

**MORGAN HILL UNIFIED
SCHOOL DISTRICT**

ANNUAL FINANCIAL REPORT

JUNE 30, 2007

MORGAN HILL UNIFIED SCHOOL DISTRICT
OF SANTA CLARA COUNTY
MORGAN HILL, CALIFORNIA
JUNE 30, 2007

GOVERNING BOARD

| <u>MEMBER</u> | <u>OFFICE</u> | <u>TERM EXPIRES</u> |
|--------------------|----------------|---------------------|
| Peter Mendel | President | 2008 |
| Kathleen Sullivan | Vice President | 2008 |
| Don Moody | Member | 2010 |
| Michael J. Hickey. | Member | 2010 |
| Julia Hover-Smoot | Member | 2008 |
| Shelle Thomas | Member | 2010 |
| Bart Fisher | Member | 2010 |

ADMINISTRATION

| | |
|-------------------|-----------------------|
| Alan K. Nishino | Superintendent |
| Bonnie Tognazzini | Deputy Superintendent |

MORGAN HILL UNIFIED SCHOOL DISTRICT

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FINANCIAL SECTION



INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Morgan Hill Unified School District (the "District") as of and for the year ended June 30, 2007, 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 2006-07* 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, 2007, 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 January 18, 2008, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The required supplementary information, such as management's discussion and analysis on pages 3 through 13 and budgetary comparison information on page 43, is not a required part of the basic financial statements, but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

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

Vasinek Time Day + Co. LLP

Palo Alto, California
January 18, 2008

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2007

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, 2007. 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 Auditors' 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 have increased. For 2004-05 to 2005-06, ADA increased by 125, or 1.5%. For 2005-06 to 2006-07, ADA increased by 136 or 1.63%.

The increase in general fund revenue reflects the increase in ADA, a 5.92% Cost of Living Adjustment (COLA) and the reduction in the deficit factor resulted in additional revenue limit resources of almost \$3.9 million or 8% increase over 2005-06. Total general fund revenue increased by \$9.5 million or 12.9%, excluding the "on-behalf" STRS payment of \$1.5 million. The increase in the total general fund revenue reflects increases in restricted resources due to increased funding due to COLA, funding for new state programs and one-time funding and spending more carryover funds compared to prior periods.

The general fund expenditures increased compared to prior year due to the increased funding and utilizing carryover funds. With the increased funding, our expenditures increased in the general fund by approximately \$6.8 million. Instructional and instructional related expenditures increased by \$3.9 million or 8.8%. The District's expenditures for pupil services, general administration, maintenance supplies and other outlay increased by approximately \$2.9 million, or 15.2% compared to 2005-06.

At year end, the District's general fund was able to increase its fund balance to \$8.6 million, an increase of \$3,078,336, a 55.5% increase, over the prior year.

The government-wide revenue reflected on the Statement of Activities decreased from \$90.2 million for 2005-06 to \$89.1 million for 2006-07, a decrease of \$1.08 million, or 1.2% decrease. This decrease reflects reductions in capital project funding and contributions that were used to purchase buses.

The government-wide expenses reflected on the Statement of Activities increased from \$73.0 million for 2005-06 to \$79.9 million for 2006-07, an increase of \$6.9 million, an increase of 9.6% over the prior year.

The district-wide net assets increased to \$131.0 million, an increase of \$9.2 million or 7.5% compared to 2005-06.

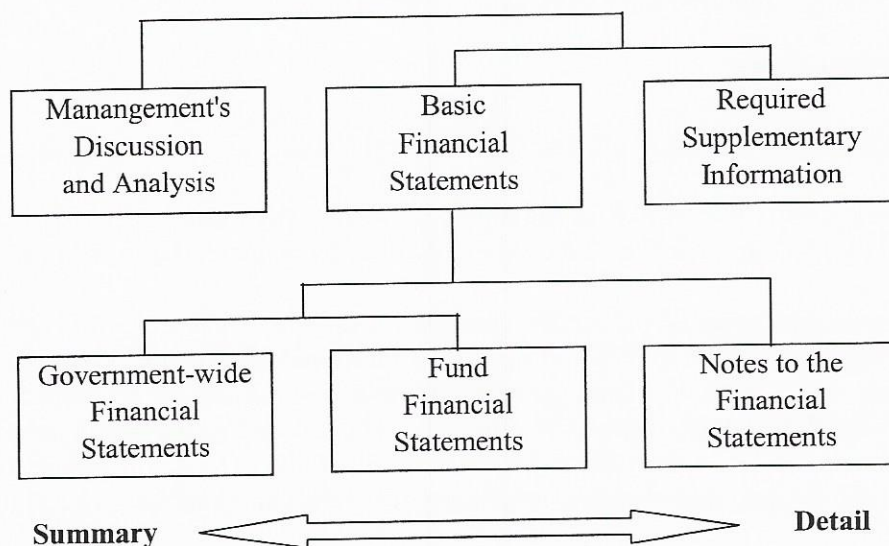
MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2007

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Components of the Financial Section



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

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2007

REPORTING THE DISTRICT AS A WHOLE

The Statement of Net Assets and the Statement of Activities

These two statements provide information about the District as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all the District's assets and liabilities using the accrual basis of accounting. This basis of accounting takes into account all of the current year's revenues and expenses regardless of when cash is received or paid. These statements report information on the district as a whole and its activities in a way that helps answer the question, "How did we do financially during 2006-07?"

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

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2007

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

◆ Fiduciary Funds

The District is the trustee, or fiduciary, for its student activity funds and scholarship funds. All of the District's fiduciary activities are reported in separate Statements of Fiduciary Net Assets. We exclude these activities from the District's other financial statements because the District cannot use these assets to finance its operations. The District is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2007

FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS

The School District as a Whole

The District's net assets were \$121.9 million at June 30, 2006. Of this amount \$4.2 million was unrestricted. For the period ending June 30, 2007, the District's net assets increased to \$131 million, or a 7.5% increase. Of this amount \$5.9 million was unrestricted.

(Table 1)
Comparative Statement of Net Assets

| | Governmental Activities | |
|---|-------------------------|-----------------------|
| | 2007 | 2006 |
| Deposits and investments | \$ 38,592,650 | \$ 26,085,639 |
| Receivables | 5,511,051 | 2,883,604 |
| Prepaid expenses | 2,194,557 | 772,272 |
| Stores inventory | 144,346 | 157,186 |
| Capital assets | 174,516,532 | 169,385,052 |
| Total Assets | 220,959,136 | 199,283,753 |
| Accounts payable and other current liabilities | 4,673,310 | 3,963,947 |
| Deferred revenue | 2,251,678 | 1,621,284 |
| Long-term liabilities | 83,007,569 | 71,833,225 |
| Total Liabilities | 89,932,557 | 77,418,456 |
| Net assets | | |
| Invested in capital assets, net of related debt | 112,116,549 | 108,688,148 |
| Restricted | 13,048,544 | 8,970,214 |
| Unrestricted | 5,861,486 | 4,206,935 |
| Total Net Assets | \$ 131,026,579 | \$ 121,865,297 |

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2007

The District's net asset position increased by \$9.2 million for this fiscal year (See Table 1). The District's expenses for instruction and pupil services represented 74 percent of total expenses. The purely administrative activities of the District account for just 6 percent of total costs. The remaining 20 percent was spent in the areas of plant services and other expenses, i.e., interest on long-term obligations, depreciation of capital assets and other outgo.

(Table 2)
Comparative Statement of Change in Net Assets

| | Governmental Activities | |
|---|-------------------------|----------------------|
| | 2007 | 2006 |
| Revenues | | |
| Program revenues: | \$ 19,694,810 | \$ 29,236,736 |
| General revenues: | | |
| Taxes levied for general purposes | 38,085,638 | 38,994,271 |
| Taxes levied for debt service | 6,897,072 | 4,668,278 |
| Taxes levied for other specific purpose | 1,303,125 | 863,162 |
| Federal and State Aid not restricted to specific purposes | 15,678,115 | 9,906,638 |
| Interest and investment earnings | 931,620 | 432,416 |
| Miscellaneous | 6,555,876 | 6,127,179 |
| Total Revenues | 89,146,256 | 90,228,680 |
| Expenses | | |
| Instruction | 43,177,798 | 40,627,500 |
| Instruction related services | 8,201,434 | 7,729,720 |
| Pupil support services | 7,882,612 | 7,354,640 |
| General administration | 4,736,120 | 4,299,197 |
| Plant services | 7,115,000 | 4,470,660 |
| Other | 8,872,010 | 8,526,635 |
| Total Expenses | 79,984,974 | 73,008,352 |
| Increase In Net Assets | \$ 9,161,282 | \$ 17,220,328 |

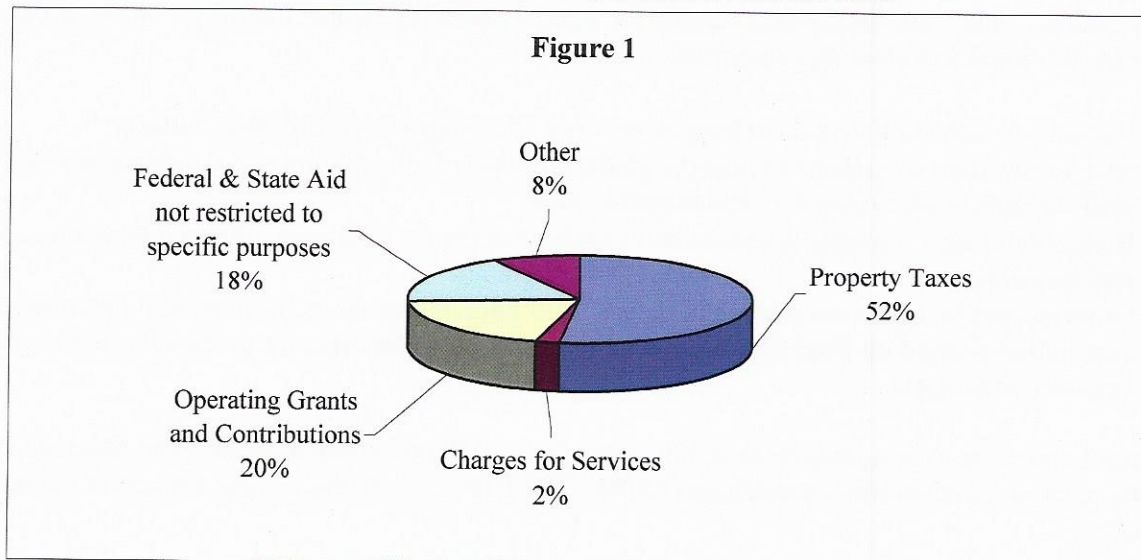
MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2007

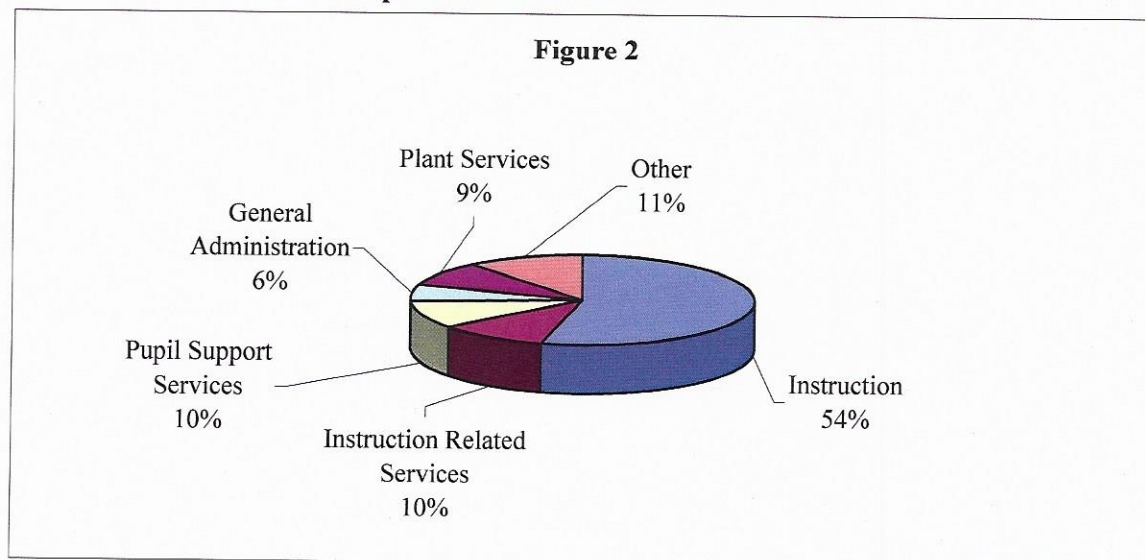
Governmental Activities

As reported in the Statement of Activities, the cost of all the District's governmental activities this year was \$79 million. The amount that our local taxpayers financed for these activities through property taxes was \$46.2 million. Federal and State aid not restricted to specific purposes total \$15.6 million. State and Federal Categorical program revenues which include charges for services and sales of \$1.9 million and operating grants and contributions of \$17.7 million totaling over \$19.6 million, or 22% of the revenue of the entire District (See Figure 1).

Sources of Revenue for the 2006-07 Fiscal Year



Expenses for the Fiscal Year 2006-07



MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2007

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 \$39.2 million, an increase of \$13.7 million from the previous fiscal year. This increase is mainly reflected in the Building Fund and Capital Facilities Fund. The General Fund balance increased \$3,078,336.

General Fund Budgetary Highlights

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

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

The District ended the year adding \$3,078,336 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 6.42%.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2007

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

By the end of the 2006-07 fiscal year, the District had invested \$214 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 \$174 million at June 30, 2007, which is an increase of \$5 million from the previous year due to acquisitions totaling \$7 million and depreciation expense of \$2 million.

Table 3

| Comparative Schedule of Capital Assets (net of depreciation) June 30, 2007 and 2006 | | | | |
|---|-----------------------|-----------------------|---------------------|-------------------|
| | 2007 | 2006 | Difference | Percent Change |
| Land | \$ 724,021 | \$ 724,021 | \$ - | 0.0% |
| Buildings and improvements | 74,084,913 | 76,357,457 | (2,272,544) | -3.0% |
| Machinery & Equipment | 3,376,396 | 2,318,008 | 1,058,388 | 45.7% |
| Work in Progress | 96,331,202 | 89,985,566 | 6,345,636 | 7.1% |
| Totals | \$ 174,516,532 | \$ 169,385,052 | \$ 5,131,480 | 3.0% |

Long-Term Obligations

As June 30, 2007, the District has \$83 million in long-term obligations outstanding.

Table 4

| Comparative Schedule of Outstanding Debt June 30, 2007 and 2006 | | |
|--|----------------------|----------------------|
| | 2007 | 2006 |
| General obligation bonds | \$ 82,663,477 | \$ 71,488,366 |
| Compensated absences | 344,092 | 344,859 |
| Totals | \$ 83,007,569 | \$ 71,833,225 |

The long-term obligations paid by the District were \$1,355,000.

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2007

FACTORS BEARING ON THE DISTRICT'S FUTURE

Under the leadership of superintendent, Dr. Alan Nishino, Morgan Hill Unified School District has focused on improving our students' test scores and enhancing our ability to identify those students to meet their individual needs. The Morgan Hill Unified School District has set the following goals:

- Student Achievement, 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 originally issued in 2002 and 2003. The result of this refinancing was an additional \$10 million to 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.

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 55 for a specified period of no more than 5 years. Currently a total of 134 employees meet these eligibility requirements. During the year, expenditures of \$455,178 were recognized for retirees' health care benefits. The District will review the implementation of Governmental Accounting Standards Board (GASB) 45 and the impact of reporting the costs of providing post-employment benefits to our staff.

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

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2007

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, 2007

| | Governmental Activities |
|---|------------------------------------|
| ASSETS | |
| Deposits and investments | \$ 38,592,650 |
| Receivables | 5,511,051 |
| Prepaid expenses | 734,756 |
| Deferred charges | 1,459,801 |
| Stores inventories | 144,346 |
| Capital assets not depreciated | 97,055,223 |
| Capital assets, net of accumulated depreciation | 77,461,309 |
| Total Assets | 229,959,136 |
| LIABILITIES | |
| Accounts payable | 3,410,025 |
| Interest payable | 1,263,285 |
| Deferred revenue | 2,251,678 |
| Current portion of long-term obligations | 4,188,607 |
| Noncurrent portion of long-term obligations | 78,818,962 |
| Total Liabilities | 89,932,557 |
| NET ASSETS | |
| Invested in capital assets, net of related debt | 112,116,549 |
| Restricted for: | |
| Legally restricted | 5,400,905 |
| Debt service | 4,493,550 |
| Capital projects | 1,723,019 |
| Special revenue | 1,431,070 |
| Unrestricted | 5,861,486 |
| Total Net Assets | \$ 131,026,579 |

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, 2007

| Functions/Programs | Expenses | Program Revenues | | Net (Expenses) Revenues and Changes in Net Assets |
|---|----------------------|--------------------------------------|--|--|
| | | Charges for Services and Sales | Operating Grants and Contributions | |
| Governmental Activities: | | | | |
| Instruction | \$ 43,177,798 | \$ 39,616 | \$ 9,024,252 | \$ (34,113,930) |
| Instruction-related activities: | | | | |
| Supervision of instruction | 1,752,754 | 37,593 | 1,028,430 | (686,731) |
| Instructional library and technology | 542,847 | 3,469 | 492,053 | (47,325) |
| School site administration | 5,905,833 | 23,433 | 594,398 | (5,288,002) |
| Pupil services: | | | | |
| Home-to-school transportation | 3,064,753 | 290,157 | 1,720,105 | (1,054,491) |
| Food services | 2,336,013 | 1,092,477 | 1,168,458 | (75,078) |
| All other pupil services | 2,481,846 | - | 959,012 | (1,522,834) |
| General administration: | | | | |
| Data processing | 748,441 | - | - | (748,441) |
| All other general administration | 3,987,679 | 76,108 | 978,246 | (2,933,325) |
| Plant services | 7,115,000 | 353,721 | 544,832 | (6,216,447) |
| Ancillary services | 513,685 | - | - | (513,685) |
| Community services | 33,531 | - | - | (33,531) |
| Interest on long-term obligations | 3,605,167 | - | - | (3,605,167) |
| Other outgo | 4,719,627 | 39,419 | 1,229,031 | (3,451,177) |
| Total Governmental-Type Activities | \$ 79,984,974 | \$ 1,955,993 | \$ 17,738,817 | (60,290,164) |
| General revenues and subventions: | | | | |
| Property taxes, levied for general purposes | | | | 38,085,638 |
| Property taxes, levied for debt service | | | | 6,897,072 |
| Taxes levied for other specific purposes | | | | 1,303,125 |
| Federal and State aid not restricted to specific purposes | | | | 15,678,115 |
| Interest and investment earnings | | | | 931,620 |
| Miscellaneous | | | | 6,555,876 |
| Subtotal, General Revenues | | | | 69,451,446 |
| Change in Net Assets | | | | 9,161,282 |
| Net Assets - Beginning | | | | 121,865,297 |
| Net Assets - Ending | | | | \$ 131,026,579 |

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

GOVERNMENTAL FUNDS BALANCE SHEET JUNE 30, 2007

| | General Fund | Building Fund | Bond Interest and Redemption Fund |
|--|----------------------|----------------------|---|
| ASSETS | | | |
| Deposits and investments | \$ 8,075,685 | \$ 20,177,457 | \$ 5,722,947 |
| Receivables | 4,595,072 | 247,130 | 33,888 |
| Due from other funds | 282,131 | 2,399 | - |
| Prepaid expenses | 734,756 | - | - |
| Stores inventories | 137,260 | - | - |
| Total Assets | \$ 13,824,904 | \$ 20,426,986 | \$ 5,756,835 |
| LIABILITIES AND FUND BALANCES | | | |
| Liabilities: | | | |
| Accounts payable | \$ 3,012,901 | \$ 161,844 | \$ - |
| Due to other funds | 13,904 | 1,648 | - |
| Deferred revenue | 2,175,114 | - | - |
| Total Liabilities | 5,201,919 | 163,492 | - |
| Fund Balances: | | | |
| Reserved for: | | | |
| Legally restricted programs | 3,054,588 | - | - |
| Other reservations | 886,516 | - | - |
| Unreserved: | | | |
| Designated | 3,679,444 | - | - |
| Undesignated, reported in: | | | |
| General fund | 1,002,437 | - | - |
| Special revenue funds | - | - | - |
| Debt service funds | - | - | 5,756,835 |
| Capital projects funds | - | 20,263,494 | - |
| Total Fund Balance | 8,622,985 | 20,263,494 | 5,756,835 |
| Total Liabilities and Fund Balances | \$ 13,824,904 | \$ 20,426,986 | \$ 5,756,835 |

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

| Non Major Governmental Funds | Total Governmental Funds |
|---|---|
| \$ 4,616,561 | \$ 38,592,650 |
| 478,981 | 5,355,071 |
| 15,552 | 300,082 |
| - | 734,756 |
| 7,086 | 144,346 |
| <u>\$ 5,118,180</u> | <u>\$ 45,126,905</u> |

| | |
|----------------|------------------|
| \$ 235,280 | \$ 3,410,025 |
| 284,530 | 300,082 |
| 76,564 | 2,251,678 |
| <u>596,374</u> | <u>5,961,785</u> |

| | |
|---------------------|----------------------|
| - | 3,054,588 |
| 24,592 | 911,108 |
| 646,000 | 4,325,444 |
| - | 1,002,437 |
| 2,128,195 | 2,128,195 |
| - | 5,756,835 |
| 1,723,019 | 21,986,513 |
| <u>4,521,806</u> | <u>39,165,120</u> |
| <u>\$ 5,118,180</u> | <u>\$ 45,126,905</u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET ASSETS JUNE 30, 2007

Total Fund Balance - Governmental Funds \$ 39,165,120

**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

\$214,607,301

Accumulated depreciation is

(40,090,769)

Net Capital Assets

174,516,532

Expenditures relating to issuance of debt of next fiscal year were recognized on modified accrual basis, but are not recognized on the accrual basis.

1,459,801

In governmental funds, unmatured interest on long-term obligations is recognized in the period when it is due. On the government-wide statements, unmatured interest on long-term obligations is recognized when it is incurred.

(1,263,285)

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

155,980

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

76,954,040

Defeasance cost

(4,862,063)

Premium

9,705,350

Accreted interest on the bonds

866,150

Compensated absences (vacations)

344,092

Total Long-Term Liabilities

(83,007,569)

Total Net Assets - Governmental Activities

\$ 131,026,579

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, 2007

| | General Fund | Building Fund | Bond Interest and Redemption Fund |
|---|---------------------|----------------------|---|
| REVENUES | | | |
| Revenue limit sources | \$ 49,071,131 | \$ - | \$ - |
| Federal sources | 3,244,716 | - | - |
| Other State sources | 14,427,553 | - | 50,251 |
| Other local sources | 7,001,708 | 886,290 | 6,925,255 |
| Total Revenues | 73,745,108 | 886,290 | 6,975,506 |
| EXPENDITURES | | | |
| Current | | | |
| Instruction | 40,741,440 | - | - |
| Instruction-related activities: | | | |
| Supervision of instruction | 1,685,393 | - | - |
| Instructional library, media and technology | 521,985 | - | - |
| School site administration | 5,404,535 | - | - |
| Pupil services: | | | |
| Home-to-school transportation | 2,946,970 | - | - |
| Food services | - | - | - |
| All other pupil services | 2,386,465 | - | - |
| General administration: | | | |
| Data processing | 719,678 | - | - |
| All other general administration | 3,588,581 | - | - |
| Plant services | 7,192,174 | 2 | - |
| Facility acquisition and construction | 6,115 | 2,280,986 | - |
| Ancillary services | 493,943 | - | - |
| Community services | 32,242 | - | - |
| Other outgo | 4,719,627 | - | - |
| Debt service | | | |
| Principal | - | - | 1,355,000 |
| Interest and other | - | 1,581,451 | 3,059,917 |
| Total Expenditures | 70,439,148 | 3,862,439 | 4,414,917 |
| Excess (Deficiency) of | | | |
| Revenues Over Expenditures | 3,305,960 | (2,976,149) | 2,560,589 |
| Other Financing Sources (Uses): | | | |
| Transfers in | 108,735 | 441,938 | - |
| Other sources | - | 87,468,169 | - |
| Transfers out | (336,359) | - | - |
| Other uses | - | (75,461,926) | - |
| Net Financing Sources (Uses) | (227,624) | 12,448,181 | - |
| NET CHANGE IN FUND BALANCES | 3,078,336 | 9,472,032 | 2,560,589 |
| Fund Balance - Beginning | 5,544,649 | 10,791,462 | 3,196,246 |
| Fund Balance - Ending | \$ 8,622,985 | \$ 20,263,494 | \$ 5,756,835 |

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

| Nonmajor Governmental Funds | Total Governmental Funds |
|-----------------------------------|--------------------------------|
| \$ 668,056 | \$ 49,739,187 |
| 1,208,370 | 4,453,086 |
| 970,928 | 15,448,732 |
| 4,730,993 | 19,544,246 |
| <u>7,578,347</u> | <u>89,185,251</u> |
| 836,692 | 41,578,132 |
| - | 1,685,393 |
| - | 521,985 |
| 274,328 | 5,678,863 |
| - | 2,946,970 |
| 2,246,236 | 2,246,236 |
| - | 2,386,465 |
| - | 719,678 |
| 238,245 | 3,826,826 |
| 1,066,519 | 8,258,695 |
| 4,129,898 | 6,416,999 |
| - | 493,943 |
| - | 32,242 |
| - | 4,719,627 |
| - | 1,355,000 |
| - | 4,641,368 |
| <u>8,791,918</u> | <u>87,508,422</u> |
| <u>(1,213,571)</u> | <u>1,676,829</u> |
| 336,359 | 887,032 |
| - | 87,468,169 |
| (550,673) | (887,032) |
| - | (75,461,926) |
| <u>(214,314)</u> | <u>12,006,243</u> |
| <u>(1,427,885)</u> | <u>13,683,072</u> |
| 5,949,691 | 25,482,048 |
| <u>\$ 4,521,806</u> | <u>\$ 39,165,120</u> |

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, 2007

| | | |
|---|------------------|----------------------|
| Total Net Change in Fund Balances - Governmental Funds | | \$ 13,683,072 |
| 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 | \$ (2,418,752) | |
| Capital outlays | <u>7,560,694</u> | |
| Net Expense Adjustment | | 5,141,942 |
| Loss on disposal of capital assets is reported in the government-wide statement of net assets, but is not recorded in the governmental funds. | | (10,462) |
| In the statement of activities, certain operating expenses, such as compensated absences (vacations) are measured by the amounts earned during the year. In the governmental funds, however, expenditures for these items are measured by the amount of financial resources used (essentially, the amounts actually paid). Vacation used was more than the amounts earned by \$767. | | 767 |
| Proceeds received from sale of bonds is a revenue source in the governmental funds, but it increases long-term liabilities in the statement of net assets and does not affect the statement of activities. | | (87,468,169) |
| Amortization of issuance cost is not recorded in the governmental funds, but it is amortized over the life of the bond in the statement of activities. | | (121,650) |
| Amortization of premium on long-term liabilities is not recognized in the governmental funds. In the government-wide statements, it is deferred and amortized over the life of the related debt. | | 808,779 |
| Debt defeasance costs are not recognized in governmental funds but are amortized to operations in the statement of activities over the life of the refunding bonds. | | (405,172) |
| Accreted interest on capital appreciation bonds does not require the use of current financial resources, and thus is not recorded in the governmental funds. In the statement of activities, however, accreted interest expense is recognized in the entity-wide statements as an addition to long-term liabilities. | | (927,475) |
| 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 | | 1,355,000 |
| Defeased debt as a result of the refunding is an expenditure in governmental funds but is recorded as a reduction of long term debt in the statement of net assets and does not affect the statement of activities | | 75,461,926 |

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES TO THE GOVERNMENT-WIDE STATEMENT OF ACTIVITIES (CONTINUED) FOR THE YEAR ENDED JUNE 30, 2007

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.

100,268

Payment of issuance costs related to the refunding debt is an expenditure in the governmental funds, but such costs are deferred and amortized to operations in the government wide statement of activities over the life of the refunding debt.

1,581,451

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.

(38,995)

Change in Net Assets of Governmental Activities

\$ 9,161,282

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

FIDUCIARY FUNDS STATEMENT OF NET ASSETS JUNE 30, 2007

| | <u>Agency Funds</u> |
|--------------------------|-------------------------|
| ASSETS | |
| Deposits and investments | \$ 522,195 |
| Total Assets | <u>\$ 522,195</u> |
| LIABILITIES | |
| Due to student groups | \$ 522,195 |
| Total Liabilities | <u>\$ 522,195</u> |

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007

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, 2007

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, 2007

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, 2007

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

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

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

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

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

Cash and Cash Equivalents

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

Investments

Investments held at June 30, 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, 2007

Restricted Assets

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

Prepaid Expenditures

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

Stores Inventories

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

Capital Assets and Depreciation

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

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

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

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

Interfund Balances

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

Compensated Absences

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007

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

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

Accrued Liabilities and Long-Term Obligations

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

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

Fund Balance Reserves and Designations

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

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

Net Assets

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007

Interfund Activity

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures in the purchaser funds. Flows of cash or goods from one fund to another without a requirement for repayment are reported as interfund transfers. Interfund transfers are reported as other financing sources/uses in governmental funds. Repayments from funds responsible for particular expenditures to the funds that initially paid for them are not presented in the financial statements. Interfund transfers are eliminated in the governmental and business-type activities columns of the statement of activities, except for the net residual amounts transferred between governmental and business-type activities.

Estimates

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

Budgetary Data

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

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

Property Tax

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

New Accounting Pronouncements

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2007

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, 2007, are classified in the accompanying financial statements as follows:

| | |
|--------------------------------|----------------------|
| Governmental activities | \$ 38,592,650 |
| Fiduciary funds | 522,195 |
| Total Deposits and Investments | <u>\$ 39,114,845</u> |

Deposits and investments as of June 30, 2007, consist of the following:

| | |
|--------------------------------|----------------------|
| Cash on hand and in banks | \$ 591,302 |
| Investments | 38,523,543 |
| Total Deposits and Investments | <u>\$ 39,114,845</u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007

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, 2007

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, 2007 was \$38,394,795 and the weighted average maturity of the pool was 470 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, 2007.

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, 2007

NOTE 3 - RECEIVABLES

Receivables at June 30, 2007, consisted of intergovernmental grants, entitlements, interest and other local sources. All receivables are considered collectible in full.

| | General Fund | Building Fund | Bond Interest and Redemption Fund | Non-Major Governmental Funds | Total |
|---------------------|--------------------|-------------------|---|------------------------------------|---------------------|
| Federal Government | | | | | |
| Categorical aid | \$ 905,858 | \$ - | \$ - | \$ 234,421 | \$ 1,140,279 |
| State Government | | | | | |
| Apportionment | 1,298,397 | - | - | 158,201 | 1,456,598 |
| Categorical aid | 1,456,557 | - | - | 13,343 | 1,469,900 |
| Lottery | 587,140 | - | - | - | 587,140 |
| Local Government | | | | | |
| Interest | 254,400 | 246,130 | 33,888 | 67,669 | 602,087 |
| Other Local Sources | 92,720 | 1,000 | - | 5,347 | 99,067 |
| Total | <u>\$4,595,072</u> | <u>\$ 247,130</u> | <u>\$ 33,888</u> | <u>\$ 478,981</u> | <u>\$ 5,355,071</u> |

Long-term receivables of \$155,980 consist of the special education mandated settlement which will be received at a rate of approximately \$38,995 each year for the next four (4) years.

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2007, was as follows:

| | Balance July 1, 2006 | Additions | Deductions | Balance June 30, 2007 |
|--|-------------------------|---------------------|------------------|--------------------------|
| Governmental Activities | | | | |
| Capital Assets Not Being Depreciated: | | | | |
| Land | \$ 724,021 | \$ - | \$ - | \$ 724,021 |
| Construction in Progress | 89,985,566 | 6,345,636 | - | 96,331,202 |
| Total Capital Assets Not Being Depreciated | 90,709,587 | 6,345,636 | - | 97,055,223 |
| Capital Assets Being Depreciated: | | | | |
| Buildings and Improvements | 111,681,875 | - | - | 111,681,875 |
| Furniture and Equipment | 5,017,372 | 1,215,058 | 362,227 | 5,870,203 |
| Total Capital Assets Being Depreciated | 116,699,247 | 1,215,058 | 362,227 | 117,552,078 |
| Total Capital Assets | 207,408,834 | 7,560,694 | 362,227 | 214,607,301 |
| Less Accumulated Depreciation: | | | | |
| Buildings and Improvements | 35,324,418 | 2,272,544 | - | 37,596,962 |
| Furniture and Equipment | 2,699,364 | 146,208 | 351,765 | 2,493,807 |
| Total Accumulated Depreciation | 38,023,782 | 2,418,752 | 351,765 | 40,090,769 |
| Governmental Activities Capital Assets, Net | <u>\$ 169,385,052</u> | <u>\$ 5,141,942</u> | <u>\$ 10,462</u> | <u>\$ 174,516,532</u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2007

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

Governmental Activities

| | |
|--|---------------------|
| Instruction | \$ 1,600,433 |
| Supervision of instruction | 67,361 |
| Instructional library, media, and technology | 20,862 |
| School site administration | 226,970 |
| Home-to-school transportation | 117,783 |
| Food services | 89,777 |
| All other pupil services | 95,381 |
| Ancillary services | 19,742 |
| Community services | 1,289 |
| Data processing | 28,763 |
| All other general administration | 150,391 |
| Total Depreciation Expense All Activities | <u>\$ 2,418,752</u> |

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 | | | Total |
|------------------------------|-------------------|-----------------|------------------------|-------------------|
| | General Fund | Building Fund | Non-major Governmental | |
| General | \$ - | \$ - | \$ 13,904 | \$ 13,904 |
| Building | - | - | 1,648 | 1,648 |
| Non-Major Governmental funds | 282,131 | 2,399 | - | 284,530 |
| Total | <u>\$ 282,131</u> | <u>\$ 2,399</u> | <u>\$ 15,552</u> | <u>\$ 300,082</u> |

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2007

Operating Transfers

Interfund transfers for the year ended June 30, 2007, consisted of the following:

| Transfer Out | Transfer In | | | Total |
|------------------------------|-------------------|-------------------|-----------------------------|-------------------|
| | General Fund | Building Fund | Non-Major Governmental Fund | |
| General Fund | \$ - | \$ - | \$ 336,359 | \$ 336,359 |
| Non-Major Governmental funds | 108,735 | 441,938 | - | 550,673 |
| Total | <u>\$ 108,735</u> | <u>\$ 441,938</u> | <u>\$ 336,359</u> | <u>\$ 887,032</u> |

| | |
|---|-------------------|
| Capital Facility Fund transferred to General Fund for the administration support. | \$ 108,735 |
| General Fund transferred to Deferred Maintenance Fund for District match. | 336,359 |
| Mello-Roos Fund transferred to Building Fund for construction project costs. | 441,938 |
| Total | <u>\$ 887,032</u> |

NOTE 6 - ACCOUNTS PAYABLE

Accounts payable at June 30, 2007, consisted of the following:

| | General Fund | Building Fund | Non-Major Governmental Funds | Total |
|-----------------------|---------------------|-------------------|------------------------------|---------------------|
| Vendor payables | \$ 605,921 | \$ 159,843 | \$ 163,346 | \$ 929,110 |
| State apportionment | 824,283 | - | - | 824,283 |
| Salaries and benefits | 1,582,697 | 2,001 | 71,934 | 1,656,632 |
| Total | <u>\$ 3,012,901</u> | <u>\$ 161,844</u> | <u>\$ 235,280</u> | <u>\$ 3,410,025</u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2007

NOTE 7 - DEFERRED REVENUE

Deferred revenue at June 30, 2007, consists of the following:

| | General Fund | Non-Major Governmental Funds | Total |
|------------------------------|---------------------|------------------------------------|---------------------|
| Federal financial assistance | \$ 14,105 | \$ - | \$ 14,105 |
| State categorical aid | 267,980 | 76,564 | 344,544 |
| Other local | 1,893,029 | - | 1,893,029 |
| Total | <u>\$ 2,175,114</u> | <u>\$ 76,564</u> | <u>\$ 2,251,678</u> |

NOTE 8 - TAX AND REVENUE ANTICIPATION NOTES (TRANS)

On July 6, 2006, the District issued \$8,370,000 Tax and Revenue Anticipation Notes bearing interest at 3.5 percent. The notes were issued to supplement cash flows. Interest and principal were due and payable on July 6, 2007. By June 6, 2007, the District had paid 100 percent of principal and interest for the sole purpose of satisfying the notes. The District was not required to make any additional payments on the notes. Changes in the outstanding liability for the Tax and Revenue Anticipation Note are as follows:

| Issue Date | Rate | Maturity Date | Outstanding July 1, 2006 | Additions | Payments | Outstanding June 30, 2007 |
|------------|-------|---------------|-----------------------------|--------------|--------------|------------------------------|
| 7/6/2006 | 3.50% | 07/06/2007 | \$ - | \$ 8,370,000 | \$ 8,370,000 | \$ - |

NOTE 9 - LONG-TERM OBLIGATIONS

Summary

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

| | Balance July 1, 2006 | Additions | Deductions | Balance June 30, 2007 | Due in One Year |
|--|-------------------------|----------------------|----------------------|--------------------------|---------------------|
| General obligation bonds | \$ 69,862,754 | \$ 76,954,040 | \$ 69,862,754 | \$ 76,954,040 | \$ 3,785,000 |
| Defeasance cost | - | (5,267,235) | (405,172) | (4,862,063) | (405,172) |
| Premium | - | 10,514,129 | 808,779 | 9,705,350 | 808,779 |
| Accretions on general obligation bonds | 1,625,612 | 927,475 | 1,686,937 | 866,150 | - |
| Accumulated vacation - net | 344,859 | - | 767 | 344,092 | - |
| | <u>\$ 71,833,225</u> | <u>\$ 83,128,409</u> | <u>\$ 71,954,065</u> | <u>\$ 83,007,569</u> | <u>\$ 4,188,607</u> |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007

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, 2006 | Issued/ Accreted | Redeemed/ Defeased | Bonds Outstanding June 30, 2007 |
|----------------------|--------------------------|---------------|-----------------------|--------------------------------|----------------------|----------------------|---------------------------------|
| 2000 | 2025 | 4.6%-5.5% | \$ 38,000,000 | \$ 36,865,000 | \$ - | \$ 36,865,000 | \$ - |
| 2002 | 2020 | 3.5%-5.25% | 28,210,000 | 26,710,000 | - | 26,710,000 | - |
| 2002 | 2026 | 5.5%-5.6% | 6,287,754 | 7,913,366 | 61,325 | 7,974,691 | - |
| 2006 Refunding (CIB) | 2020 | 3.5%-4.24% | 68,180,000 | - | 68,180,000 | - | 68,180,000 |
| 2006 Refunding (CAB) | 2016 | 4.25%-4.42% | 8,774,040 | - | 9,640,190 | - | 9,640,190 |
| | | | <u>\$ 149,451,794</u> | <u>\$ 71,488,366</u> | <u>\$ 77,881,515</u> | <u>\$ 71,549,691</u> | <u>77,820,190</u> |
| | | | | | | Defeasance | (4,862,063) |
| | | | | | | Premium | 9,705,350 |
| | | | | | | | <u>\$ 82,663,477</u> |

Defeasance Bond Note Disclosure

On August 22, 2006, the District issued general obligation bonds of \$76,954,040 (par value) with interest rates ranging from 3.5% to 4.42% to advance refund the previously issued current interest bond series 2000, current interest series 2002, and capital appreciation bond series 2002 with interest rates ranging from 4.6%-5.5%, 3.5%-5.25% and 5.5%-5.6%, respectively. The current interest bonds of series 2000 and 2002 had outstanding balances of \$36,385,000 and \$25,835,000, respectively, and the capital appreciation bond of series 2002 had an aggregate accreted value of \$7,974,691 as of August 22, 2006. The new refunding bonds were issued at a premium of \$10,514,129; and, after paying issuance costs of \$1,581,451, the net proceeds were \$85,886,718. Of the total proceeds, \$75,461,926 was deposited in an irrevocable trust with an escrow agent to provide debt service payments until the defeased debt matured and the remaining amount of \$10,424,792 was deposited in the building fund.

As a result of the advance refunding, the District reduced its total debt service requirement by \$1,159,262, which resulted in an economic gain (difference between the present value of the debt service payments on the old and new debt) of \$1,672,633.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2007

Debt Service Requirements to Maturity

The bonds mature through 2022 as follows:

| Fiscal Year | Principal | Interest to Maturity | Total |
|-------------------|----------------------|-------------------------|-----------------------|
| 2008 | \$ 3,785,000 | \$ 3,031,884 | \$ 6,816,884 |
| 2009 | 3,660,000 | 3,068,300 | 6,728,300 |
| 2010 | 4,140,000 | 2,921,900 | 7,061,900 |
| 2011 | 4,660,000 | 2,756,300 | 7,416,300 |
| 2012 | 5,215,000 | 2,569,900 | 7,784,900 |
| 2013-2017 | 21,209,040 | 23,968,210 | 45,177,250 |
| 2018-2022 | 34,285,000 | 3,956,450 | 38,241,450 |
| Total | <u>76,954,040</u> | <u>\$42,272,944</u> | <u>\$ 119,226,984</u> |
| Accretion to Date | 866,150 | | |
| | <u>\$ 77,820,190</u> | | |

Accumulated Unpaid Employee Vacation

The long-term portion of accumulated unpaid employee vacation for the District at June 30, 2007, amounted to \$344,092.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2007

NOTE 10 - FUND BALANCES

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

| | General Fund | Building Fund | Bond Interest and Redemption Fund | Non-Major Governmental Funds | Total |
|------------------------|-----------------|------------------|---|------------------------------------|---------------|
| Reserved | | | | | |
| Revolving cash | \$ 14,500 | \$ - | \$ - | \$ 6,000 | \$ 20,500 |
| Stores inventory | 137,260 | - | - | 18,592 | 155,852 |
| Prepaid expenditures | 734,756 | - | - | - | 734,756 |
| Restricted programs | 3,054,588 | - | - | - | 3,054,588 |
| Total Reserved | 3,941,104 | - | - | 24,592 | 3,965,696 |
| Unreserved | | | | | |
| Designated | | | | | |
| Economic uncertainties | 2,078,146 | - | - | - | 2,078,146 |
| Other designation | 1,601,298 | - | - | 646,000 | 2,247,298 |
| Total Designated | 3,679,444 | - | - | 646,000 | 4,325,444 |
| Undesignated | 1,002,437 | 20,263,494 | 5,756,835 | 3,851,214 | 30,873,980 |
| Total Unreserved | 4,681,881 | 20,263,494 | 5,756,835 | 4,497,214 | 35,199,424 |
| Total | \$ 8,622,985 | \$ 20,263,494 | \$ 5,756,835 | \$ 4,521,806 | \$ 39,165,120 |

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 134 employees meet these eligibility requirements. During the year, expenditures of \$455,178 were recognized for retiree's health care benefits.

The approximate accumulated future liability for the District at June 30, 2007, amounts to \$2,001,706. 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, 2007, multiplied by the number of years of payments remaining.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2007

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.

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, 2007, 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 2007, 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 |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007

Employee Medical Benefits

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

NOTE 13 - EMPLOYEE RETIREMENT SYSTEMS

Qualified employees are covered under multiple-employer contributory retirement plans maintained by agencies of the State of California. Certificated employees are members of the 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 2006-2007 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, 2007, 2006, and 2005, were \$2,803,223, \$2,632,560, and \$2,586,316, 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, 2007

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 2006-2007 was 9.124 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, 2007, 2006, and 2005, were \$842,235, \$760,982, and \$759,441, 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 \$1,534,812 (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 \$1,503,962, \$11,358 and \$19,492, respectively. No contributions were made for PERS for the year ended June 30, 2007. 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, 2007.

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, 2007.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2007

Construction Commitments

As of June 30, 2007, the District had the following commitments with respect to the unfinished capital projects:

| Capital Project | Remaining Construction Commitment | Expected Date of Completion |
|-------------------------------|---|-----------------------------------|
| Sobrato High School | \$ 84,693,145 | 2007-2008 |
| LOHS Renovation | 2,817,114 | 2009-2010 |
| Los Paseos Modernization | 2,571,483 | 2007-2008 |
| Los Paseos Multi Purpose Room | 5,633,628 | 2007-2008 |
| Machado Modernization | 157,114 | 2007-2008 |
| Charter School | 458,721 | 2007-2008 |
| Live Oak High School | 11,020,000 | 2007-2008 |

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, 2007, the District made payment of \$408,125 to the Santa Clara County Schools Insurance Group.

NOTE 16 - SUBSEQUENT EVENTS

The District issued \$8,480,000 of Tax and Revenue Anticipation Notes dated June 6, 2007. The notes mature on July 6, 2008, and yield 3.62 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, 2008, until 100 percent of principal and interest due is on account in May, 2008.

Legal Settlement

According to the legal confirmation response from Miller, Brown, and Dannis, the L.L. v. Morgan Hill Unified School District Special Education case has settled on October 31, 2007. As a result of this settlement, the District is expected to pay \$75,000 - \$100,000 settlement cost for tuition, transportation expenses, and the cost of the proceeding itself.

REQUIRED SUPPLEMENTARY INFORMATION

MORGAN HILL UNIFIED SCHOOL DISTRICT

GENERAL FUND BUDGETARY COMPARISON SCHEDULE FOR THE YEAR ENDED JUNE 30, 2007

| | Budgeted Amounts (GAAP Basis) | | Actual (GAAP Basis) | Variances - Favorable (Unfavorable) Final to Actual |
|--|----------------------------------|---------------------|------------------------|---|
| | Original | Final | | |
| REVENUES | | | | |
| Revenue limit sources | \$ 48,643,550 | \$ 49,071,131 | \$ 49,071,131 | \$ - |
| Federal sources | 3,113,949 | 3,406,348 | 3,244,716 | (161,632) |
| Other State sources | 8,851,014 | 13,249,348 | 14,427,553 | 1,178,205 |
| Other local sources | 5,010,923 | 8,543,222 | 7,001,708 | (1,541,514) |
| Total Revenues¹ | 65,619,436 | 74,270,049 | 73,745,108 | (524,941) |
| EXPENDITURES | | | | |
| Current | | | | |
| Instruction | 36,133,794 | 42,707,494 | 40,741,440 | 1,966,054 |
| Instruction-related activities: | | | | |
| Supervision of instruction | 1,722,387 | 1,845,957 | 1,685,393 | 160,564 |
| Instructional library, media, and technology | 200,103 | 527,846 | 521,985 | 5,861 |
| School site administration | 5,354,682 | 5,574,449 | 5,404,535 | 169,914 |
| Pupil services: | | | | |
| Home-to-school transportation | 3,094,542 | 3,411,000 | 2,946,970 | 464,030 |
| Food services | 235 | 770 | - | 770 |
| All other pupil services | 2,161,098 | 2,606,588 | 2,386,465 | 220,123 |
| General administration: | | | | |
| Data processing | 706,583 | 710,781 | 719,678 | (8,897) |
| All other general administration | 3,390,760 | 3,806,499 | 3,588,581 | 217,918 |
| Plant services | 6,312,177 | 8,294,004 | 7,192,174 | 1,101,830 |
| Facility acquisition and construction | 9,403 | 595,013 | 6,115 | 588,898 |
| Ancillary services | 517,575 | 546,679 | 493,943 | 52,736 |
| Community services | - | 31,324 | 32,242 | (918) |
| Other outgo | 4,702,903 | 4,871,587 | 4,719,627 | 151,960 |
| Total Expenditures¹ | 64,306,242 | 75,529,991 | 70,439,148 | 5,090,843 |
| Excess (Deficiency) of Revenues Over Expenditures | 1,313,194 | (1,259,942) | 3,305,960 | 4,565,902 |
| Other Financing Sources (Uses): | | | | |
| Transfers in | 193,955 | 215,730 | 108,735 | (106,995) |
| Other sources | - | 100,035 | - | (100,035) |
| Transfers out | (310,000) | (646,359) | (336,359) | 310,000 |
| Other uses | - | (163,245) | - | 163,245 |
| Net Financing Sources (Uses) | (116,045) | (493,839) | (227,624) | 266,215 |
| NET CHANGE IN FUND BALANCES | 1,197,149 | (1,753,781) | 3,078,336 | 4,832,117 |
| Fund Balance - Beginning | 5,544,649 | 5,544,649 | 5,544,649 | - |
| Fund Balance - Ending | \$ 6,741,798 | \$ 3,790,868 | \$ 8,622,985 | \$ 4,832,117 |

¹ On behalf payments of \$1,503,962 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, 2007

| Federal Grantor/Pass-Through Grantor/Program or Cluster Title | Federal CFDA Number | Pass-Through Entity Identifying Number | Federal Expenditures |
|--|---------------------------|---|-------------------------|
| U.S. DEPARTMENT OF EDUCATION | | | |
| Passed through California Department of Education (CDE): | | | |
| No Child Left Behind Act: | | | |
| Title I-Basic Grants Low Income and Neglected ¹ | 84.010 | 13797 | \$ 753,137 |
| Title I, Part C, Migrant Education | 84.011 | 13174 | 224,877 |
| Title I, Part C, Migrant Education Summer Program | 84.011 | 10005 | 32,429 |
| Title I, Even Start Migrant Education | 84.214 | 10030 | 25,750 |
| Title II, Part A, Teacher Quality | 84.367 | 14341 | 357,234 |
| Title II, Part D, Education Technology | 84.318 | 14368 | 17,576 |
| Title III, Limited English Proficiency Student Program | 84.365 | 10084 | 98,817 |
| Title IV, Part A, Drug-Free Schools | 84.186 | 14347 | 43,249 |
| Title V, Part A, Innovative Education Strategies | 84.298A | 14354 | 7,182 |
| Individuals with Disabilities Act: | | | |
| Basic Local Assistance Entitlement | 84.027 | 13379 | 1,511,211 |
| Workability I | 84.027 | 13705 | 1,056 |
| Preschool Grants | 84.173 | 13430 | 46,502 |
| Preschool Local Entitlement | 84.027A | 13682 | 71,854 |
| Local Staff Development Grants | 84.027A | 13613 | 3,261 |
| Preschool Staff Development Grants | 84.173A | 13431 | 847 |
| Carl Perkins Act: | | | |
| Vocational and Applied Technology | 84.048 | 13577 | 51,814 |
| Adult Education Act: | | | |
| Adult Basic Education | 84.002A | 13973 | 39,375 |
| Priority 5, Adult Secondary Education | 84.002 | 13978 | 9,225 |
| English Literacy and Civics Education | 84.002A | 14109 | 24,944 |
| California Alternative Performance Assessment (CAPA) | ² | 14488 | 295 |
| Subtotal | | | <u>3,320,635</u> |
| U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES | | | |
| Passed through CDE: | | | |
| Child Development Act: | | | |
| Quality Improvement Activities | 93.575 | 13942 | 19,823 |
| Medi-Cal Billing Option | 93.778 | 10013 | 514 |
| Subtotal | | | <u>20,337</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, 2007

U.S. DEPARTMENT OF AGRICULTURE

Passed through CDE:

Child Nutrition Act: ¹

| | | | |
|--------------------------------------|--------|-----------------|---------------------|
| National School Lunch Program | 10.555 | 13524 | 777,959 |
| Especially Needy Breakfast | 10.553 | 13526 | 47,294 |
| Basic School Breakfast Program | 10.553 | 13390 | 286,861 |
| Commodity Supplemental Food Program | 10.565 | ^{3, 4} | 59,780 |
| Subtotal | | | <u>1,171,894</u> |
| Total Expenditures of Federal Awards | | | <u>\$ 4,512,866</u> |

¹ Tested as a major program

² Catalog number not available

³ Pass-through numbers not available

⁴ Not recorded on the financial statements

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

LOCAL EDUCATION AGENCY ORGANIZATION STRUCTURE JUNE 30, 2007

ORGANIZATION

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

GOVERNING BOARD

| <u>MEMBER</u> | <u>OFFICE</u> | <u>TERM EXPIRES</u> |
|-------------------|----------------|---------------------|
| Peter Mendel | President | 2008 |
| Kathleen Sullivan | Vice President | 2008 |
| Don Moody | Member | 2010 |
| Michael J. Hickey | Member | 2010 |
| Julia Hover-Smoot | Member | 2008 |
| Shelle Thomas | Member | 2010 |
| Bart Fisher | Member | 2010 |

ADMINISTRATION

| | |
|-------------------|-----------------------|
| Alan K. Nishimo | Superintendent |
| Bonnie Tognazzini | Deputy Superintendent |

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF AVERAGE DAILY ATTENDANCE FOR THE YEAR ENDED JUNE 30, 2007

| | Second Period Report | Annual Report |
|---------------------------|----------------------------|------------------------|
| ELEMENTARY | | |
| Kindergarten | 599 | 600 |
| First through third | 1,858 | 1,865 |
| Fourth through sixth | 1,921 | 1,925 |
| Seventh and eighth | 1,228 | 1,228 |
| Home and hospital | 4 | 3 |
| Special education | 128 | 129 |
| Total Elementary | 5,738 | 5,750 |
| SECONDARY | | |
| Regular classes | 2,568 | 2,560 |
| Continuation education | 89 | 87 |
| Home and hospital | 3 | 3 |
| Special education | 70 | 69 |
| Total Secondary | 2,730 | 2,719 |
| Total K-12 | 8,468 | 8,469 |
| CLASSES FOR ADULTS | | |
| Concurrently enrolled | 16 | 21 |
| Not concurrently enrolled | 173 | 187 |
| Total Classes for Adults | 189 | 208 |
| Grand Total | 8,657 | 8,677 |
| | | Hours of Attendance |
| SUMMER SCHOOL | | |
| Elementary | | 58,517 |
| High school | | 50,316 |
| Total Hours | | 108,833 |

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF INSTRUCTIONAL TIME FOR THE YEAR ENDED JUNE 30, 2007

| Grade Level | 1982-1983 | 1986-1987 | 2006-2007 | 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 | 51,025 | 180 | Complied |
| Grades 4 - 6 | 52,740 | 54,000 | 54,550 | 180 | Complied |
| Grades 7 - 8 | 54,560 | 54,000 | 55,730 | 180 | Complied |
| Grades 9 - 12 | 57,726 | 64,800 | 65,084 | 180 | Complied |

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**RECONCILIATION OF ANNUAL FINANCIAL AND BUDGET REPORT WITH
AUDITED FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007**

There were no adjustments to the Unaudited Actual Financial Report, which required reconciliation to the audited financial statements at June 30, 2007.

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2007

| | (Budget) 2008 ¹ | 2007 | 2006 | 2005 |
|---|-------------------------------|---------------|---------------|---------------|
| GENERAL FUND | | | | |
| Revenues | \$ 68,117,825 | \$ 73,745,108 | \$ 64,194,647 | \$ 56,022,853 |
| Other sources | 175,095 | 108,735 | 158,806 | 136,957 |
| Total Revenues and Other Sources | 68,292,920 | 73,853,843 | 64,353,453 | 56,159,810 |
| Expenditures | 67,838,135 | 70,439,148 | 63,629,707 | 54,631,572 |
| Other uses and transfers out | 310,000 | 336,359 | 334,067 | 327,861 |
| Total Expenditures and Other Uses | 68,148,135 | 70,775,507 | 63,963,774 | 54,959,433 |
| INCREASE (DECREASE) IN FUND BALANCE | \$ 144,785 | \$ 3,078,336 | \$ 389,679 | \$ 1,200,377 |
| ENDING FUND BALANCE | \$ 8,767,770 | \$ 8,622,985 | \$ 5,544,649 | \$ 5,154,970 |
| AVAILABLE RESERVES ² | \$ 2,782,221 | \$ 4,448,300 | \$ 2,773,379 | \$ 3,309,098 |
| AVAILABLE RESERVES AS A PERCENTAGE OF TOTAL OUTGO ³ | 4.08% | 6.42% | 4.43% | 6.02% |
| LONG-TERM OBLIGATIONS | \$ 78,818,962 | \$ 83,007,569 | \$ 71,833,225 | \$ 72,607,678 |
| K-12 AVERAGE DAILY ATTENDANCE AT P-2 | 8,493 | 8,468 | 8,332 | 8,207 |

The General Fund balance has increased by \$3,468,015, over the past two years. The fiscal year 2007-2008 budget projects a further increase of \$144,785 (1.67 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 2007-2008 fiscal year. Total long-term obligations have increased by \$10,399,891 over the past two years.

Average daily attendance has increased by 261 over the past two years. Additional growth of 25 ADA is anticipated during fiscal year 2007-2008.

¹ Budget 2008 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 \$1,503,962 and \$1,408,215 have been excluded from the calculation of the available reserves percentage for fiscal year ending June 30, 2007 and 2006, respectively.

MORGAN HILL UNIFIED SCHOOL DISTRICT

EXCESS SICK LEAVE JUNE 30, 2007

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

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

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SCHEDULE OF CHARTER SCHOOLS
FOR THE YEAR ENDED JUNE 30, 2007**

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

See accompanying note to supplementary information.

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION JUNE 30, 2007

NOTE 1 - PURPOSE OF SCHEDULES

Schedule of Expenditures of Federal Awards

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

Local Education Agency Organization Structure

This schedule provides information about the District's boundaries and schools operated, members of the governing board, and members of the administration.

Schedule of Average Daily Attendance (ADA)

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

Schedule of Instructional Time

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

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

Reconciliation of Annual Financial and Budget Report with Audited Financial Statements

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

Schedule of Financial Trends and Analysis

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

Excess Sick Leave

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

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION JUNE 30, 2007

Schedule of Charter Schools

This schedule lists all Charter Schools chartered by the Morgan Hill Unified School District, and displays information for each Charter School on whether or not the Charter School is included in the Morgan Hill Unified School District audit.

SUPPLEMENTARY INFORMATION - UNAUDITED

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MORGAN HILL UNIFIED SCHOOL DISTRICT

NON-MAJOR GOVERNMENTAL FUNDS COMBINING BALANCE SHEET - UNAUDITED JUNE 30, 2007

| | Adult Education Fund | Child Development Fund | Cafeteria Fund |
|--|----------------------------|------------------------------|-------------------|
| ASSETS | | | |
| Deposits and investments | \$ 265,388 | \$ 109,586 | \$ 328,982 |
| Receivables | 219,554 | 14,135 | 183,277 |
| Due from other funds | - | - | 13,904 |
| Stores inventories | - | - | 7,086 |
| Total Assets | <u>\$ 484,942</u> | <u>\$ 123,721</u> | <u>\$ 533,249</u> |
| LIABILITIES AND FUND BALANCES | | | |
| Liabilities: | | | |
| Accounts payable | \$ 35,817 | \$ 40,708 | \$ 34,160 |
| Due to other funds | 27,598 | 6,449 | 139,349 |
| Deferred revenue | - | 76,564 | - |
| Total Liabilities | <u>63,415</u> | <u>123,721</u> | <u>173,509</u> |
| Fund Balances: | | | |
| Reserved for: | | | |
| Other reservations | 5,000 | - | 19,592 |
| Designated | - | - | - |
| Special revenue funds | 416,527 | - | 340,148 |
| Capital projects funds | - | - | - |
| Total Fund Balance | <u>421,527</u> | <u>-</u> | <u>359,740</u> |
| Total Liabilities and Fund Balances | <u>\$ 484,942</u> | <u>\$ 123,721</u> | <u>\$ 533,249</u> |

See accompanying note to supplementary information - unaudited.

| Deferred Maintenance Fund | Special Reserve Non-Capital Fund | Capital Facilities Fund | Mello Roos Fund | Total Non-Major Governmental Funds |
|--|---|--|----------------------------|---|
| \$ 644,643 | \$ 1,350,751 | \$ 1,916,033 | \$ 1,178 | \$ 4,616,561 |
| 8,796 | 16,966 | 35,032 | 1,221 | 478,981 |
| - | - | 1,648 | - | 15,552 |
| - | - | - | - | 7,086 |
| <u>\$ 653,439</u> | <u>\$ 1,367,717</u> | <u>\$ 1,952,713</u> | <u>\$ 2,399</u> | <u>\$ 5,118,180</u> |
| \$ 3,636 | \$ - | \$ 120,959 | \$ - | \$ 235,280 |
| - | - | 108,735 | 2,399 | 284,530 |
| - | - | - | - | 76,564 |
| <u>3,636</u> | <u>-</u> | <u>229,694</u> | <u>2,399</u> | <u>596,374</u> |
| - | - | - | - | 24,592 |
| - | 646,000 | - | - | 646,000 |
| 649,803 | 721,717 | - | - | 2,128,195 |
| - | - | 1,723,019 | - | 1,723,019 |
| <u>649,803</u> | <u>1,367,717</u> | <u>1,723,019</u> | <u>-</u> | <u>4,521,806</u> |
| <u>\$ 653,439</u> | <u>\$ 1,367,717</u> | <u>\$ 1,952,713</u> | <u>\$ 2,399</u> | <u>\$ 5,118,180</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, 2007

| | Adult Education Fund | Child Development Fund | Cafeteria Fund |
|--|----------------------------|------------------------------|-------------------|
| REVENUES | | | |
| Revenue limit sources | \$ 668,056 | \$ - | \$ - |
| Federal sources | 76,433 | 19,823 | 1,112,114 |
| Other state sources | 6,052 | 545,237 | 83,280 |
| Other local sources | 70,788 | - | 1,176,908 |
| Total Revenues | 821,329 | 565,060 | 2,372,302 |
| EXPENDITURES | | | |
| Current | | | |
| Instruction | 307,629 | 529,063 | - |
| Instruction-related activities: | | | |
| School site administration | 274,328 | - | - |
| Pupil services: | | | |
| Food services | - | - | 2,246,236 |
| General administration: | | | |
| All other general administration | 27,598 | 35,997 | 174,650 |
| Plant services | 18,803 | - | - |
| Facility acquisition and construction | - | - | - |
| Total Expenditures | 628,358 | 565,060 | 2,420,886 |
| Excess (Deficiency) of | | | |
| Revenues Over Expenditures | 192,971 | - | (48,584) |
| Other Financing Sources (Uses): | | | |
| Transfers in | - | - | - |
| Transfers out | - | - | - |
| Net Financing Sources (Uses) | - | - | - |
| NET CHANGE IN FUND BALANCES | 192,971 | - | (48,584) |
| Fund Balance - Beginning | 228,556 | - | 408,324 |
| Fund Balance - Ending | \$ 421,527 | \$ - | \$ 359,740 |

See accompanying note to supplementary information – unaudited.

| Deferred Maintenance Fund | Special Reserve Non-Capital Fund | Capital Facilities Fund | County School Facilities Fund | Mello Roos Fund | Total Non-Major Governmental Funds |
|---------------------------------|--|-------------------------------|-------------------------------------|--------------------|--|
| \$ - | \$ - | \$ - | \$ - | \$ - | \$ 668,056 |
| - | - | - | - | - | 1,208,370 |
| 336,359 | - | - | - | - | 970,928 |
| 25,732 | 64,517 | 2,947,834 | 2 | 445,212 | 4,730,993 |
| 362,091 | 64,517 | 2,947,834 | 2 | 445,212 | 7,578,347 |
| - | - | - | - | - | 836,692 |
| - | - | - | - | - | 274,328 |
| - | - | - | - | - | 2,246,236 |
| - | - | - | - | - | 238,245 |
| 938,271 | - | 107,758 | - | 1,687 | 1,066,519 |
| 210 | - | 4,128,099 | - | 1,589 | 4,129,898 |
| 938,481 | - | 4,235,857 | - | 3,276 | 8,791,918 |
| (576,390) | 64,517 | (1,288,023) | 2 | 441,936 | (1,213,571) |
| 336,359 | - | - | - | - | 336,359 |
| - | - | (108,735) | (2) | (441,936) | (550,673) |
| 336,359 | - | (108,735) | (2) | (441,936) | (214,314) |
| (240,031) | 64,517 | (1,396,758) | - | - | (1,427,885) |
| 889,834 | 1,303,200 | 3,119,777 | - | - | 5,949,691 |
| \$ 649,803 | \$ 1,367,717 | \$ 1,723,019 | \$ - | \$ - | \$ 4,521,806 |

MORGAN HILL UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION - UNAUDITED JUNE 30, 2007

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, 2007, which collectively comprise Morgan Hill Unified School District's basic financial statements and have issued our report thereon dated January 18, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control.

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

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

Compliance and Other Matters

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

This report is intended solely for the information and use of the governing board, management, the California Department of Education, the State Controller's Office, 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
January 18, 2008



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

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

Compliance

We have audited the compliance of Morgan Hill Unified School District with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major Federal programs for the year ended June 30, 2007. 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, 2007.

Internal Control Over Compliance

The management of Morgan Hill Unified School District is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to Federal programs. In planning and performing our audit, we considered Morgan Hill Unified School District's internal control over compliance with the requirements that could have a direct and material effect on a major Federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Morgan Hill Unified School District's internal control over compliance.

A control deficiency in a district's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a Federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to administer a Federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a Federal program that is more than inconsequential will not be prevented or detected by the District's internal control.

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

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

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

Vasinek Trine Day + Co. LLP

Palo Alto, California
January 18, 2008

**INDEPENDENT AUDITORS' REPORT ON STATE COMPLIANCE**

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Morgan Hill Unified School District as of and for the year ended June 30, 2007, and have issued our report thereon dated January 18, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *Standards and Procedures for Audits of California K-12 Local Educational Agencies 2006-07*, 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:

| | <u>Procedures in Audit Guide</u> | <u>Procedures Performed</u> |
|--|--------------------------------------|---------------------------------|
| Attendance Accounting: | | |
| Attendance reporting | 8 | Yes |
| Kindergarten continuance | 3 | Yes |
| Independent study | 23 | No |
| Continuation education | 10 | Yes |
| Adult education | 9 | Yes |
| Regional occupational centers and programs | 6 | Not Applicable |
| Instructional Time: | | |
| School districts | 6 | Yes |
| County offices of education | 3 | Not Applicable |
| Community day schools | 9 | Not Applicable |
| Morgan-Hart Class Size Reduction | 7 | Not Applicable |
| Instructional Materials: | | |
| General requirements | 12 | Yes |
| K-8 only | 1 | Yes |
| 9-12 only | 1 | Yes |
| Ratios of Administrative Employees to Teachers | 1 | Yes |

| | Procedures in Audit Guide | Procedures Performed |
|--|------------------------------|-------------------------|
| Early retirement incentive | 4 | Not Applicable |
| Gann limit calculation | 1 | Yes |
| School Construction Funds: | | |
| School District bonds | 3 | Yes |
| State school facilities funds | 1 | Not Applicable |
| Alternative pension plans | 2 | Not Applicable |
| Excess sick leave | 3 | Yes |
| Notice of right to elect California State Teachers Retirement System (CalSTRS) membership | | Yes |
| Proposition 20 Lottery Funds (Cardenas Textbook Act of 2000) | 1 | Yes |
| State Lottery Funds (California State Lottery Act of 1984) | 2 | Yes |
| California School Age Families Education (Cal-SAFE) Program | 3 | Not Applicable |
| School Accountability Report Card | 3 | Yes |
| Class Size Reduction Program (including in Charter Schools): | | |
| General requirements | 7 | Yes |
| Option one classes | 3 | Yes |
| Option two classes | 4 | Not Applicable |
| District or charter schools with only one school serving K-3 | 4 | Not Applicable |
| Charter Schools: | | |
| Contemporaneous records of attendance | 1 | Not Applicable |
| Mode of instruction | 1 | Not Applicable |
| Non classroom-based instruction/independent study | 15 | Not Applicable |
| Determination of funding for non classroom-based instruction | 3 | Not Applicable |
| Annual instruction minutes classroom based | 3 | Not Applicable |

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

Based on our audit, we found that for the items tested, the Morgan Hill Unified School District complied with the State laws and regulations referred to above. 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 governing board, management, the California Department of Education, the State Controller's Office, the California Department of Finance, Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Vannink Trine Day + Co. LLP

Palo Alto, California
January 18, 2008

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

MORGAN HILL UNIFIED SCHOOL DISTRICT

SUMMARY OF AUDITORS' RESULTS FOR THE YEAR ENDED JUNE 30, 2007

FINANCIAL STATEMENTS

Type of auditors' report issued:

Unqualified

Internal control over financial reporting:

No

Material weaknesses identified?

None reported

Significant deficiencies identified not considered to be material weaknesses?

No

Noncompliance material to financial statements noted?

FEDERAL AWARDS

Internal control over major programs:

No

Material weaknesses identified?

None reported

Significant deficiencies identified not considered to be material weaknesses?

Unqualified

Type of auditors' report issued on compliance for major programs:

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

Circular A-133, Section .510(a)

No

Identification of major programs:

CFDA Number(s)

Name of Federal Program or Cluster

84.010

NCLB - Title I

10.555 & 10.553

Child Nutrition Cluster

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

\$ 300,000

Auditee qualified as low-risk auditee?

Yes

STATE AWARDS

Internal control over State programs:

No

Material weaknesses identified?

None reported

Significant deficiencies identified not considered to be material weaknesses?

Unqualified

Type of auditors' report issued on compliance for State programs:

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FINANCIAL STATEMENT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2007**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2007**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**STATE AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2007**

None reported.

MORGAN HILL UNIFIED SCHOOL DISTRICT

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2007**

None reported.