			
Current			
Instruction	323,787	494,325	-
Instruction-related activities:			
School site administration	271,193	-	-
Pupil services:			
Food services	-	-	2,129,341
General administration:			
All other general administration	23,943	34,337	106,781
Plant services	18,298	-	-
Total Expenditures	637,221	528,662	2,236,122
Excess (Deficiency) of			
Revenues Over Expenditures	9,318	-	6,372
Other Financing Sources (Uses):			
Transfers in	-	-	-
Transfers out	-	-	-
Net Financing Sources (Uses)	-	-	-
NET CHANGE IN FUND BALANCES	9,318	-	6,372
Fund Balance - Beginning	219,238	-	401,952
Fund Balance - Ending	\$ 228,556	\$ -	\$ 408,324

See accompanying note to supplementary information – unaudited.

Deferred Maintenance Fund	Special Reserve Non-Capital Fund	Mello Roos Fund	Total Non-Major Governmental Funds
\$ -	\$ -	\$ -	\$ 411,441
-	-	-	1,009,429
334,067	-	-	973,880
24,475	48,033	872,979	2,302,499
358,542	48,033	872,979	4,697,249
-	-	-	818,112
-	-	-	271,193
-	-	-	2,129,341
-	-	-	165,061
504,074	-	3,717	526,089
504,074	-	3,717	3,909,796
(145,532)	48,033	869,262	787,453
334,067	-	-	334,067
-	-	(869,262)	(869,262)
334,067	-	(869,262)	(535,195)
188,535	48,033	-	252,258
701,299	1,255,167	-	2,577,656
\$ 889,834	\$ 1,303,200	\$ -	\$ 2,829,914

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION - UNAUDITED JUNE 30, 2006

NOTE 1 - PURPOSE OF SCHEDULES

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

The Non-Major Governmental Funds Combining Balance Sheet and Combining Statement of Revenues, Expenditures and Changes in Fund Balance is included to provide information regarding the individual funds that have been included in the Non-Major Governmental Funds column on the Governmental Funds Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balance.

INDEPENDENT AUDITORS' REPORTS

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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Morgan Hill Unified School District as of and for the year ended June 30, 2006, which collectively comprise the Morgan Hill Unified School District's basic financial statements and have issued our report thereon dated October 20, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Morgan Hill Unified School District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Morgan Hill Unified School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Vasinek Trine Day + Co. LLP

Palo Alto, California
October 20, 2006



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

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

Compliance

We have audited the compliance of Morgan Hill Unified School District with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major Federal programs for the year ended June 30, 2006. Morgan Hill Unified School District's major Federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major Federal programs is the responsibility of Morgan Hill Unified School District's management. Our responsibility is to express an opinion on Morgan Hill Unified School District's compliance based on our audit.

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

In our opinion, Morgan Hill Unified School District complied, in all material respects, with the requirements referred to above that are applicable to each of its major Federal programs for the year ended June 30, 2006.

Internal Control Over Compliance

The management of Morgan Hill Unified School District is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to Federal programs. In planning and performing our audit, we considered Morgan Hill Unified School District's internal control over compliance with 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 the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud 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 control over compliance and its operation that we consider to be material weaknesses.

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

Vasnick Time Day + Co. LLP

Palo Alto, California
October 20, 2006



INDEPENDENT AUDITORS' REPORT ON STATE COMPLIANCE

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Morgan Hill Unified School District as of and for the year ended June 30, 2006, and have issued our report thereon dated October 20, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *Standards and Procedures for Audits of California K-12 Local Educational Agencies 2005-06*, issued by the California Education Audit Appeals Panel as regulations. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

Compliance with the requirements of laws, regulations, contracts, and grants listed below is the responsibility of Morgan Hill Unified School District's management. In connection with the audit referred to above, we selected and tested transactions and records to determine the Morgan Hill Unified School District's compliance with the State laws and regulations applicable to the following items:

	Procedures in Audit Guide	Procedures Performed
Attendance Accounting:		
Attendance reporting	8	Yes
Kindergarten continuance	3	Yes
Independent study	22	Yes
Continuation education	10	Yes
Adult education	9	Yes
Regional occupational centers and programs	6	Not Applicable
Instructional Time:		
School districts	4	Yes
County offices of education	3	Not Applicable
Community Day Schools	9	Not Applicable
Morgan-Hart Class Size Reduction	7	Not Applicable

	<u>Procedures in Audit Guide</u>	<u>Procedures Performed</u>
Instructional Materials:		
General requirements	12	Yes
K-8 only	1	Yes
9-12 only	1	Yes
Ratios of Administrative Employees to Teachers	1	Yes
Early Retirement Incentive	4	Not Applicable
Gann Limit Calculation	1	Yes
School Construction Funds:		
School District bonds	3	Yes
State school facilities funds	1	Yes
Alternative Pension Plans	2	Not Applicable
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)		Not Applicable
Program	3	
School Accountability Report Card	3	Yes
Class Size Reduction Program:		
General requirements	7	Yes
Option one classes	3	Yes
Option two classes	4	Not Applicable
District or charter schools with only one school serving K-3	4	Not Applicable
Charter Schools:		
Contemporaneous records of attendance	1	Not Applicable
Non classroom-based instruction/independent study	15	Not Applicable
Additional Non classroom-based instruction	1	Not Applicable
Determination of funding for non classroom-based instruction	3	Not Applicable
Annual instruction minutes classroom based	3	Not Applicable

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. Further, based on our audit, for items not tested, nothing came to our attention to indicate that the Morgan Hill Unified School District had not complied with the laws and regulations. Our audit does not provide a legal determination on Morgan Hill Unified School District's compliance with the State laws and regulations referred to above.

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

Vannink Time Day + Co. LLP

Palo Alto, California
October 20, 2006

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

SUMMARY OF AUDITORS' RESULTS FOR THE YEAR ENDED JUNE 30, 2006

Unqualified

No

None reported

No

No

None reported

Unqualified

No

Special Education (PL94-142)

\$ 300,000

Yes

No

None reported

Unqualified

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FINANCIAL STATEMENT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2006**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FEDERAL AWARD FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2006**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**STATE AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2006**

None Reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2006**

None Reported.