

**PALO ALTO UNIFIED
SCHOOL DISTRICT**

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED JUNE 30, 2016

PALO ALTO UNIFIED SCHOOL DISTRICT

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JUNE 30, 2016

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FINANCIAL SECTION

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INDEPENDENT AUDITOR'S REPORT

Governing Board
Palo Alto Unified School District
Palo Alto, California

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Palo Alto Unified School District (the District) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *2015-2016 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting*, 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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 Palo Alto Unified School District, as of June 30, 2016, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter - Change in Accounting Principles

As discussed in Note 1 to the financial statements, in 2016, the District adopted new accounting guidance, GASB Statement No. 72, *Fair Value Measurement and Application*; GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statement 67 and 68*; GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*; and GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the required supplementary information, such as management's discussion and analysis, budgetary comparison schedule, schedule of other postemployment benefits funding progress, schedule of the district's proportionate share of net pension liability, and the schedule of district's pension contributions, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Palo Alto Unified School District's basic financial statements. The accompanying supplementary information such as the combining and individual nonmajor fund financial statements and Schedule of Expenditures of Federal Awards, as required by Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* and the other supplementary information as listed on the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The accompanying supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 2016, on our consideration of the Palo Alto Unified School 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Palo Alto Unified School District's internal control over financial reporting and compliance.

Vavrinek, Trine, Day & Co. LLP

Palo Alto, California
December 10, 2016

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PALO ALTO UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2016



PALO ALTO UNIFIED SCHOOL DISTRICT
25 Churchill Avenue - Palo Alto, California 94306-1099

Business Services - Phone: 650-329-3980 Fax: 650-329-3803

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of Palo Alto Unified School District's (PAUSD) annual financial report presents our discussion and analysis of the District's financial performance during the fiscal year that ended on June 30, 2016. Please read it in conjunction with the District's financial statements, which immediately follow this section.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Financial Statements

The financial statements presented herein include all of the activities of the Palo Alto Unified School District (the District) using the integrated approach as prescribed by GASB Statement Number 34.

The *Government-Wide Financial Statements* present the financial picture of the District from the economic resources measurement focus using the accrual basis of accounting. These statements include all assets of the District (including capital assets) as well as all liabilities (including long-term obligations). Additionally, certain eliminations have occurred as prescribed by the statement in regards to interfund activity, payables, and receivables.

The *Fund Financial Statements* include statements for each of the three categories of activities: governmental, proprietary and fiduciary.

The *Governmental Fund Financial Statements* are prepared using the current financial resources measurement focus and the modified accrual basis of accounting.

The *Proprietary Fund Financial Statements* are prepared using the economic resources measurement focus and the accrual basis of accounting.

The *Fiduciary Activities* are agency funds, which only report a balance sheet and do not have a measurement focus.

The Primary unit of the government is the Palo Alto Unified School District.

PALO ALTO UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2016

REPORTING THE DISTRICT AS A WHOLE

The Statement of Net Position and the Statement of Activities

The *Statement of Net Position* and the *Statement of Activities* report information about the District as a whole and about its activities. These statements include *all* assets and liabilities of the District using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the District's net position and changes in it. Net position is the difference between assets, liabilities, deferred inflows and outflows, which is one way to measure the District's financial health, or financial position. Over time, increases or decreases in net position is one indicator of whether the District's financial health is improving or deteriorating. Other factors to consider are changes in the property tax base and the condition of facilities.

The difference between revenues and expenses is the District's operating results. Since the board's responsibility is to provide services to our students and not to generate profit as commercial entities do, one must consider other factors when evaluating the overall financial health of the District. The quality of the education and the safety of our schools will likely be an important component in this evaluation.

In the *Statement of Net Position* and the *Statement of Activities* the activities of the District are presented as follows:

Governmental Activities - All of the District's services are reported in this category. This includes the education of kindergarten through grade twelve students, adult education students, the operation of child development activities, and the on-going effort to improve and maintain buildings and sites. Property taxes, state income taxes, user fees, interest income, federal, state and local grants, as well as general obligation bonds, finance these activities.

REPORTING THE DISTRICT'S MOST SIGNIFICANT FUNDS

Fund Financial Statements

The fund financial statements provide detailed information about the most significant funds - not the District as a whole. Some funds are required to be established by State law and by bond covenants. However, management establishes many other funds to help it control and manage money for particular purposes or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money that it receives from the other federal and state agencies.

Governmental Funds - Most of the District's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds 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 general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. The differences of results in the governmental fund financial statements to those in the government-wide financial statements are explained in a reconciliation following each governmental fund financial statement.

PALO ALTO UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2016

Proprietary Funds - When the District charges users for the services it provides, whether to outside customers or to other departments within the District, these services are generally reported in proprietary funds. We use internal service funds (a component of proprietary funds) to report activities that provide supplies and services for the District's other programs and activities - such as the District's Self-Insurance Fund. The internal service fund is reported with governmental activities in the government-wide financial statements.

THE DISTRICT AS TRUSTEE

Reporting the District's Fiduciary Responsibilities

The District is the trustee, or *fiduciary*, for funds held on behalf of others, like our funds for associated student body activities and scholarships. The District's fiduciary activities are reported in separate *Statements of Fiduciary Net Position*. We exclude these activities from the District's other financial statements because the District cannot use these assets to finance its operations. The District is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

FINANCIAL HIGHLIGHTS

THE DISTRICT AS A WHOLE

Net Position

The District's net position was negative \$47.8 million as of June 30, 2016. Of this amount, \$42.8 million was restricted. Restricted net position is reported separately to show legal constraints from debt covenants and enabling legislation that limit the school board's ability to use the net position for day-to-day operations. Our analysis below focuses on the net position (Table 1) and change in net position (Table 2) of the District's *Governmental Activities*.

TABLE 1

(Amounts in thousands)	2014-15 Governmental Activities	2015-16 Governmental Activities
Current and other assets	\$ 181,129	\$ 205,312
Capital assets	339,553	345,726
Total Assets and Deferred Outflows	520,682	551,038
Current liabilities	56,447	48,558
Non current liabilities	509,949	550,291
Total Liabilities and Deferred Inflows	566,396	598,849
Net position		
Net invested in capital assets	50,277	50,457
Restricted	45,492	42,764
Unrestricted	(141,483)	(141,031)
Total Net Position	\$ (45,714)	\$ (47,810)

PALO ALTO UNIFIED SCHOOL DISTRICT

**MANAGEMENT’S DISCUSSION AND ANALYSIS
JUNE 30, 2016**

Changes in Net Position

The results of this year’s operations for the District as a whole are reported in the *Statement of Activities* on page 13. Table 2 takes the information from the statement and condenses it so you can see our total revenues and expenses for the year.

TABLE 2

(Amounts in thousands)	2014-15 Governmental Activities	2015-16 Governmental Activities
Revenues		
Program revenues:		
Charges for services	\$ 1,915	\$ 1,953
Operating grants and contributions	15,404	17,363
General revenues:		
Property taxes - general purposes	139,608	158,006
Property taxes - other purposes	39,962	43,964
Other general revenues	46,306	47,182
Total Revenues	243,195	268,468
Expenses		
Instruction and instruction related	175,561	186,124
Student support services	17,777	19,086
Administration	11,956	12,895
Maintenance and operations	21,695	36,026
Other	15,207	16,433
Total Expenses	242,196	270,564
Change in Net Position	\$ 999	\$ (2,096)

Governmental Activities

As reported in the Statement of Activities on page 13, the cost of all of our governmental activities this year was \$270.6 million. However, the amount that our taxpayers ultimately financed for these activities through local taxes was only \$251.2 million because the cost was paid by those who benefited from the programs (\$2.0 million), or by other governments and organizations who subsidized certain programs with grants and contributions (\$17.4 million). We paid for the remaining "public benefit" portion of our governmental activities with State funds and with other revenues, like interest and general entitlements.

In Table 3, we have presented the cost of each of the District’s seven largest functions – instruction, instruction related, pupil services, general administration, plant services, interest and other activities as well as each program’s net cost (total cost less revenues generated by the activities). As discussed above, net cost shows the financial burden that was placed on the District’s taxpayers by each of these functions. Providing this information allows our citizens to consider the cost of each function in comparison to the benefits they believe are provided by that function.

PALO ALTO UNIFIED SCHOOL DISTRICT

**MANAGEMENT’S DISCUSSION AND ANALYSIS
JUNE 30, 2016**

TABLE 3

(Amounts in thousands)	2014-15 Net Cost of Services	2015-16 Net Cost of Services
Instruction	\$ 135,671	\$ 144,447
Instruction related	26,720	26,521
Pupil services	14,290	15,735
General administration	11,845	12,592
Plant services	21,215	35,602
Interest on long-term debt	13,657	13,165
Other activities	1,478	3,187
Totals	\$ 224,876	\$ 251,248

THE DISTRICT’S FUNDS

The Statement of Revenues, Expenditures, and Changes in Fund Balances reports on financial information by major fund and aggregate remaining funds. As the District completed this year, our governmental funds reported a combined fund balance of \$162.9 million, which is an increase of \$19.2 million from last year. This includes a increase of \$10 million to the General Fund, an increase of \$15.4 million to the Building Fund, and a decrease of \$6.1 million to all other funds.

The fund balance in the General Fund, our principal operating fund, increased from \$45.9 million to \$55.9 million.

The Bond Interest and Redemption Fund decreased \$6.8 million.

The Building Fund’s source for expenditures was \$120 million General Obligation bonds issued in 2008-09, \$25 million General Obligation bonds issued in 2010-11, \$70 million issued in 2012-13, \$40 million issued in 2013-14 and \$45 million issued in 2015-16.

The District’s expenses in the General Fund are predominantly in instruction, followed by plant services, such as maintenance, operations and utilities; school administration; and all other general administration and instruction supervision.

General Fund Budgetary Highlights

The Education Code requires that all school districts adopt a budget by July 1, and then twice a year submit to their County Offices of Education interim financial reports. The interim reports reflect the status of district finances as of October 31 and January 31. Year-end actuals are submitted by September 15.

Over the course of the year, the District revises its budget as it attempts to deal with unexpected changes in revenues and expenditures. During fiscal year 2015-16, significant revenue revisions were made to property tax revenue, state, federal and local income. These revisions were made as new information was received or when new grants/donations were received. Significant expenditure revisions were also made to include personnel costs, utilities, budgets for new grants/donations and special education costs.

PALO ALTO UNIFIED SCHOOL DISTRICT

**MANAGEMENT’S DISCUSSION AND ANALYSIS
JUNE 30, 2016**

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2016, the District had \$345.7 million in a broad range of capital assets, including land, buildings, and furniture and equipment. This amount represents an increase (including additions, deductions and depreciation) of \$6.2 million from last year. More detailed information is presented in Note 4 of the financial statements.

TABLE 4

(Amounts in thousands)	2014-15 Governmental Activities	2015-16 Governmental Activities
Land and land improvements	\$ 50,596	\$ 54,065
Construction in progress	16,578	19,650
Buildings and improvements	552,510	565,851
Furniture and equipment	8,898	9,217
Library collections	293	293
Total Assets	628,875	649,076
Less Accumulated Depreciation	(289,322)	(303,351)
Totals	\$ 339,553	\$ 345,726

This year’s additions of \$20.2 million included primarily land and building improvements. Since August 2008, the District sold bonds totaling \$353 million of the \$378 million authorized by the June 2008 General Obligation Bond ballot measure. Major capital projects are in process at many of the District’s sites, including all of the secondary sites.

Long-Term Obligations

At the end of this year, the District had \$360 million in general obligation bonds outstanding versus \$340.2 million last year.

TABLE 5

(Amounts in thousands)	2014-15 Governmental Activities	2015-16 Governmental Activities
General obligation bonds	\$ 340,181	\$ 360,007
Bond premium	3,881	4,975
Accumulated vacation	370	552
OPEB obligation	11,412	13,651
Net Pension Liability	147,365	168,401
	\$ 503,209	\$ 547,586

The State limits the amount of general obligation debt that districts can issue to 2.5 percent of the assessed value of all taxable property within the district’s boundaries. The current legal debt limit for the District is \$750 million. The District’s outstanding general obligation debt of \$360 million is significantly below this limit.

PALO ALTO UNIFIED SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2016

Other obligations include post employment benefits. We present more detailed information regarding our long-term obligations in Note 10 of the financial statements.

HIGHLIGHTS FOR THE 2016-17 BUDGET

In considering the District's Adopted Budget for the 2016-17 year, the District Board and management used the following criteria:

The key assumptions in our revenue forecast are:

1. Property tax revenues will increase by 8.67 percent due to an estimated increase in assessed valuation.
2. Basic Aid "fair share" reduction of \$7.4 million.
3. Voluntary transfer program funding is based upon 70 percent of the base funding of the Local Control Funding Formula.
4. Education Protection Account State Aid - \$200 per ADA.
5. Lottery revenue projected at \$181 per ADA.
6. Parcel tax revenue projected at \$14.8 million, 2% increase from prior year.
7. \$5.7 million donation from the Palo Alto Partners in Education (PAPIE).
8. One-time discretionary funds of \$2.6 million.
9. Adult Education Block Grant of \$1.0 million.
10. Lease revenue based upon current lease agreements.

Expenditures are based on the following forecasts:

1. Certificated staffing to accommodate the increase in enrollment.
2. Certificated and Classified step and column costs.
3. Increase in CalSTRS rate by 1.85 percent.
4. Updated other benefit rates, including unemployment, workers' compensation, and PERS.
5. Title I funding for Addison, Briones, El Carmelo, and Escondido.
6. Budget for staff training and development.
7. Additional resource allocations of \$2.7 million.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, students, 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 any additional financial information, contact the Chief Business Officer, Business Services, at Palo Alto Unified School District, 25 Churchill Avenue, Palo Alto, California, 94306.

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PALO ALTO UNIFIED SCHOOL DISTRICT

STATEMENT OF NET POSITION JUNE 30, 2016

	Governmental Activities
ASSETS	
Deposits and investments	\$ 176,820,721
Receivables	5,434,516
Loan receivable	1,458,888
Prepaid expenses	161,551
Stores inventories	193,904
Capital assets not depreciated	29,376,530
Capital assets, net of accumulated depreciation	316,349,321
Total Assets	529,795,431
DEFERRED OUTFLOWS OF RESOURCES	
Deferred amount on refunding	4,111,912
Deferred outflows of resources related to pensions	17,130,917
Total Deferred Outflows of Resources	21,242,829
LIABILITIES	
Accounts payable	6,427,108
Interest payable	3,284,325
Unearned revenue	7,909,256
Claim liabilities	4,797,000
Long-term obligations:	
Current portion of long-term obligations other than pensions	26,139,785
Noncurrent portion of long-term obligations other than pensions	353,045,401
Aggregate net pension liability	168,401,060
Total Liabilities	570,003,935
DEFERRED INFLOWS OF RESOURCES	
Difference inflows of resources related to pensions	28,844,567
Total Deferred Inflows of Resources	28,844,567
NET POSITION	
Net investment in capital assets	50,456,818
Restricted for:	
Educational programs	5,488,583
Debt service	29,212,182
Child nutrition services	152,286
Capital projects	5,882,160
Self-insurance	2,028,667
Unrestricted	(141,030,938)
Total Net Position	\$ (47,810,242)

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

PALO ALTO UNIFIED SCHOOL DISTRICT

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2016**

Functions/Programs	Expenses	Program Revenues		Net (Expenses)
		Charges for Services and Sales	Operating Grants and Contributions	Revenues
				Governmental Activities
Governmental Activities				
Instruction	\$ 156,812,139	\$ -	\$ 12,365,367	\$ (144,446,772)
Instruction-related activities				
Supervision of instruction	9,849,816	-	1,598,343	(8,251,473)
Instructional library and technology	3,432,981	-	48,108	(3,384,873)
School site administration	16,028,705	-	1,144,519	(14,884,186)
Pupil services				
Home-to-school transportation	2,653,635	-	-	(2,653,635)
Food services	2,937,653	1,952,567	567,991	(417,095)
All other pupil services	13,494,709	-	830,401	(12,664,308)
General administration				
Data processing	5,126,794	-	-	(5,126,794)
All other general administration	7,768,687	-	303,485	(7,465,202)
Plant services	36,026,168	-	424,385	(35,601,783)
Ancillary services	1,455,773	-	76,565	(1,379,208)
Community services	180,227	-	-	(180,227)
Enterprise services	1,621,074	-	-	(1,621,074)
Interest on long-term obligations	13,165,442	-	-	(13,165,442)
Other outgo	10,473	-	4,317	(6,156)
Total Governmental Activities	<u>\$ 270,564,276</u>	<u>\$ 1,952,567</u>	<u>\$ 17,363,481</u>	<u>(251,248,228)</u>
General revenues and subventions				
Property taxes, levied for general purposes				158,006,453
Property taxes, levied for debt service				29,417,620
Taxes levied for other specific purposes				14,546,135
Federal and state aid not restricted to specific purposes				17,521,467
Interest and investment earnings				712,807
Intergovernmental				1,338,643
Miscellaneous				27,608,954
Subtotal, general revenues				<u>249,152,079</u>
Change in Net Position				(2,096,149)
Net Position - Beginning				<u>(45,714,093)</u>
Net Position - Ending				<u>\$ (47,810,242)</u>

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

PALO ALTO UNIFIED SCHOOL DISTRICT

GOVERNMENTAL FUNDS

BALANCE SHEET

JUNE 30, 2016

	General Fund	Building Fund	Bond Interest and Redemption Fund	Nonmajor Governmental Funds	Total Governmental Funds
ASSETS					
Deposits and investments	\$ 61,642,922	\$ 66,385,624	\$ 32,455,097	\$ 9,513,419	\$ 169,997,062
Accounts receivables	5,079,108	93,850	41,410	207,666	5,422,034
Loan receivable	1,458,888	-	-	-	1,458,888
Due from other funds	174,359	-	-	-	174,359
Prepaid expenditures	152,716	-	-	8,835	161,551
Stores inventories	143,487	-	-	50,417	193,904
Total Assets	\$ 68,651,480	\$ 66,479,474	\$ 32,496,507	\$ 9,780,337	\$ 177,407,798
LIABILITIES AND FUND BALANCES					
Liabilities					
Accounts payable	\$ 5,298,870	\$ 878,717	\$ -	\$ 239,047	\$ 6,416,634
Due to other funds	-	-	-	174,359	174,359
Unearned revenue	7,481,853	-	-	427,403	7,909,256
Total Liabilities	12,780,723	878,717	-	840,809	14,500,249
Fund Balances					
Nonspendable	1,785,091	-	-	59,252	1,844,343
Restricted	5,333,915	65,600,757	32,496,507	6,153,736	109,584,915
Committed	-	-	-	2,726,540	2,726,540
Assigned	27,717,479	-	-	-	27,717,479
Unassigned	21,034,272	-	-	-	21,034,272
Total Fund Balances	55,870,757	65,600,757	32,496,507	8,939,528	162,907,549
Total Liabilities and Fund Balances	\$ 68,651,480	\$ 66,479,474	\$ 32,496,507	\$ 9,780,337	\$ 177,407,798

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

PALO ALTO UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET POSITION JUNE 30, 2016

Amounts Reported for governmental activities in the Statement of Net Position are different because of the following:

Total Fund Balance - Governmental Funds		\$ 162,907,549
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	\$ 649,076,360	
Accumulated depreciation is	<u>(303,350,509)</u>	
Net capital assets		345,725,851
Deferred outflows related to pension plans were not recognized on the modified accrual basis, but are recognized on the accrual basis.		17,130,917
In governmental funds, accrued interest on long-term obligations are recognized in the period when paid. In the government-wide statements, accrued interest on long-term obligations are recognized as they accrue.		(3,284,325)
An internal service fund is used by the District's management to charge the costs of the workers' compensation insurance to the individual funds. The assets and liabilities of the internal service fund are included with governmental activities.		2,028,667
Deferred inflows related to pensions were not recognized on the modified accrual basis of accounting.		(28,844,567)
Long-term obligations at year end consist of the following:		
Bonds payable and related premiums and defeasance cost	360,869,790	
Compensated absences (vacations)	552,170	
Other postemployment benefit (OPEB)	13,651,314	
Net pension liability	<u>168,401,060</u>	
Total long-term obligations		<u>(543,474,334)</u>
Total Net Position - Governmental Activities		<u>\$ (47,810,242)</u>

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

PALO ALTO UNIFIED SCHOOL DISTRICT

**GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2016**

	General Fund	Building Fund	Bond Interest and Redemption Fund	Nonmajor Governmental Funds	Total Governmental Funds
REVENUES					
Local Control Funding Formula	\$ 7,699,824	\$ -	\$ -	\$ -	\$ 7,699,824
Property taxes	172,534,006	-	-	-	172,534,006
Federal sources	3,394,291	-	1,238,761	709,351	5,342,403
Other State sources	17,930,741	711	90,428	5,141,695	23,163,575
Other local sources	22,281,633	1,662,670	29,426,547	3,654,060	57,024,910
Total Revenues	223,840,495	1,663,381	30,755,736	9,505,106	265,764,718
EXPENDITURES					
Current					
Instruction and related activities:	140,964,675	-	-	1,490,185	142,454,860
Supervision of instruction	8,922,897	-	-	25,097	8,947,994
Instructional library, media and technology	3,118,667	-	-	-	3,118,667
School site administration	13,567,784	-	-	993,377	14,561,161
Pupil services:					
Home-to-school transportation	2,410,675	-	-	-	2,410,675
Food services	120,923	-	-	2,547,767	2,668,690
All other pupil services	12,259,171	-	-	-	12,259,171
Administration:					
Data processing	4,701,173	-	-	-	4,701,173
All other administration	6,912,905	-	-	144,502	7,057,407
Plant services	18,743,057	-	-	98,807	18,841,864
Facility acquisition and construction	239,452	34,222,121	-	976,830	35,438,403
Ancillary services	1,322,486	-	-	-	1,322,486
Community services	163,726	-	-	-	163,726
Debt service:					
Principal	-	-	32,255,483	-	32,255,483
Interest and other	-	-	6,641,533	-	6,641,533
Total Expenditures	213,447,591	34,222,121	38,897,016	6,276,565	292,843,293
Excess (Deficiency) of Revenues Over Expenditures	10,392,904	(32,558,740)	(8,141,280)	3,228,541	(27,078,575)
Other Financing Sources (Uses)					
Transfers in	43,213	3,000,000	-	450,000	3,493,213
Other sources	-	45,000,000	1,336,590	-	46,336,590
Transfers out	(450,000)	-	-	(3,043,213)	(3,493,213)
Other uses	(10,473)	-	-	-	(10,473)
Net Financing Sources (Uses)	(417,260)	48,000,000	1,336,590	(2,593,213)	46,326,117
NET CHANGE IN FUND BALANCES	9,975,644	15,441,260	(6,804,690)	635,328	19,247,542
Fund Balance - Beginning	45,895,113	50,159,497	39,301,197	8,304,200	143,660,007
Fund Balance - Ending	\$ 55,870,757	\$ 65,600,757	\$ 32,496,507	\$ 8,939,528	\$ 162,907,549

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

PALO ALTO UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2016

Amounts reported for governmental activities in the statement of activities are different because of the following items:

Net change in fund balances - governmental funds	\$	19,247,542
<p>Capital outlays to purchase or build capital assets are reported in governmental funds as expenditures; however, for governmental activities, those costs are capitalized in the statement of net position and allocated over their estimated useful lives as annual depreciation expenses in the statement of activities.</p> <p>This is the amount by which capital outlays exceed depreciation in the period:</p>		
Capital outlays	\$ 20,201,257	
Depreciation expense	<u>(14,028,706)</u>	
Net expense adjustment		6,172,551
<p>In the governmental funds, proceeds from the sale of bonds is recorded as revenue when received. In the government-wide statements the bond proceeds are recorded as an increase in long-term debt with no impact on the statement of activities.</p>		
		(46,336,590)
<p>Amortization of the bond premium and defeasance costs are not recognized in the governmental funds. In the statement of activities, they are amortized over the life of the bonds.</p>		
		(271,764)
<p>Accreted interest is not an expenditure in the governmental funds, but it increases the long term liabilities in the statement of net position and is reflected as additional interest expense in the statement of activities.</p>		
		(7,081,483)
<p>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 earned was more than the amounts used by this amount.</p>		
		(182,608)

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

PALO ALTO UNIFIED SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES (Continued) FOR THE YEAR ENDED JUNE 30, 2016

In the governmental funds, pension costs are based on employer contributions made to pension plans during the year. However, in the statement of activities, pension expense is the net effect of all changes in the deferred outflows, deferred inflows and net pension liability during the year.

This is the amount by which pension expense exceeded pension contributions in the period:

Pension expense reported on the governmental funds	14,744,770
Pension expense reported on the entry-wide statement of activities	(20,413,227)
State onbehalf pension contributions reported on the entry-wide statement of activities	<u>541,225</u>

Total pension related items	(5,127,232)
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Payment of principal on general obligation bonds is an expenditure in the governmental funds, but it reduces long-term liabilities in the statement of net position and does not affect the statement of activities.	32,255,483
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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.	829,338
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Payments of the retiree benefits are recorded as an expenditure in the governmental funds. However, the difference between the annual required contributions and the actual benefit payments made, if less, is recorded as an expense in the statement of activities. The amount of the payment was less than the annual required contributions.	(2,239,656)
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An internal service fund is used by the District's management to charge the costs of the workers' compensation insurance program to the individual funds. The net revenue of the internal service fund is reported with governmental activities.	638,270
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Change in net position of governmental activities	<u>\$ (2,096,149)</u>
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The accompanying notes are an integral part of these financial statements.

PALO ALTO UNIFIED SCHOOL DISTRICT

**PROPRIETARY FUND
STATEMENT OF NET POSITION
JUNE 30, 2016**

	Governmental Activities - Internal Service Fund
ASSETS	
Current Assets	
Deposits and investments	\$ 6,823,659
Receivables	12,482
Total Current Assets	<u>6,836,141</u>
LIABILITIES	
Current Liabilities	
Accounts payable	10,474
Noncurrent Liabilities	
Claim liabilities	4,797,000
Total Liabilities	<u>4,807,474</u>
NET POSITION	
Restricted for insurance programs	2,028,667
Total Net Position	<u>\$ 2,028,667</u>

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

PALO ALTO UNIFIED SCHOOL DISTRICT

**PROPRIETARY FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES
IN FUND NET POSITION
FOR THE YEAR ENDED JUNE 30, 2016**

	Governmental Activities - Internal Service Fund
OPERATING REVENUES	
In-district premiums	\$ 2,119,421
Total operating revenues	<u>2,119,421</u>
OPERATING EXPENSES	
Payroll costs	25,117
Supplies and materials	34
Claims expense	1,498,761
Total operating expenses	<u>1,523,912</u>
Operating income	<u>595,509</u>
NONOPERATING REVENUES	
Interest income	42,761
Total nonoperating revenue	<u>42,761</u>
Change in Net Position	638,270
Total Net Position - Beginning	1,390,397
Total Net Position - Ending	<u><u>\$ 2,028,667</u></u>

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

PALO ALTO UNIFIED SCHOOL DISTRICT

**PROPRIETARY FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2016**

	Governmental Activities - Internal Service Fund
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash received from user charges	\$ 2,561,836
Cash payments to employees for services	(94,014)
Cash payments for insurance claims	(1,918,761)
Cash payments to suppliers for goods and services	(34)
Net Cash provided by operating activities	<u>549,027</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest on investments	<u>30,279</u>
Net Increase in Cash and Cash Equivalents	579,306
Cash and Cash Equivalents at beginning of year	<u>6,244,353</u>
Cash and Cash Equivalents at end of year	<u><u>\$ 6,823,659</u></u>
RECONCILIATION OF OPERATING INCOME TO NET CASH USED FOR OPERATING ACTIVITIES	
Operating income	\$ 595,509
Increase in accounts receivable	442,415
Decrease in accounts payable	(68,897)
Decrease in claims liability	<u>(420,000)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u><u>\$ 549,027</u></u>

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

PALO ALTO UNIFIED SCHOOL DISTRICT

**FIDUCIARY FUNDS
STATEMENT OF FIDUCIARY NET POSITION
JUNE 30, 2016**

	<u>Agency Funds</u>
ASSETS	
Deposits and investments	\$ 2,143,329
Total Assets	<u>\$ 2,143,329</u>
 LIABILITIES	
Due to student groups	\$ 603,103
Scholarships	1,540,226
Total Liabilities	<u>\$ 2,143,329</u>

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

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity

The Palo Alto Unified School District (the District) was founded on March 20, 1893 under the laws of the State of California. The District operates under a locally elected five-member board form of government and provides educational services to grades K - 12 as mandated by the state and federal agencies. The District operates twelve elementary, three middle, two high schools, an adult education program, a Young Fives program and two children's centers.

A reporting entity is comprised of the primary government, 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 the District, this includes general operations, food service, and student related activities of the District.

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 three broad fund categories: governmental, proprietary, 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 nonmajor governmental funds:

Major Governmental Funds

General Fund The General Fund is the chief operating fund for all districts. It is used to account for the ordinary operations of the District. All transactions except those accounted for in another fund are accounted for in this fund.

Two funds currently defined as special revenue funds in the California School Accounting Manual (CSAM) do not meet the GASB Statement No. 54 special revenue fund definition. Specifically, Fund 17, Special Reserve Fund for Other Than Capital Outlay Projects, and Fund 20, Special Revenue Fund for Postemployment Benefits, are not substantially composed of restricted or committed revenue sources. While these funds are authorized by statute and will remain open for internal reporting purposes, these funds function effectively as extensions of the General Fund, and accordingly have been combined with the General Fund for presentation in these audited financial statements.

Building Fund The Building Fund exists primarily to account separately for proceeds from the sale of bonds (*Education Code* Section 15146) and may not be used for any purposes other than those for which the bonds were issued.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Bond Interest and Redemption Fund The Bond Interest and Redemption Fund is used for the repayment of bonds issued for a District (*Education Code* Sections 15125-15262).

Nonmajor Governmental Funds

Special Revenue Funds The Special Revenue funds are used to account for the proceeds from specific revenue sources (other than trusts, major capital projects, or debt service) that are restricted or committed to the financing of particular activities and that compose a substantial portion of the inflows of the fund. Additional resources that are restricted, committed, or assigned to the purpose of the fund may also be reported in the fund.

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

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

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

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

Capital Project Funds The Capital Project funds are used to account for financial resources that are restricted, committed, or assigned to the acquisition or construction of major capital facilities and other capital assets (other than those financed by proprietary funds and trust funds).

Capital Facilities Fund The Capital Facilities Fund is used primarily to account separately for monies received from fees levied on developers or other agencies as a condition of approving a development (*Education Code* Sections 17620-17626). Expenditures are restricted to the purposes specified in *Government Code* Sections 65970-65981 or to the items specified in agreements with the developer (*Government Code* Section 66006).

County School Facilities Fund The County School Facilities Fund is established pursuant to *Education Code* Section 17070.43 to receive apportionments from the 1998 State School Facilities Fund (Proposition 1A), the 2002 State School Facilities Fund (Proposition 47), the 2004 State School Facilities Fund (Proposition 55), or the 2006 State Schools Facilities Fund (Proposition 1D) authorized by the State Allocation Board for new school facility construction, modernization projects, and facility hardship grants, as provided in the Leroy F. Greene School Facilities Act of 1998 (*Education Code* Section 17070 et seq.).

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Proprietary Funds Proprietary funds are used to account for activities that are more business-like than government-like in nature. Business-type activities include those for which a fee is charged to external users or to other organizational units of the local education agency, normally on a full cost-recovery basis. Proprietary funds are generally intended to be self-supporting and are classified as enterprise or internal service. The District has the following proprietary fund:

Internal Service Fund Internal service funds may be used to account for goods or services provided to other funds of the District on a cost-reimbursement basis. The District operates a self-insurance fund that is accounted for in an internal service fund.

Fiduciary Funds Fiduciary funds are used to account for assets held in trustee or agent capacity for others that cannot be used to support the District's own programs. The fiduciary fund category is split into four classifications: pension trust funds, investment trust funds, private-purpose trust funds, and agency funds. The key distinction between trust and agency funds is that trust funds are subject to a trust agreement that affects the degree of management involvement and the length of time that the resources are held.

Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. The District's agency fund accounts are 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 for each governmental function and excludes fiduciary activity. Direct expenses are those that are specifically associated with a service, program, or department and are therefore, clearly identifiable to a particular function. The District does not allocate indirect expenses to functions in the Statement of Activities, except for depreciation and other post-employment benefits. Program revenues include charges paid by the recipients of the goods or services offered by the programs and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues. The comparison of program revenues and expenses identifies the extent to which each program is self-financing or draws from the general revenues of the District. Eliminations have been made to minimize the double counting of internal activities.

Net position should be reported as restricted when constraints placed on net position 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.

Fund Financial Statements Fund financial statements report detailed information about the District. The focus of governmental fund financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Nonmajor 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.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

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.

Proprietary Funds Proprietary funds are accounted for using the flow of economic resources measurement focus and the accrual basis of accounting. All assets and all liabilities associated with the operation of this fund are included in the statement of net position. The statement of changes in fund net position presents increases (revenues) and decreases (expenses) in net total position. The statement of cash flows provides information about how the District finances and meets the cash flow needs of its proprietary fund.

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.

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 sixty days of fiscal year-end. However, to achieve comparability of reporting among California districts and so as not to distort normal revenue patterns, with respect to reimbursement grants and correcting state-aid apportionments, the California Department of Education has defined available for districts as collectible within one year. The following revenue sources are considered to be both measurable and available at fiscal year-end: state apportionment, 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.

Unearned Revenue Unearned 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 unearned revenue is removed from the balance sheet and revenue is recognized.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Certain grants received before the eligibility requirements are met are recorded as unearned revenue. On the governmental fund financial statements, receivables that will not be collected within the available period are also recorded as unearned 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, and typically paid within ninety days. Principal and interest on long-term obligations, which have not matured, are recognized when paid in the governmental funds as expenditures. Allocations of costs, such as depreciation and amortization, are not recognized in the governmental funds but are recognized in the government-wide statements.

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 for purposes of the statement of cash flows.

Investments

Investments held at the balance sheet date 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.

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 \$5,000. 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 a life are not capitalized, but are expensed as incurred.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

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

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, 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 statement of net position.

Compensated Absences

Compensated absences are accrued as a liability as the benefits are earned. The entire compensated absence liability is reported on the government-wide statement of net position. For governmental funds, the current portion of unpaid compensated absences is recognized as a current expense and reported as part of accounts payable. These amounts are reported in the general fund.

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. Credit for unused sick leave is applicable to all certificated employees and is determined by dividing the number of unused sick days by the number of base service days required to complete the last school year, if employed full-time.

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.

Debt Issuance Costs, Premiums and Discounts

In the government-wide financial statements and in the proprietary fund type financial statements, long-term obligations are reported as liabilities in the applicable governmental activities, or proprietary fund statement of net position. Debt premiums and discounts related are amortized over the life of the bonds using the straight-line method.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position also reports deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an expense or expenditure until then. The District reports deferred outflows of resources for deferred charges on refunding of debt and for pension related items.

In addition to liabilities, the statement of financial position reports a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as revenue until then. The District reports deferred inflows of resources for pension related items.

Pensions

For purposes of measuring the net pension liability and deferred outflows/inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the California State Teachers Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS) plan for schools (Plans) and additions to/deductions from the Plans' fiduciary net position have been determined on the same basis as they are reported by CalSTRS and CalPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Member contributions are recognized in the period in which they are earned. Investments are reported at fair value.

Fund Balances - Governmental Funds

Fund balances of the governmental funds are classified as follows:

Nonspendable - amounts that cannot be spent either because they are in nonspendable form or because they are legally or contractually required to be maintained intact.

Restricted - amounts that can be spent only for specific purposes because of constitutional provisions or enabling legislation or because of constraints that are externally imposed by creditors, grantors, contributors, or the laws or regulations of other governments.

Committed - amounts that can be used only for specific purposes determined by a formal action of the governing board. The governing board is the highest level of decision-making authority for the District. Commitments may be established, modified, or rescinded only through resolutions or other action as approved by the governing board.

Assigned - amounts that do not meet the criteria to be classified as restricted or committed but that are intended to be used for specific purposes. Under the District's adopted policy, only the governing board or chief business officer may assign amounts for specific purposes.

Unassigned - all other spendable amounts.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Spending Order Policy

When an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available, the District considers restricted funds to have been spent first. When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, the District considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds, as needed, unless the governing board has provided otherwise in its commitment or assignment actions.

Minimum Fund Balance Policy

In fiscal year 2010-11, the governing board adopted a minimum fund balance policy for the General Fund in order to protect the district against revenue shortfalls or unpredicted on-time expenditures. The policy requires a reserve for economic uncertainties consisting of unassigned amounts equal to no less than three percent of general fund expenditures and other financing uses.

Net Position

Net position represents the difference between assets and liabilities. Net position net of investment in capital assets, 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 position is 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 position is available.

Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For the District, these revenues are in-district premiums. Operating expenses are necessary costs incurred to provide the good or service that are the primary activity of the fund.

Interfund Activity

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures/expenses 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 and after non-operating revenues/expenses in proprietary funds. Repayments from funds responsible for particular expenditures/expenses to the funds that initially paid for them are not presented in the financial statements.

Estimates

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

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

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 budget purposes, on-behalf payments have not been included as revenue and expenditures.

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.

Change in Accounting Principles

In February 2015, the GASB issued Statement No. 72, *Fair Value Measurement and Application*. This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

The District has implemented the provisions of this Statement as of June 30, 2016.

In June 2015, the GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*. The objective of this Statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

This Statement establishes requirements for defined benefit pensions that are not within the scope of Statement No. 68, *Accounting and Financial Reporting for Pensions*, as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of Statement No. 68. It also amends certain provisions of Statement No. 67, *Financial Reporting for Pension Plans*, and Statement No. 68 for pension plans and pensions that are within their respective scopes.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

The provisions in this Statement effective as of June 30, 2016, include the provisions for assets accumulated for purposes of providing pensions through defined benefit plans and the amended provisions of Statements No. 67 and No. 68. The District has implemented these provisions as of June 30, 2016. The provisions in this Statement related to defined benefit pensions that are not within the scope of Statement No. 68 are effective for periods beginning after June 15, 2016.

In June 2015, the GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify – in the context of the current governmental financial reporting environment – the hierarchy of generally accepted accounting principles (GAAP). The "GAAP hierarchy" consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

This Statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*.

The District has implemented the provisions of this Statement as of June 30, 2016.

In December 2015, the GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. This Statement addresses accounting and financial reporting for certain external investment pools and pool participants. Specifically, it establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. An external investment pool qualifies for that reporting if it meets all of the applicable criteria established in this Statement. The specific criteria address (1) how the external investment pool transacts with participants, (2) requirements for portfolio maturity, quality, diversification, and liquidity; and (3) calculation and requirements of a shadow price. Significant noncompliance prevents the external investment pool from measuring all of its investments at amortized cost for financial reporting purposes. Professional judgment is required to determine if instances of noncompliance with the criteria established by this Statement during the reporting period, individually or in the aggregate, were significant.

If an external investment pool does not meet the criteria established by this Statement, that pool should apply the provisions in paragraph 16 of Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, as amended. If an external investment pool meets the criteria in this Statement and measures all of its investments at amortized cost, the pool's participants also should measure their investments in that external investment pool at amortized cost for financial reporting purposes. If an external investment pool does not meet the criteria in this Statement, the pool's participants should measure their investments in that pool at fair value, as provided in paragraph 11 of Statement No. 31, as amended.

This Statement establishes additional note disclosure requirements for qualifying external investment pools that measure all of their investments at amortized cost for financial reporting purposes and for governments that participate in those pools. Those disclosures for both the qualifying external investment pools and their participants include information about any limitations or restrictions on participant withdrawals.

The District has implemented the provisions of this Statement as of June 30, 2016.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

New Accounting Pronouncements

In June 2015, the GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

This Statement replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended, Statement No. 43, and Statement No. 50, *Pension Disclosures*.

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2016. Early implementation is encouraged.

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pension*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

This Statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans.

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2017. Early implementation is encouraged.

In August 2015, the GASB issued Statement No. 77, *Tax Abatement Disclosures*. This Statement requires governments that enter into tax abatement agreements to disclose the following information about the agreements:

- Brief descriptive information, such as the tax being abated, the authority under which tax abatements are provided, eligibility criteria, the mechanism by which taxes are abated, provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients
- The gross dollar amount of taxes abated during the period
- Commitments made by a government, other than to abate taxes, as part of a tax abatement agreement

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2015. Early implementation is encouraged.

In December 2015, the GASB issued Statement No. 78, *Pensions Provided Through Certain Multiple-Employer Defined Benefit Pension Plans*. The objective of this Statement is to address a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local governmental employers whose employees are provided with such pensions.

Prior to the issuance of this Statement, the requirements of Statement No. 68 applied to the financial statements of all state and local governmental employers whose employees are provided with pensions through pension plans that are administered through trusts that meet the criteria in paragraph 4 of that Statement.

This Statement amends the scope and applicability of Statement No. 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local government pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This Statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2015. Early implementation is encouraged.

In January 2016, the GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - amendment of GASB Statement No. 14*. The objective of this Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity, as amended*. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. Early implementation is encouraged.

In March 2016, the GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*. The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2016, and should be applied retroactively. Early implementation is encouraged.

In March 2016, the GASB issued Statement No. 82, *Pension Issues - An Amendment of GASB Statements No. 67, No. 68, and No. 73*. The objective of this Statement is to address certain issues that have been raised with respect to Statements No 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68 and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. Early implementation is encouraged.

NOTE 2 - DEPOSITS AND INVESTMENTS

Summary of Deposits and Investments

Deposits and investments as of June 30, 2016, are classified in the accompanying financial statements as follows:

Governmental funds	\$ 169,997,062
Fiduciary funds	2,143,329
Proprietary fund	6,823,659
Total deposits and investments	<u>\$ 178,964,050</u>

Deposits and investments as of June 30, 2016, consist of the following:

Cash on hand and in banks	\$ 8,973,268
Investments	169,990,782
Total deposits and investments	<u>\$ 178,964,050</u>

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.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

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 amortized cost of which approximate 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.

Investment in the State Investment Pool - The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California government code Section 16429 under the oversight of the Treasurer of the State of California. The fair value of the District's investment in the pool is reported in the accompanying financial statement at amounts based upon the District's pro-rata share of the amortized cost which approximates fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which is recorded on the amortized cost basis.

General Authorizations

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

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

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. The District manages its exposure to interest rate risk by depositing substantially all of its funds in the county treasury pool.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

The District monitors the interest rate risk inherent in its portfolio by measuring the weighted average maturity of its portfolio. Information about the maturity of the District's portfolio is presented in the following schedule:

<u>Investment Type</u>	<u>Cost</u>	<u>Uncategorized Fair Value</u>	<u>Weighted Average Maturity</u>
County Pool	\$ 169,979,310	\$ 170,490,778	439
State Investment Pool	11,472	11,479	167
Total	<u>\$ 169,990,782</u>	<u>\$ 170,502,257</u>	

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 and LAIF are not rated as of June 30, 2016.

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 agency. As of June 30, 2016, the District's bank balance of \$6,460,832 was exposed to custodial credit risk because it was uninsured and collateralized with securities held by the pledging financial institution's trust department or agent, but not in the name of the District.

Fair Value Measurements

The District categorizes the fair value measurements of its investments based on the hierarchy established by generally accepted accounting principles. The fair value hierarchy, which has three levels, is based on the valuation inputs used to measure an asset's fair value. The following provides a summary of the hierarchy used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets that the District has the ability to access at the measurement date. Level 1 assets may include debt and equity securities that are traded in an active exchange market and that are highly liquid and are actively traded in over-the-counter markets.

Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets in active markets, quoted prices for identical or similar assets in markets that are not active, or other inputs that are observable, such as interest rates and curves observable at commonly quoted intervals, implied volatilities, and credit spreads. For financial reporting purposes, if an asset has a specified term, a Level 2 input is required to be observable for substantially the full term of the asset.

Level 3 - Unobservable inputs should be developed using the best information available under the circumstances, which might include the District's own data. The District should adjust that data if reasonable available information indicates that other market participants would use different data or certain circumstances specific to the District are not available to other market participants.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Uncategorized – The District’s investments in the Santa Clara County Treasury Investment Pool and state investment pools are not measured using the input levels described above because transactions are based on a stable net asset value per share. All contributions and redemptions are transacted at \$1.00 net asset value per share.

NOTE 3 - RECEIVABLES

Receivables at June 30, 2016, consisted of intergovernmental grants, entitlements, interest and other local sources. All receivables are considered collectible in full as noted in the following table:

	General Fund	Building Fund	Bond Interest and Redemption Fund	Nonmajor Governmental Funds	Total Governmental Funds	Proprietary Fund
Federal government						
Categorical aid	\$ 3,016,710	\$ -	\$ -	\$ 123,787	\$ 3,140,497	\$ -
State government						
State apportionment	174,653	-	-	-	174,653	-
Categorical aid	213,634	-	-	52,444	266,078	-
Lottery	1,174,797	-	-	-	1,174,797	-
Local government						
Interest	123,958	65,390	41,410	18,872	249,630	-
Other local sources	375,356	28,460	-	12,563	416,379	12,482
Total receivables	<u>\$ 5,079,108</u>	<u>\$ 93,850</u>	<u>\$ 41,410</u>	<u>\$ 207,666</u>	<u>\$ 5,422,034</u>	<u>\$ 12,482</u>

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2016, was as follows:

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016
Governmental Activities				
Capital assets not being depreciated				
Land	\$ 9,726,493	\$ -	\$ -	\$ 9,726,493
Construction in progress	16,578,063	16,085,382	13,013,408	19,650,037
Nondepreciable capital assets	<u>26,304,556</u>	<u>16,085,382</u>	<u>13,013,408</u>	<u>29,376,530</u>
Capital assets being depreciated				
Land improvements	40,869,121	3,469,377	-	44,338,498
Buildings and improvements	552,509,765	13,340,890	-	565,850,655
Furniture and equipment	8,898,255	319,016	-	9,217,271
Library collections	293,406	-	-	293,406
Depreciable capital assets	<u>602,570,547</u>	<u>17,129,283</u>	<u>-</u>	<u>619,699,830</u>
Total capital assets	<u>628,875,103</u>	<u>33,214,665</u>	<u>13,013,408</u>	<u>649,076,360</u>
Less accumulated depreciation				
Land improvements	10,739,558	2,057,912	-	12,797,470
Buildings and improvements	272,605,529	11,274,154	-	283,879,683
Furniture and equipment	5,683,312	696,638	-	6,379,950
Library collections	293,406	-	-	293,406
Total accumulated depreciation	<u>289,321,805</u>	<u>14,028,704</u>	<u>-</u>	<u>303,350,509</u>
Net capital assets	<u>\$ 339,553,298</u>	<u>\$ 19,185,961</u>	<u>\$ 13,013,408</u>	<u>\$ 345,725,851</u>

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

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

Governmental Activities

Instruction	\$ 9,145,924
Supervision of instruction	574,482
Instructional library media and technology	200,226
School administration	934,860
Pupil transportation	154,771
Food services	171,336
Other pupil services	787,067
Ancillary services	84,907
Community services	10,512
Other general administration	453,102
Data processing services	301,826
Plant maintenance and operations	<u>1,209,691</u>
Total depreciation expense	<u>\$ 14,028,704</u>

NOTE 5 - INTERFUND TRANSACTIONS

Interfund Receivables/Payables (Due To/Due From)

Interfund receivable and payable balances arise from interfund transactions and are recorded by all funds affected in the period in which transactions are executed. At June 30, 2016, the Nonmajor Governmental Funds has a payable to the General Fund of \$174,359.

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

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

Operating Transfers

Interfund transfers for the year ended June 30, 2016, consisted of the following:

Transfers out	Transfers in			Total Transfers in
	General Fund	Building Fund	Nonmajor Governmental Funds	
General Fund	\$ -	\$ -	\$ 450,000	\$ 450,000
Nonmajor Governmental Funds	43,213	3,000,000	-	3,043,213
Total transfers out	<u>\$ 43,213</u>	<u>\$ 3,000,000</u>	<u>\$ 450,000</u>	<u>\$ 3,493,213</u>

The County School Services Fund transferred reimbursements of former bond expenditures to the Building Fund.	\$ 3,000,000
	450,000
The Capital Facilities Fund transferred to the General Fund for administrative cost recovery.	43,213
Total interfund transfers	<u>\$ 3,493,213</u>

NOTE 6 - ACCOUNTS PAYABLE

Accounts payable at June 30, 2016, consisted of the following:

	General Fund	Building Fund	Nonmajor Governmental Funds	Total Governmental Funds	Proprietary Funds
Vendor payables	\$ 2,653,382	\$ 878,717	\$ 218,366	\$ 3,750,465	\$ 10,474
Salaries and benefits	2,645,488	-	20,681	2,666,169	-
Total payables	<u>\$ 5,298,870</u>	<u>\$ 878,717</u>	<u>\$ 239,047</u>	<u>\$ 6,416,634</u>	<u>\$ 10,474</u>

NOTE 7 - UNEARNED REVENUE

Unearned revenue at June 30, 2016, consists of the following:

	General Fund	Nonmajor Governmental Fund	Total
Other federal financial assistance	\$ 25,704	\$ -	\$ 25,704
Other local assistance	1,386,158	427,403	1,813,561
Palo Alto Partners in Education	5,700,000	-	5,700,000
Total unearned revenue	<u>\$ 7,481,853</u>	<u>\$ 427,403</u>	<u>\$ 7,909,256</u>

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 8 - LONG-TERM OBLIGATIONS

Summary

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

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016	Due in One Year
General obligation bonds	\$ 340,180,555	\$ 52,081,483	\$ 32,255,483	\$ 360,006,555	\$ 25,827,213
Bond premium	3,880,782	1,336,590	242,225	4,975,147	312,572
Compensated absences	369,562	182,608	-	552,170	-
OPEB obligation	11,411,655	2,636,076	396,417	13,651,314	-
Net pension liability	147,365,220	21,035,840	-	168,401,060	-
	<u>\$ 503,207,774</u>	<u>\$ 77,272,597</u>	<u>\$ 32,894,125</u>	<u>\$ 547,586,246</u>	<u>\$ 26,139,785</u>
Deferred amount on refunding	<u>\$ (4,625,901)</u>	<u>\$ -</u>	<u>\$ (513,989)</u>	<u>\$ (4,111,912)</u>	<u>\$ (513,989)</u>

Payments on the general obligation bonds are made by the Bond Interest and Redemption Fund with local revenues. Compensated absences and pension liability will be paid by the fund for which the employee worked. The OPEB obligation will be paid by the General Fund.

Bonded Debt

The outstanding general obligation bonded debt is as follows:

Issue Date	Maturity Date	Interest Rate	Original Issue	Bonds Outstanding July 1, 2015	Additons/ Accretion	Deductions/ Redemption	Bonds Outstanding June 30, 2016
2005	2025	2.0-4.6%	\$ 107,225,000	\$ 14,280,000	\$ -	\$ 6,965,000	\$ 7,315,000
2009	2034	5.0-5.5%	109,414,249	155,665,555	7,081,483	2,540,483	160,206,555
2011	2028	4.7-5.8%	25,000,000	25,000,000	-	-	25,000,000
2013	2025	0.4-2.9%	52,845,000	50,685,000	-	1,065,000	49,620,000
2013	2037	2.0-3.5%	70,000,000	54,550,000	-	1,500,000	53,050,000
2014	2024	2.0-3.25%	40,000,000	40,000,000	-	20,185,000	19,815,000
2016	2035	2.0-4.0%	45,000,000	-	45,000,000	-	45,000,000
				<u>\$ 340,180,555</u>	<u>\$ 52,081,483</u>	<u>\$ 32,255,483</u>	<u>\$ 360,006,555</u>

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

Debt Service Requirements to Maturity

The bonds mature through 2037 as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest to Maturity</u>	<u>Total</u>
2017	\$ 25,827,213	\$ 6,535,517	\$ 32,362,730
2018	22,412,864	6,452,850	28,865,714
2019	21,959,344	6,067,167	28,026,511
2020	17,413,383	5,787,598	23,200,981
2021	18,422,790	5,379,904	23,802,694
2022-2026	65,217,797	29,576,961	94,794,758
2027-2031	57,973,263	23,640,703	81,613,966
2032-2036	66,567,112	13,018,618	79,585,730
2037	10,880,000	190,400.00	11,070,400
Subtotal	<u>306,673,766</u>	<u>\$ 96,649,718</u>	<u>\$ 403,323,484</u>
Accretion to date	<u>53,332,789</u>		
Total	<u>\$ 360,006,555</u>		

Accumulated Unpaid Employee Vacation

The long-term portion of accumulated unpaid employee vacation for the District at June 30, 2016, amounted to \$552,170.

Other Postemployment Benefits (OPEB) Obligation

The District's annual required contribution for the year ended June 30, 2016, was \$2,735,170 and contributions made by the District during the year were \$396,417. Interest on the net OPEB obligation and adjustments to the annual required contribution were \$444,866 and \$543,960 respectively, resulting in an increase to the net OPEB obligation of \$2,239,659. As of June 30, 2016, the net OPEB obligation was \$13,651,224. See Note 10 for additional information regarding the OPEB obligation and the postemployment benefits plan.

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 9 - FUND BALANCES

Fund balances are composed of the following elements:

	General Fund	Building Fund	Bond Interest and Redemption Fund	Nonmajor Governmental Funds	Total Governmental Funds
Nonspendable					
Revolving cash	\$ 30,000	\$ -	\$ -	\$ -	\$ 30,000
Stores inventories	143,487	-	-	50,417	193,904
Prepaid expenditures	152,716	-	-	8,835	161,551
Loan receivable	1,458,888	-	-	-	1,458,888
Total nonspendable	1,785,091	-	-	59,252	1,844,343
Restricted					
Capital projects	-	8,784,236	-	5,882,160	14,666,396
Debt service	-	56,816,521	32,496,507	-	89,313,028
Educational programs	5,333,915	-	-	271,576	5,605,491
Total restricted	5,333,915	65,600,757	32,496,507	6,153,736	109,584,915
Committed					
Adult education	-	-	-	1,750,051	1,750,051
Deferred maintenance	-	-	-	971,341	971,341
Cafeteria	-	-	-	5,148	5,148
Total committed	-	-	-	2,726,540	2,726,540
Assigned					
Educational programs	25,434,880	-	-	-	25,434,880
Retiree benefits	2,282,599	-	-	-	2,282,599
Total assigned	27,717,479	-	-	-	27,717,479
Unassigned					
Reserve for economic uncertainties	20,919,051	-	-	-	20,919,051
Remaining unassigned	115,221	-	-	-	115,221
Total unassigned	21,034,272	-	-	-	21,034,272
Total fund balance	\$ 55,870,757	\$ 65,600,757	\$ 32,496,507	\$ 8,939,528	\$ 162,907,549

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

Reconciliation of statement of net position to the General Fund

The following is a reconciliation of the difference between the General Fund unassigned balance and the deficit unrestricted net position, as shown in the governmental statement of net position:

Unassigned fund balance of the General Fund	\$ 21,034,272
Add	
Assigned fund balance of the General Fund	27,717,479
Nonspendable fund balance of the General Fund	1,785,091
Deferred Maintenance Fund balance	971,341
Adult Education Fund balance	1,773,925
Cafeteria Fund Balance	5,148
Deferred outflows of resources	17,130,917
Deduct	
OPEB	(13,651,314)
Compensated absences liability	(552,170)
Net pension liability	(168,401,060)
Deferred inflows of resources	(28,844,567)
	<u>\$ (141,030,938)</u>

NOTE 10 - POSTEMPLOYMENT HEALTH CARE PLAN AND OTHER POSTEMPLOYMENT BENEFITS (OPEB) OBLIGATION

Plan Description

The Postemployment Benefit Plan (the Plan) is a single-employer defined benefit healthcare plan administered by the District. The Plan provides medical, dental and vision insurance benefits to eligible retirees and their spouses for a maximum of five years or until the retiree reaches age 65, whichever comes first. No benefits are paid to surviving spouses or other dependents after the retiree's death. After the benefit period expires, retirees are permitted to continue coverage, but the retiree must pay 100% of all premiums.

The unfunded portion of annual required contributions (net OPEB obligation) is presented in the statement of net position as a portion of long-term obligations.

Funding Policy

The contribution requirements of Plan members and the District are established and may be amended by the District, the District's bargaining units, and unrepresented groups. The required contribution is based on projected pay-as-you-go financing requirements, with an additional amount to prefund benefits as determined annually through the agreements between the District, the District's bargaining units, and unrepresented groups. Plan members receiving benefits who select HMO are not required to contribute for employee only coverage. Plan members receiving benefits who select PPO are required to pay excess of active premium over the Blue Cross HMO premium. Contributions made by retirees who selected PPO are \$985 per month for retiree-only coverage, and \$2,230 to \$3,032 per month for retiree and family coverage. The remainder of the premiums was funded from the District's General Fund.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Annual OPEB Cost and Net OPEB Obligation

The District's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial accrued liabilities (UAAL) (or funding excess) over a period not to exceed thirty years. The following table shows the components of the annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the net OPEB obligation to the Plan:

Annual required contribution	\$ 2,735,170
Interest on net OPEB obligation	444,866
Adjustment to annual required contribution	<u>(543,960)</u>
Annual OPEB cost (expense)	2,636,076
Contributions made (pay-as-you-go)	<u>(396,417)</u>
Increase in net OPEB obligation	2,239,659
Net OPEB obligation, beginning of year	<u>11,411,655</u>
Net OPEB obligation, end of year	<u><u>\$ 13,651,314</u></u>

Trend Information

Trend information for annual OPEB cost, the percentage of annual OPEB cost contributed to the Plan, and the net OPEB obligation is was as follows:

Year Ended <u>June 30,</u>	Annual <u>OPEB Cost</u>	Actual <u>Contribution</u>	Percentage <u>Contributed</u>	Net OPEB <u>Obligation</u>
2016	\$ 2,636,076	\$ 396,417	15.04%	\$ 13,651,314
2015	2,501,230	543,785	21.74%	11,411,655
2014	2,776,678	484,065	15.00%	9,454,210

Funded Status and Funding Progress

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, investment returns, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the Plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

A schedule of funding progress as of the most recent actuarial valuation is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
July 1, 2014	\$ -	\$ 23,520,252	\$ 23,520,252	0%	\$ 122,469,237	19.21%

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2014, actuarial valuation, the projected unit credit method was used. The actuarial assumptions included a 4 percent investment rate of return (net of administrative expenses), based on the assets invested in the General Fund. Healthcare cost trend rates ranged from an initial 7.5 percent and 4.5 percent, to an ultimate rate of 4.5 percent. The cost trend rate used for the Dental and Vision programs was 3 percent. The UAAL is being amortized at a level percent of payroll. The remaining amortization period at July 1, 2014, was 24 years on a closed basis. At June 30, 2016, the District’s General Fund held total assigned assets in the amount of \$2,362,599 consisting of \$2,357,824 on deposit with the county treasurer, and receivables in the amount of \$4,775.

NOTE 11 - RISK MANAGEMENT

Property and Liability

The District is exposed to various risks of loss related to torts, theft, damage, destruction of asset’s, errors and omissions, and injuries to employees and natural disasters. During fiscal year ending June 30, 2016, the District contracted with Northern California Relief for property and liability insurance coverage for liabilities exceeding \$50,000 with a limit \$1,000,000 per occurrence. 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

The District is a participant in the Schools Alliance for Workers’ Compensation Excess Self-Funded insurance purchasing pool (the Insurance Pool). The intent of the Insurance Pool is to achieve the benefit of a reduced premium for the District by virtue of its grouping and representation with other participants in the Insurance Pool. 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 Insurance Pool. Each participant pays its workers' compensation premium based on its individual rate. Total savings are then calculated and each participant's individual performance is compared to the overall savings percentage of each participating school district. 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 Insurance Pool. Participation in the Insurance Pool is limited to districts that can meet the Insurance Pool’s selection criteria.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Employee Medical Benefits

The District has purchased health insurance for its employees from Kaiser Foundation and Blue Cross. Rates are set through an annual calculation process by the health plan providers. The District pays the health plan provider a monthly premium.

Claims Liabilities

The District records an estimated liability for indemnity torts and other claims against the District. Claims liabilities are based on estimates of the ultimate cost of reported claims including future claim adjustment expenses and an estimate for claims incurred, but not reported based on historical experience.

Unpaid Claims Liabilities

The self-insurance fund establishes a liability for both reported and unreported events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represent the changes in approximate aggregate liabilities for the District from July 1, 2014 to June 30, 2016:

	<u>Workers'</u> <u>Compensation</u>
Liability Balance, July 1, 2014	\$ 6,431,000
Claims and changes in estimates	(753,192)
Claims payments	(380,808)
Liability Balance, June 30, 2015	<u>5,297,000</u>
Claims and changes in estimates	985,555
Claims payments	(1,485,555)
Liability Balance, June 30, 2016	<u><u>\$ 4,797,000</u></u>
Assets available to pay claims at June 30, 2016	<u><u>\$ 6,825,667</u></u>

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 12 - EMPLOYEE RETIREMENT SYSTEMS

Qualified employees are covered under multiple-employer defined benefit pension plans maintained by agencies of the State of California. Academic employees are members of the California State Teachers' Retirement System (CalSTRS) and classified employees are members of the California Public Employees' Retirement System (CalPERS).

For the fiscal year ended June 30, 2016, the District reported net pension liabilities, deferred outflows of resources, deferred inflows of resources, and pension expense for each of the above plans as follows:

Pension Plan	Collective Net	Collective	Collective Deferred	Collective
	Pension Liability	Deferred Outflows of Resources	Inflows of Resources	Pension Expense
CalSTRS	\$ 128,709,093	\$ 10,810,489	\$ 18,191,222	\$ 9,957,213
CalPERS	39,691,967	6,320,428	10,653,345	10,456,014
Total	<u>\$ 168,401,060</u>	<u>\$ 17,130,917</u>	<u>\$ 28,844,567</u>	<u>\$ 20,413,227</u>

The details of each plan are as follows:

California State Teachers' Retirement System (CalSTRS)

Plan Description

The District contributes to the State Teachers Retirement Plan (STRP) administered by the California State Teachers' Retirement System (CalSTRS). STRP is a cost-sharing multiple-employer public employee retirement system defined benefit pension plan. Benefit provisions are established by State statutes, as legislatively amended, within the State Teachers' Retirement Law.

A full description of the pension plan regarding benefit provisions, assumptions (for funding, but not accounting purposes), and membership information is listed in the June 30, 2014, annual actuarial valuation report, Defined Benefit Program Actuarial Valuation. This report and CalSTRS audited financial information are publically available reports that can be found on the CalSTRS website under Publications at: <http://www.calstrs.com/member-publications>.

Benefits Provided

The STRP provides retirement, disability and survivor benefits to beneficiaries. Benefits are based on members' final compensation, age and years of service credit. Members hired on or before December 31, 2012, with five years of credited service are eligible for the normal retirement benefit at age 60. Members hired on or after January 1, 2013, with five years of credited service are eligible for the normal retirement benefit at age 62. The normal retirement benefit is equal to 2.0 percent of final compensation for each year of credited service.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

The STRP is comprised of four programs: Defined Benefit Program, Defined Benefit Supplement Program, Cash Balance Benefit Program and Replacement Benefits Program. The STRP holds assets for the exclusive purpose of providing benefits to members and beneficiaries of these programs. CalSTRS also uses plan assets to defray reasonable expenses of administering the STRP. Although CalSTRS is the administrator of the STRP, the state is the sponsor of the STRP and obligor of the trust. In addition, the state is both an employer and nonemployer contributing entity to the STRP.

The District contributes exclusively to the STRP Defined Benefit Program, thus disclosures are not included for the other plans.

The STRP provisions and benefits in effect at June 30, 2016, are summarized as follows:

	<u>STRP Defined Benefit Program</u>	
	On or before December 31, 2012	On or after January 1, 2013
Hire date	December 31, 2012	January 1, 2013
Benefit formula	2% at 60	2% at 62
Benefit vesting schedule	5 years of service	5 years of service
Benefit payments	Monthly for life	Monthly for life
Retirement age	60	62
Monthly benefits as a percentage of eligible compensation	2.0% - 2.4%	2.0% - 2.4%
Required employee contribution rate	9.20%	8.56%
Required employer contribution rate	10.73%	10.73%
Required state contribution rate	7.13%	7.13%

Contributions

Required member, District and State of California contribution rates are set by the California Legislature and Governor and detailed in Teachers' Retirement Law. The contributions rates are expressed as a level percentage of payroll using the entry age normal actuarial method. In accordance with AB 1469, employer contributions into the CalSTRS will be increasing to a total of 19.1 percent of applicable member earnings phased over a seven year period. The contribution rates for each plan for the year ended June 30, 2016, are presented above and the District's total contributions were \$10,810,489.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2016, the District reported a liability for its proportionate share of the net pension liability that reflected a reduction for State pension support provided to the District. The amount recognized by the District as its proportionate share of the net pension liability, the related state support and the total portion of the net pension liability that was associated with the District were as follows:

District's proportionate share of net pension liability	\$ 128,709,093
State's proportionate share of the net pension liability associated with the District	68,072,922
Total net pension liability, including State share	<u><u>\$ 196,782,015</u></u>

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

The net pension liability was measured as of June 30, 2015. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating school districts and the State, actuarially determined. The District's proportionate share for the measurement period June 30, 2015 and June 30, 2014, respectively was 0.19118 percent and 0.20007 percent, resulting in a net decrease in the proportionate share of 0.0089 percent.

For the year ended June 30, 2016, the District recognized pension expense of \$9,957,213. In addition, the District recognized pension expense and revenue of \$6,342,500 for support provided by the State. At June 30, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Inflows of Resources	Deferred Inflows of Resources
Pension contributions subsequent to measurement date	\$ 10,810,489	\$ -
Net differences between projected and actual earnings on plan investments	-	10,491,882
Differences between expected and actual experience	-	2,150,759
Change in Proportions	-	5,548,581
Total	<u>\$ 10,810,489</u>	<u>\$ 18,191,222</u>

The deferred outflows of resources related to pensions resulting from District contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the subsequent fiscal year. The remaining deferred outflows and inflows of resources will be amortized over the Expected Average Remaining Service Life (EARSL) of all members that are provided benefits (active, inactive, and retirees) as of the beginning of the measurement period. The EARSL for the 2014-2015 measurement period is 7 years and will be recognized in pension expense as follows:

Asset Class	Assumed Asset Allocation	Long-term Expected Real Rate of Return
Global equity	47.00%	4.50%
Private equity	12.00%	6.20%
Real estate	15.00%	4.35%
Inflation sensitive	5.00%	3.20%
Fixed income	20.00%	0.20%
Cash/liquidity	1.00%	0.00%
Total	<u>100.00%</u>	

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Actuarial Methods and Assumptions

Total pension liability for STRP was determined by applying update procedures to a financial reporting actuarial valuation as of June 30, 2014, and rolling forward the total pension liability to June 30, 2015. The financial reporting actuarial valuation as of June 30, 2014, used the following methods and assumptions, applied to all prior periods included in the measurement:

Valuation date	June 30, 2014
Measurement date	June 30, 2015
Experience study	July 1, 2006 through June 30, 2010
Actuarial cost method	Entry age normal
Discount rate	7.60%
Investment rate of return	7.60%
Consumer price inflation	3.00%
Wage growth	3.75%

CalSTRS uses custom mortality tables to best fit the patterns of mortality among its members. These custom tables are based on RP2000 series tables adjusted to fit CalSTRS experience.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. The best estimate ranges were developed using capital market assumptions from CalSTRS general investment consultant. Based on the model for CalSTRS consulting actuary's investment practice, a best estimate range was determined by assuming the portfolio is re-balanced annually and that the annual returns are lognormally distributed and independent from year to year to develop expected percentiles for the long-term distribution of annualized returns. The assumed asset allocation is based on Teachers' Retirement Board of the California State Teachers' Retirement System (board) policy for target asset allocation in effect on February 2, 2012, the date the current experience study was approved by the board. Best estimates of 10-year geometric real rates of return and the assumed asset allocation for each major asset class used as input to develop the actuarial investment rate of return are summarized in the following table:

<u>Asset Class</u>	<u>Assumed Asset Allocation</u>	<u>Expected Real Rate of Return</u>
Global equity	47.00%	4.50%
Private equity	12.00%	6.20%
Real estate	15.00%	4.35%
Inflation sensitive	5.00%	3.20%
Fixed income	20.00%	0.20%
Cash/liquidity	1.00%	0.00%
Total	<u>100.00%</u>	

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

Discount Rate

The discount rate used to measure the total pension liability was 7.60 percent. The projection of cash flows used to determine the discount rate assumed the contributions from plan members and employers will be made at statutory contribution rates. Projected inflows from investment earnings were calculated using the long-term assumed investment rate of return (7.60 percent) and if contributions, benefit payments and administrative expense occurred midyear. Based on these assumptions, the STRP's fiduciary net position was projected to be available to make all projected future benefit payments to current plan members. Therefore, the long-term assumed investment rate of return was applied to all periods of projected benefit payments to determine total pension liability.

The following presents the District's proportionate share of the net pension liability calculated using the current discount rate as well as what the net pension liability would be if it were calculated using a discount rate that is one percent lower or higher than the current rate:

<u>Discount Rate</u>	<u>Net Pension Liability</u>
1% decrease (6.60%)	\$ 194,340,713
Current discount rate (7.60%)	128,709,093
1% increase (8.60%)	74,163,921

California Public Employees Retirement System (CalPERS)

Plan Description

Qualified employees are eligible to participate in the School Employer Pool (SEP) under the California Public Employees' Retirement System (CalPERS), a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by CalPERS. Benefit provisions are established by State statutes, as legislatively amended, within the Public Employees' Retirement Law.

A full description of the pension plan(s) regarding benefit provisions, assumptions (for funding, but not accounting purposes), and membership information is listed in the June 30, 2014 annual actuarial valuation report, Schools Pool Actuarial Valuation, 2014. This report and CalPERS audited financial information are publically available reports that can be found on the CalPERS website under Forms and Publications at: <https://www.calpers.ca.gov/page/forms-publications>.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Benefits Provided

CalPERS provides service retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. Benefits are based on years of service credit, a benefit factor and the member's final compensation. Members hired on or before December 31, 2012, with five years of total service are eligible to retire at age 50 with statutorily reduced benefits. Members hired on or after January 1, 2013, with five years of total service are eligible to retire at age 52 with statutorily reduced benefits. All members are eligible for non-duty disability benefits after five years of service. The Basic Death Benefit is paid to any member's beneficiary if the member dies while actively employed. An employee's eligible survivor may receive the 1957 Survivor Benefit if the member dies while actively employed, is at least age 50 (or 52 for members hired on or after January 1, 2013), and has at least five years of credited service. The cost of living adjustments for each plan are applied as specified by the Public Employees' Retirement Law.

The CalPERS provisions and benefits in effect at June 30, 2016, are summarized as follows:

	School Employer Pool (CalPERS)	
	On or before	On or after
Hire date	December 31, 2012	January 1, 2013
Benefit formula	2% at 55	2% at 62
Benefit vesting schedule	5 years of service	5 years of service
Benefit payments	Monthly for life	Monthly for life
Retirement age	55	62
Monthly benefits as a percentage of eligible compensation	1.1% - 2.5%	1.0% - 2.5%
Required employee contribution rate	7.0%	6.0%
Required employer contribution rate	11.8%	11.8%

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Contributions

Section 20814(c) of the California Public Employees' Retirement Law requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. Total plan contributions are calculated through the CalPERS annual actuarial valuation process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The District is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. The contributions rates are expressed as percentage of annual payroll. The contribution rates for each plan for the year ended June 30, 2016, are presented above and the total District contributions were \$3,934,281 for the year ended June 30, 2016.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

As of June 30, 2016, the District reported net pension liabilities for its proportionate share of the CalPERS net pension liability totaling \$39,691,967. The net pension liability was measured as of June 30, 2015. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating school districts, actuarially determined. The District's proportionate share for the measurement period June 30, 2015 and June 30, 2014, respectively was 0.26928 percent and 0.26824 percent, resulting in a net increase in the proportionate share of 0.00104 percent.

For the year ended June 30, 2016, the District recognized pension expense of \$10,456,014. At June 30, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension contributions subsequent to measurement date	\$ 3,934,281	\$ -
Differences between projected and actual earnings on plan investments	-	1,359,087
Change in assumption	-	2,438,785
Differences between expected and actual experience	2,268,454	-
Change in Proportions	117,693	6,855,473
Total	<u>\$ 6,320,428</u>	<u>\$ 10,653,345</u>

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

The deferred outflows/(inflows) of resources related to pensions resulting from District contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year 2016-17. The deferred outflows/(inflows) of resources related to the difference between projected and actual earnings on pension plan investments will be amortized over a closed five-year period and will be recognized in pension expense as follows:

Year Ended June 30,	
2017	\$ (4,622,570)
2018	(4,261,757)
2019	(1,012,616)
2020	1,629,745
Total	<u>\$ (8,267,198)</u>

Actuarial Methods and Assumptions

Total pension liability for the SEP was determined by applying update procedures to a financial reporting actuarial valuation as of June 30, 2014, and rolling forward the total pension liability to June 30, 2015. The financial reporting actuarial valuation as of June 30, 2014, used the following methods and assumptions, applied to all prior periods included in the measurement:

Valuation date	June 30, 2014
Measurement date	June 30, 2015
Experience study	July 1, 1997 through June 30, 2011
Actuarial cost method	Entry age normal
Discount rate	7.65%
Investment rate of return	7.65%
Consumer price inflation	2.75%
Wage growth	Varies by entry age and services

Mortality assumptions are based on mortality rates resulting from the most recent CalPERS experience study adopted by the CalPERS Board. For purposes of the post-retirement mortality rates, those revised rates include five years of projected ongoing mortality improvement using Scale AA published by the Society of Actuaries.

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Using historical returns of all the funds' asset classes, expected compound returns were calculated over the short-term (first ten years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent. The target asset allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Assumed Asset Allocation	Long-term Expected Real Rate of Return
Global equity	51.0%	5.3%
Global fixed income	19.0%	1.0%
Private equity	10.0%	6.8%
Real estate	10.0%	4.5%
Inflation sensitive	6.0%	0.5%
Infrastructure and Forestland	2.0%	4.5%
Liquidity	2.0%	-0.6%
Total	100.00%	

Discount Rate

The discount rate used to measure the total pension liability was 7.65 percent. The projection of cash flows used to determine the discount rate assumed the contributions from plan members and employers will be made at statutory contribution rates. Based on these assumptions, the School Employer Pool fiduciary net position was projected to be available to make all projected future benefit payments to current plan members. Therefore, the long-term assumed investment rate of return was applied to all periods of projected benefit payments to determine total pension liability.

The following presents the District's proportionate share of the net pension liability calculated using the current discount rate as well as what the net pension liability would be if it were calculated using a discount rate that is one percent lower or higher than the current rate:

Discount rate	Net Pension Liability
1% decrease (6.65%)	\$ 64,601,983
Current discount rate (7.65%)	39,691,967
1% increase (8.65%)	18,977,624

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Social Security

As established by Federal law, all public sector employees who are not members of their employer's existing retirement system (CalSTRS or CalPERS) must be covered by social security or an alternative plan. The District has elected to use social security. Contributions made by the District and an employee vest immediately. The District contributes 6.2% of an employee's gross earnings and employees are required to contribute an additional 6.2% of gross earnings.

On Behalf Payments

The State of California makes contributions to CalSTRS on behalf of the District. These payments consist of State General Fund contributions to CalSTRS in the amount of \$6,342,500 (7.125 percent of annual payroll). Contributions are no longer appropriated in the annual *Budget Act* for the legislatively mandated benefits to CalPERS. Therefore, there is no on behalf contribution rate for CalPERS. Under accounting principles generally accepted in the United States of America, these amounts are to be reported as revenues and expenditures. Accordingly, these amounts have been recorded in these financial statements. On behalf payments have been excluded from the calculation of available reserves, and have not been included in the budgeted amounts reported in the *General Fund - Budgetary Comparison Schedule*.

State General Fund contributions for the current year and preceding two years were as follows:

<u>Fiscal Year</u>	<u>Percent of Annual Payroll</u>	<u>Total Contribution</u>
2015-16	7.125%	\$ 6,342,500
2014-15	5.679%	4,731,786
2013-14	5.541%	4,260,083

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 13 - 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, 2016.

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, 2016.

Construction Commitment

As of June 30, 2016, the District had the following commitments with respect to the unfinished capital project

<u>Capital Project</u>	<u>Remaining Construction Commitment</u>	<u>Expected Date of Completion</u>
Palo Alto High School New Theatre	\$ 82,788	5/6/2016
Gunn High School Campus Light	35,587	5/10/2016
Total construction commitments	<u>\$ 118,375</u>	

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

NOTE 14 - OPERATING LEASE REVENUE

The District entered into a lease and covenant not to sell or develop, for non-school district purposes, with the City of Palo Alto (the City) for six school sites and eleven extended day care sites. The agreement expired on December 31, 2005 with options to renew the agreement for ten years plus an additional two five-year periods. On December 15, 2003, the Palo Alto City Council voted to exercise its option to extend the lease and covenant not to develop between the City and the Palo Alto Unified School District for additional ten years. The agreement may be partially or completely terminated under certain conditions. Future rental payments are adjusted by Consumer Price Index (CPI) increases; however, a current year's annual payment shall not be decreased if the CPI decreases. Such a decrease shall be applied against subsequent annual Index increases in making the annual payment adjustment. There is a provision for an escalation adjustment every five years. Increases in excess of ten percent shall accrue and the aggregate percentage without regard to any limitations shall be used to determine the annual payment in the 5th, 10th, and 15th years to arrive at the payment for the next subsequent year of the lease.

Future minimum lease payments under these agreements are as follows:

<u>June 30, 2015</u>	<u>Lease Payment</u>
2017	\$ 8,161,236
2018	7,335,860
2019	4,531,877
2020	1,553,051
2021	1,599,643
2022-2026	3,344,694
Total	<u>\$ 26,526,362</u>

NOTE 15 - RELATED PARTY RECEIVABLE

On September 15, 2015, the District granted a secured note receivable to its superintendent in the amount of \$1,458,888 bearing no interest for the purpose of securing a principal residence in Palo Alto area. The Note is due and payable in full upon the occurrence of the following events, whichever occurs first: 1) Cessation of employment, or 2) Sale of property. This loan is part of his employment agreement with the District.

REQUIRED SUPPLEMENTARY INFORMATION

PALO ALTO UNIFIED SCHOOL DISTRICT

**GENERAL FUND
BUDGETARY COMPARISON SCHEDULE
FOR THE YEAR ENDED JUNE 30, 2016**

	Budgeted Amounts		General Fund	Variances -
	Original	Final		Positive (Negative)
				Final to Actual
REVENUES				
Local Control Funding Formula	\$ 154,354,310	\$ 165,254,798	\$ 165,687,695	\$ 432,897
Federal sources	3,391,824	3,653,988	3,394,291	(259,697)
Other State sources	11,970,482	18,265,694	17,930,741	(334,953)
Other local sources	37,631,429	36,607,173	36,827,768	220,595
Total Revenues¹	207,348,045	223,781,653	223,840,495	58,842
EXPENDITURES				
Current				
Certificated salaries	97,664,373	102,094,828	102,065,733	29,095
Classified salaries	32,281,808	35,195,451	35,162,504	32,947
Employee benefits	39,513,291	46,897,393	46,870,311	27,082
Books and supplies	16,856,857	15,199,820	8,215,322	6,984,498
Services and operating expenditures	18,670,889	22,435,989	20,923,616	1,512,373
Capital outlay	345,000	305,073	210,105	94,968
Total Expenditures¹	205,332,218	222,128,554	213,447,591	8,680,963
Excess (Deficiency) of Revenues Over Expenditures	2,015,827	1,653,099	10,392,904	8,739,805
Other Financing Sources (Uses)				
Transfers in	101,000	269,202	43,213	(225,989)
Transfers out	(1,585,700)	(448,025)	(450,000)	(1,975)
Other uses	106,337	-	(10,473)	(10,473)
Net Financing Sources (Uses)	(1,378,363)	(178,823)	(417,260)	(238,437)
NET CHANGE IN FUND BALANCES	637,464	1,474,276	9,975,644	8,501,368
Fund Balance - Beginning	45,895,113	45,895,113	45,895,113	-
Fund Balance - Ending	\$ 46,532,577	\$ 47,369,389	\$ 55,870,757	\$ 8,501,368

¹ The consolidation of Fund 17, Special Reserve Fund for Other Than Capital Outlay Projects, and Fund 20, Special Revenue Fund for Postemployment Benefits Fund has been included in the actual and budgeted columns for comparability.

See accompanying note to required supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

**SCHEDULE OF OTHER POSTEMPLOYMENT BENEFITS (OPEB) FUNDING
PROGRESS
FOR THE YEAR ENDED JUNE 30, 2016**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age Normal (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
July 1, 2014	\$ -	\$ 23,520,252	\$ 23,520,252	0%	\$ 122,469,237	19.21%
July 1, 2012	-	22,451,506	22,451,506	0%	104,744,125	21.43%
July 1, 2010	-	21,366,638	21,366,638	0%	103,965,260	20.55%

See accompanying note to required supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

**SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE NET
PENSION LIABILITY
FOR THE YEAR ENDED JUNE 30, 2016**

	<u>2016</u>	<u>2015</u>
CalSTRS		
District's proportion of the net pension liability	<u>0.1912%</u>	<u>0.2001%</u>
District's proportionate share of the net pension liability	\$ 128,709,093	\$ 116,913,315
State's proportionate share of the net pension liability associated with the District	68,072,922	70,597,307
Total	<u>\$ 196,782,015</u>	<u>\$ 187,510,622</u>
District's covered employee payroll as of the measurement date	<u>\$ 83,779,040</u>	<u>\$ 89,006,480</u>
District's proportionate share of the net pension liability as a percentage of its covered - employee payroll	<u>153.63%</u>	<u>131.35%</u>
Plan fiduciary net position as a percentage of the total pension liability	<u>74%</u>	<u>77%</u>
CalPERS		
District's proportion of the net pension liability	<u>0.2693%</u>	<u>0.2682%</u>
District's proportionate share of the net pension liability	<u>\$ 39,691,967</u>	<u>\$ 30,451,905</u>
District's covered employee payroll as of the measurement date	<u>\$ 29,823,192</u>	<u>\$ 28,266,647</u>
District's proportionate share of the net pension liability as a percentage of its covered - employee payroll	<u>133.09%</u>	<u>107.73%</u>
Plan fiduciary net position as a percentage of the total pension liability	<u>79%</u>	<u>83%</u>

See accompanying note to required supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

**SCHEDULE OF DISTRICT'S CONTRIBUTIONS
FOR THE YEAR ENDED JUNE 30, 2016**

	<u>2016</u>	<u>2015</u>
CalSTRS		
Contractually required contribution	\$ 10,810,489	\$ 8,218,669
Contributions in relation to the contractually required contribution	<u>(10,810,489)</u>	<u>(8,218,669)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>
District's covered - employee payroll	<u>\$ 100,763,249</u>	<u>\$ 83,779,040</u>
Contributions as a percentage of covered - employee payroll	<u>11%</u>	<u>10%</u>
CalPERS		
Contractually required contribution	\$ 3,934,909	\$ 3,412,370
Contributions in relation to the contractually required contribution	<u>(3,934,909)</u>	<u>(3,412,370)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>
District's covered - employee payroll	<u>\$ 33,214,395</u>	<u>\$ 29,823,192</u>
Contributions as a percentage of covered - employee payroll	<u>12%</u>	<u>11%</u>

See accompanying note to required supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTE TO REQUIRED SUPPLEMENTARY INFORMATION JUNE 30, 2016

NOTE 1 - PURPOSE OF SCHEDULES

Budgetary Comparison Schedule

This schedule presents information for the original and final budgets and actual results of operations, as well as the variances from the final budget to actual results of operations.

Schedule of Other Postemployment Benefits (OPEB) Funding Progress

This schedule is intended to show trends about the funding progress of the District's actuarially determined liability for postemployment benefits other than pensions.

Schedule of the District's Proportionate Share of the Net Pension Liability

This schedule presents information on the District's proportionate share of the net pension liability (NPL), the plans' fiduciary net position and, when applicable, the State's proportionate share of the NPL associated with the District. In the future, as data becomes available, ten years of information will be presented.

Schedule of District's Contributions

This schedule presents information on the District's required contribution, the amounts actually contributed, and any excess or deficiency related to the required contribution. In the future, as data becomes available, ten years of information will be presented.

Changes in Benefit Terms

There were no changes in benefit terms since the previous valuation for either CalSTRS and CalPERS.

Changes in Assumptions

The CalSTRS plan rate of investment return assumption was not changed from the previous valuation. The CalPERS plan rate of investment return assumption was changed from 7.50 percent to 7.65 percent since the previous valuation.

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SUPPLEMENTARY INFORMATION

PALO ALTO UNIFIED SCHOOL DISTRICT

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2016**

Federal Grantor/Pass-through Grantor/Program or Cluster Title	CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF EDUCATION			
Passed through California Department of Education			
Adult Education-English Literacy	84.002A	14109	\$ 178,329
Adult Secondary Education	84.002	13978	3,453
Vocational and Applied Technology	84.048	14894	46,664
Title I-Basic Grants Low-Income and Neglected	84.010	14329	318,068
Title II-Improving Teacher Quality	84.367	14341	83,865
Title III-Limited English Proficiency	84.365	14346	144,813
Title III-Immigrant Education Program	84.365	15146	75,941
Special Education Cluster			
Basic Local Assistance	84.027	13379	2,057,845
Mental Health Allocation Plan, Part B, Section 611	84.027	14468	146,626
Preschool Local Entitlement, Part B, Section 611	84.027A	13682	102,023
Preschool Staff Development, Part B, Section 619	84.173A	13431	758
Preschool Grants, Part B, Section 619	84.173	13430	47,640
Special Education Cluster Subtotal			<u>2,354,892</u>
Passed through California Department of Rehabilitation			
Workability II	84.126	10006	370,048
Total U.S. Department of Education			<u>3,576,073</u>
U.S. DEPARTMENT OF AGRICULTURE			
Passed through California Department of Education:			
Child Nutrition Cluster			
Especially Needy Breakfast	10.553	13526	42,463
Basic School Breakfast Program	10.553	13525	35,481
School Lunch Program	10.555	13524	449,625
Schools/Child Nutrition Commodity Program ¹	10.555	13389	85,235
Child Nutrition Cluster Subtotal			<u>612,804</u>
Total U.S. Department of Agriculture			<u>612,804</u>
Total Expenditures of Federal Awards			<u>\$ 4,188,877</u>

¹ Not included in the financial statement.

See accompanying note to supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

SCHEDULE OF AVERAGE DAILY ATTENDANCE FOR THE YEAR ENDED JUNE 30, 2016

	<u>Amended Second Period Report</u>	<u>Annual Report</u>
Regular ADA		
Transitional kindergarten through third	3,309.26	3,312.26
Fourth through sixth	2,923.14	2,944.29
Seventh and eighth	1,905.01	1,914.16
Ninth through twelfth	3,745.37	3,606.31
Total Regular ADA	<u>11,882.78</u>	<u>11,777.02</u>
Extended Year Special Education		
Transitional kindergarten through third	3.47	3.47
Fourth through sixth	2.93	2.93
Seventh and eighth	1.85	1.85
Ninth through twelfth	2.28	2.28
Total Extended Year Special Education	<u>10.53</u>	<u>10.53</u>
Special Education, Nonpublic, Nonsectarian Schools		
Transitional kindergarten through third	2.11	1.94
Fourth through sixth	3.43	2.85
Seventh and eighth	6.83	6.07
Ninth through twelfth	17.40	14.93
Total Special Education, Nonpublic, Nonsectarian Schools	<u>29.77</u>	<u>25.79</u>
Total ADA	<u><u>11,923.08</u></u>	<u><u>11,813.34</u></u>

See accompanying note to supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

LOCAL EDUCATION AGENCY ORGANIZATION STRUCTURE JUNE 30, 2016

ORGANIZATION

The Palo Alto Unified School District was founded on March 20, 1893 under the laws of the State of California. The District operates under a locally elected five-member Board form of government and provides educational services to grades K - 12 as mandated by the State and Federal agencies. The District operates twelve elementary, three middle, two high schools, an adult education program, a Young Fives program and two children's centers.

GOVERNING BOARD

<u>MEMBER</u>	<u>OFFICE</u>	<u>TERM EXPIRES</u>
Heidi Emberling	President	2016
Terry Godfrey	Vice President	2018
Ken Dauber	Member	2018
Melissa Baten Caswell	Member	2016
Camille Townsend	Member	2016

ADMINISTRATION

Max "Glenn" McGee, Ph.D.	Superintendent
Marcus Autry, M.A	Associate Superintendent, Educational Services
Cathy Mak, M.B.A.	Chief Business Officer
Robert Golton, Ph.D.	Bond Program Manager
Scott Bowers, Ed.D.	Assistant Superintendent, Human Resources

See accompanying note to supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

**SCHEDULE OF INSTRUCTIONAL TIME
FOR THE YEAR ENDED JUNE 30, 2016**

Grade Level	2015-2016 Minutes Requirement	2015-2016 Actual Minutes	Number of Days Traditional Calendar	Status
Kindergarten	36,000	44,100	180	Complied
Grade 1	50,400	51,720	180	Complied
Grade 2	50,400	51,720	180	Complied
Grade 3	50,400	51,720	180	Complied
Grade 4	54,000	55,270	180	Complied
Grade 5	54,000	55,270	180	Complied
Grade 6	54,000	57,925	180	Complied
Grade 7	54,000	57,925	180	Complied
Grade 8	54,000	57,925	180	Complied
Grade 9	64,800	65,390	180	Complied
Grade 10	64,800	65,390	180	Complied
Grade 11	64,800	65,390	180	Complied
Grade 12	64,800	65,390	180	Complied

See accompanying note to supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

**RECONCILIATION OF ANNUAL FINANCIAL AND BUDGET REPORT WITH
AUDITED FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

There were no adjustments to the Unaudited Actual Financial Report, which require reconciliation to the audited financial statements at June 30, 2016.

See accompanying note to supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

**SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2016**

	(Budget) 2017 ¹	2016	2015	2014
GENERAL FUND ³				
Revenues	\$ 231,448,235	\$ 223,840,495	\$ 196,883,883	\$ 187,373,113
Other sources	1,028,617	43,213	47,742	45,563
Total revenues and other sources	232,476,852	223,883,708	196,931,625	187,418,696
Expenditures	229,333,370	213,447,591	195,136,756	186,781,796
Other uses and transfers out	1,448,617	460,473	1,059,191	1,055,700
Total expenditures and other uses	230,781,987	213,908,064	196,195,947	187,837,496
CHANGE IN FUND BALANCE	<u>\$ 1,694,865</u>	<u>\$ 9,975,644</u>	<u>\$ 735,678</u>	<u>\$ (418,800)</u>
ENDING FUND BALANCE	<u>\$ 46,532,577</u>	<u>\$ 55,870,757</u>	<u>\$ 45,895,113</u>	<u>\$ 45,159,435</u>
AVAILABLE RESERVES ^{2,4}	<u>\$ 22,462,843</u>	<u>\$ 21,034,272</u>	<u>\$ 21,010,115</u>	<u>\$ 26,068,856</u>
AVAILABLE RESERVES AS A PERCENTAGE OF TOTAL OUTGO	<u>9.73%</u>	<u>9.83%</u>	<u>10.71%</u>	<u>8.10%</u>
LONG-TERM OBLIGATIONS	<u>\$ 517,848,538</u>	<u>\$ 547,586,246</u>	<u>\$ 503,207,774</u>	<u>\$ 551,623,871</u>
K-12 AVERAGE DAILY ATTENDANCE AT P-2	<u>11,720</u>	<u>11,924</u>	<u>12,026</u>	<u>12,074</u>

The General Fund balance increased \$9,975,644 over the previous period, and has increased \$10,711,322 since fiscal year 2013-14. The fiscal year 2016-17 budget projects an increase of \$1,694,865 (3 percent) resulting in available reserves of \$22,462,843 (9.73 percent). For a district this size, the State recommends available reserves of at least three percent of total General Fund expenditures, transfers out, and other uses (total outgo).

Total long-term obligations have decreased by \$4,037,625 over the past two years.

Average daily attendance has decreased by 150 over the preceding two years. A decrease of 204 ADA is anticipated during fiscal year 2016-17.

¹ Budget 2017 is included for analytical purposes only and has not been subjected to audit.

² Available reserves consist of all unassigned fund balances within the General Fund.

³ General Fund amounts include activity related to the consolidation of the Special Reserve for Other than Capital Outlay Fund, and the Special Reserve for Postemployment Benefits as required by GASB Statement No. 54.

⁴ The available reserves include Fund 17, Special Reserve Fund for Other than Capital Outlay Projects ending fund balance.

See accompanying note to supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

**NONMAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
JUNE 30, 2016**

	Adult Education Fund	Child Development Fund	Cafeteria Fund	Deferred Maintenance Fund
ASSETS				
Deposits and investments	\$ 2,087,366	\$ 96,508	\$ 431,973	\$ 997,932
Receivables	129,773	52,481	12,053	1,753
Prepaid expenditures	-	-	8,835	-
Stores inventories	23,874	-	26,543	-
Total Assets	\$ 2,241,013	\$ 148,989	\$ 479,404	\$ 999,685
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	\$ 43,145	\$ 130,981	\$ 36,577	\$ 28,344
Due to other funds	127,265	18,008	-	-
Unearned revenue	142,010	-	285,393	-
Total Liabilities	312,420	148,989	321,970	28,344
Fund Balances:				
Nonspendable	23,874	-	35,378	-
Restricted	154,668	-	116,908	-
Committed	1,750,051	-	5,148	971,341
Total Fund Balances	1,928,593	-	157,434	971,341
Total Liabilities and Fund Balances	\$ 2,241,013	\$ 148,989	\$ 479,404	\$ 999,685

See accompanying note to supplementary information.

Capital Facilities Fund	County School Facilities Fund	Nonmajor Governmental Funds
\$ 5,890,875	\$ 8,765	\$ 9,513,419
11,588	18	207,666
-	-	8,835
-	-	50,417
<u>\$ 5,902,463</u>	<u>\$ 8,783</u>	<u>\$ 9,780,337</u>
\$ -	\$ -	\$ 239,047
29,086	-	174,359
-	-	427,403
<u>29,086</u>	<u>-</u>	<u>840,809</u>
-	-	59,252
5,873,377	8,783	6,153,736
-	-	2,726,540
<u>5,873,377</u>	<u>8,783</u>	<u>8,939,528</u>
<u>\$ 5,902,463</u>	<u>\$ 8,783</u>	<u>\$ 9,780,337</u>

PALO ALTO UNIFIED SCHOOL DISTRICT

**NONMAJOR GOVERNMENTAL FUNDS
COMBINING STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
FOR THE YEAR JUNE 30, 2016**

	Adult Education Fund	Child Development Fund	Cafeteria Fund	Deferred Maintenance Fund
REVENUES				
Federal sources	\$ 181,782	\$ -	\$ 527,569	\$ -
Other State sources	1,564,841	542,132	34,722	-
Other local sources	673,745	771	1,960,965	6,944
Total Revenues	2,420,368	542,903	2,523,256	6,944
EXPENDITURES				
Current				
Instruction	965,326	524,859	-	-
Instruction-related activities:				
Supervision of instruction	25,097	-	-	-
School site administration	992,570	807	-	-
Pupil services:				
Food services	-	-	2,547,767	-
Administration:				
All other administration	127,265	17,237	-	-
Plant services	95,631	-	-	3,176
Facility acquisition and construction	-	-	-	764,649
Total Expenditures	2,205,889	542,903	2,547,767	767,825
Excess (Deficiency) of Revenues Over Expenditures	214,479	-	(24,511)	(760,881)
Other Financing Sources (Uses)				
Transfers in	-	-	-	450,000
Transfers out	-	-	-	-
Net Financing Sources (Uses)	-	-	-	450,000
NET CHANGE IN FUND BALANCES	214,479	-	(24,511)	(310,881)
Fund Balance - Beginning	1,714,114	-	181,945	1,282,222
Fund Balance - Ending	\$ 1,928,593	\$ -	\$ 157,434	\$ 971,341

See accompanying note to supplementary information.

Capital Facilities Fund	County School Facilities Fund	Nonmajor Governmental Funds
\$ -	\$ -	\$ 709,351
-	3,000,000	5,141,695
1,008,339	3,296	3,654,060
<u>1,008,339</u>	<u>3,003,296</u>	<u>9,505,106</u>
-	-	1,490,185
-	-	25,097
-	-	993,377
-	-	2,547,767
-	-	144,502
-	-	98,807
212,181	-	976,830
<u>212,181</u>	<u>-</u>	<u>6,276,565</u>
<u>796,158</u>	<u>3,003,296</u>	<u>3,228,541</u>
-	-	450,000
(43,213)	(3,000,000)	(3,043,213)
<u>(43,213)</u>	<u>(3,000,000)</u>	<u>(2,593,213)</u>
752,945	3,296	635,328
5,120,432	5,487	8,304,200
<u>\$ 5,873,377</u>	<u>\$ 8,783</u>	<u>\$ 8,939,528</u>

PALO ALTO UNIFIED SCHOOL DISTRICT

**GENERAL FUND
SCHEDULE OF COMBINING BALANCE SHEET
JUNE 30, 2016**

	Non-GAAP General Fund	Special Reserve Noncapital Fund	Retiree Benefits Fund	GAAP General Fund
ASSETS				
Deposits and investments	\$ 44,895,883	\$ 14,389,215	\$ 2,357,824	\$ 61,642,922
Receivables	5,045,183	29,150	4,775	5,079,108
Long term receivable	1,458,888	-	-	1,458,888
Due from other funds	174,359	-	-	174,359
Prepaid expenditures	152,716	-	-	152,716
Stores inventories	143,487	-	-	143,487
Total Assets	\$ 51,870,516	\$ 14,418,365	\$ 2,362,599	\$ 68,651,480
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	\$ 5,298,870	\$ -	\$ -	\$ 5,298,870
Deferred revenue	7,481,853	-	-	7,481,853
Total Liabilities	12,780,723	-	-	12,780,723
Fund Balances:				
Nonspendable	1,785,091	-	-	1,785,091
Restricted	5,333,915	-	-	5,333,915
Assigned	25,354,880	-	2,362,599	27,717,479
Unassigned	6,615,907	14,418,365	-	21,034,272
Total Fund Balances	39,089,793	14,418,365	2,362,599	55,870,757
Total Liabilities and Fund Balances	\$ 51,870,516	\$ 14,418,365	\$ 2,362,599	\$ 68,651,480

See accompanying note to supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

**GENERAL FUND
SCHEDULE OF COMBINING STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
FOR THE YEAR JUNE 30, 2016**

	Non-GAAP General Fund	Special Reserve Noncapital Fund	Retiree Benefits Fund	GAAP General Fund
REVENUES				
Local Control Funding Formula	\$ 7,699,824	\$ -	\$ -	\$ 7,699,824
Property Taxes	172,534,006	-	-	172,534,006
Federal sources	3,394,291	-	-	3,394,291
Other State sources	17,930,741	-	-	17,930,741
Other local sources	22,168,348	96,582	16,703	22,281,633
Total Revenues	<u>223,727,210</u>	<u>96,582</u>	<u>16,703</u>	<u>223,840,495</u>
EXPENDITURES				
Current				
Instruction and related activities:	140,964,675	-	-	140,964,675
Supervision of instruction	8,922,897	-	-	8,922,897
Instructional library, media and technology	3,118,667	-	-	3,118,667
School site administration	13,567,784	-	-	13,567,784
Pupil services:				
Home-to-school transportation	2,410,675	-	-	2,410,675
Food services	120,923	-	-	120,923
All other pupil services	12,259,171	-	-	12,259,171
Administration:				
Data processing	4,701,173	-	-	4,701,173
All other administration	6,912,905	-	-	6,912,905
Plant services	18,743,057	-	-	18,743,057
Facility acquisition and construction	239,452	-	-	239,452
Ancillary services	1,322,486	-	-	1,322,486
Community services	163,726	-	-	163,726
Total Expenditures	<u>213,447,591</u>	<u>-</u>	<u>-</u>	<u>213,447,591</u>
Excess (Deficiency) of Revenues Over Expenditures	<u>10,279,619</u>	<u>96,582</u>	<u>16,703</u>	<u>10,392,904</u>
Other Financing Sources (Uses)				
Transfers in	43,213	-	-	43,213
Transfers out	(450,000)	-	-	(450,000)
Other uses	(10,473)	-	-	(10,473)
Net Financing Sources (Uses)	<u>(417,260)</u>	<u>-</u>	<u>-</u>	<u>(417,260)</u>
NET CHANGE IN FUND BALANCES	9,862,359	96,582	16,703	9,975,644
Fund Balance - Beginning	29,227,434	14,321,783	2,345,896	45,895,113
Fund Balance - Ending	<u>\$ 39,089,793</u>	<u>\$ 14,418,365</u>	<u>\$ 2,362,599</u>	<u>\$ 55,870,757</u>

See accompanying note to supplementary information.

PALO ALTO UNIFIED SCHOOL DISTRICT

**NOTE TO SUPPLEMENTARY INFORMATION
JUNE 30, 2016**

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 Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements. The District has not elected to use the ten percent de minimis cost rate as covered in Section 200.414 Indirect (F&A) costs of the Uniform Guidance.

The following schedule provides reconciliation between revenues reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances and the related expenditures reported on the Schedule of Expenditures of Federal Awards. The reconciling amounts consists primarily the rebated interest on qualified school construction bonds and the fair market value of noncash awards under the National School Lunch Program.

Description	CFDA Number	Amount
Federal revenues reported in the Statement of Revenues, Expenditures and Changes in Fund Balances:		\$ 5,342,403
Rebated interest on qualified school construction bonds are not included in the Schedule of Expenditures of Federal Awards, but are included in the financial statements.		(1,238,761)
Noncash Federal expenditures are not recorded on the financial statements, but are included in the Schedule of Expenditures of Federal Awards.	10.555	85,235
Total Schedule of Expenditures of Federal Awards		<u>\$ 4,188,877</u>

Schedule of Average Daily Attendance

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.

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.

PALO ALTO UNIFIED SCHOOL DISTRICT

NOTE TO SUPPLEMENTARY INFORMATION JUNE 30, 2016

Schedule of Instructional Time

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 the 1986-87 requirements, as required by *Education Code* Section 46201. The District has not received incentive funding for increasing instructional time as provided by the Incentives for Longer Instructional Day. The District has exceeded their LCFF target funding.

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.

Combining Nonmajor Governmental Funds - Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balances

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

Schedule of Combining General Fund - Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balances

The Schedules of General Fund Combining Balance Sheet and Combining Statement of Revenues, Expenditures, and Changes in Fund Balances, is included to provide information regarding the individual funds that have been included in the General Fund on the Governmental Funds Balance Sheet, and Statement of Revenues, Expenditures, and Changes in Fund Balances, as a result of GASB No. 54.

INDEPENDENT AUDITOR'S REPORTS



**INDEPENDENT AUDITOR'S 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**

Governing Board
Palo Alto Unified School District
Palo Alto, California

We have audited, in accordance with the 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, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Palo Alto Unified School District (the District) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated December 10, 2016.

Emphasis of Matter - Change in Accounting Principles

As discussed in Note 1 to the financial statements, in 2016, the District adopted new accounting guidance, GASB Statement No. 72, *Fair Value Measurement and Application*; GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statement 67 and 68*; GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*; and GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 District's internal control. Accordingly, we do not express an opinion on the effectiveness of Palo Alto Unified School District's internal control.

A *deficiency in internal control* 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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free from 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*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Vavrinek, Trine, Day & Co. LLP

Palo Alto, California
December 10, 2016



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

Governing Board
Palo Alto Unified School District
Palo Alto, California

Report on Compliance for Each Major Federal Program

We have audited Palo Alto Unified School District's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Palo Alto Unified School District's (the District) major Federal programs for the year ended June 30, 2016. The District's major Federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the federal statutes, regulations, and the terms and conditions of its Federal awards applicable to its Federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the District's major Federal programs based on our audit of the types of compliance requirements referred to above. 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 the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance 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 the 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 on compliance for each major Federal program. However, our audit does not provide a legal determination of Palo Alto Unified School District's compliance.

Opinion on Each Major Federal Program

In our opinion, Palo Alto Unified School District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major Federal programs for the year ended June 30, 2016.

Report on Internal Control Over Compliance

Management of Palo Alto Unified School District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the District's internal control over compliance with the types of requirements that could have a direct and material effect on each major Federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major Federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 Palo Alto Unified School District's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a Federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a Federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a Federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Vavrinek, Trine, Day & Co. LLP

Palo Alto, California
December 10, 2016



INDEPENDENT AUDITOR'S REPORT ON STATE COMPLIANCE

Governing Board
Palo Alto Unified School District
Palo Alto, California

Report on State Compliance

We have audited Palo Alto Unified School District's compliance with the types of compliance requirements as identified in the *2015-2016 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting* that could have a direct and material effect on each of the Palo Alto Unified School District's State government programs as noted below for the year ended June 30, 2016.

Management's Responsibility

Management is responsible for compliance with the requirements of State laws, regulations, and the terms and conditions of its State awards applicable to its State programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance of each of the Palo Alto Unified School District's State programs based on our audit of the types of compliance requirements referred to above. 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 *2015-2016 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting*. These standards require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a material effect on the applicable government programs noted below. An audit includes examining, on a test basis, evidence about Palo Alto 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 opinions. Our audit does not provide a legal determination of Palo Alto Unified School District's compliance with those requirements.

Unmodified Opinion

In our opinion, Palo Alto Unified School District complied, in all material respects, with the compliance requirements referred to above that are applicable to the government programs noted below that were audited for the year ended June 30, 2016.

In connection with the audit referred to above, we selected and tested transactions and records to determine the Palo Alto Unified School District's compliance with the State laws and regulations applicable to the following items:

	<u>Procedures Performed</u>
LOCAL EDUCATION AGENCIES OTHER THAN CHARTER SCHOOLS	
Attendance	Yes
Teacher Certification and Misassignments	Yes
Kindergarten Continuance	Yes
Independent Study	No, see below
Continuation Education	No, see below
Instructional Time	Yes
Instructional Materials	Yes
Ratios of Administrative Employees to Teachers	Yes
Classroom Teacher Salaries	Yes
Early Retirement Incentive	No, see below
Gann Limit Calculation	Yes
School Accountability Report Card	Yes
Juvenile Court Schools	No, see below
Middle or Early College High Schools	Yes
K-3 Grade Span Adjustment	Yes
Transportation Maintenance of Effort	Yes
SCHOOL DISTRICTS, COUNTY OFFICES OF EDUCATION, AND CHARTER SCHOOLS	
Educator Effectiveness	Yes
California Clean Energy Jobs Act	Yes
After School Education and Safety Program:	
General Requirements	No, see below
After School	No, see below
Before School	No, see below
Proper Expenditure of Education Protection Account Funds	Yes
Unduplicated Local Control Funding Formula Pupil Counts	Yes
Local Control Accountability Plan	Yes
Independent Study - Course Based	No, see below
Immunizations	Yes
CHARTER SCHOOLS	
Attendance	No, see below
Mode of Instruction	No, see below
Non Classroom-Based Instruction/Independent Study for Charter Schools	No, see below
Determination of Funding for Non Classroom-Based Instruction	No, see below
Annual Instruction Minutes Classroom-Based	No, see below
Charter School Facility Grant Program	

The District's independent study program was below the minimum audit threshold and therefore, we did not perform procedures related to the program. The District did not offer Continuation Education, Early Retirement Incentive, Juvenile Court Schools, After School Education and Safety Program, and Independent Study Course Based, therefore we did not perform procedures related to these programs.

The District does not have any Charter Schools; therefore, we did not perform any procedures for Charter School Programs.

Vavrinek, Trine, Day & Co. LLP

Palo Alto, California
December 10, 2016

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

PALO ALTO UNIFIED SCHOOL DISTRICT

**SUMMARY OF AUDITOR’S RESULTS
FOR THE YEAR ENDED JUNE 30, 2016**

FINANCIAL STATEMENTS

Type of auditor's report issued:	<u>Unmodified</u>
Internal control over financial reporting:	
Material weakness identified?	<u>No</u>
Significant deficiency identified?	<u>None reported</u>
Noncompliance material to financial statements noted?	<u>No</u>

FEDERAL AWARDS

Internal control over major federal programs:	
Material weakness identified?	<u>No</u>
Significant deficiency identified?	<u>None reported</u>
Type of auditor's report issued on compliance for major federal programs:	<u>Unmodified</u>
Any audit findings disclosed that are required to be reported in accordance with Section 200.516(a) of the Uniform Guidance?	<u>No</u>

Identification of major program

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
84.173, 84.173A, 84.027, 84.027A	Special Education Cluster

Dollar threshold used to distinguish between Type A and Type B programs:	<u>\$ 750,000</u>
Auditee qualified as low-risk auditee?	<u>Yes</u>

STATE AWARDS

Type of auditor's report issued on compliance for all programs:	<u>Unmodified</u>
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PALO ALTO UNIFIED SCHOOL DISTRICT

**FINANCIAL STATEMENT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2016**

None reported.

PALO ALTO UNIFIED SCHOOL DISTRICT

**FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016**

None reported.

PALO ALTO UNIFIED SCHOOL DISTRICT

**STATE AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016**

None reported.

PALO ALTO UNIFIED SCHOOL DISTRICT

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2016**

None reported.