

**MODESTO CITY SCHOOLS
(MODESTO CITY SCHOOL DISTRICT)
(MODESTO HIGH SCHOOL DISTRICT)**

ANNUAL FINANCIAL REPORT

JUNE 30, 2018

MODESTO CITY SCHOOLS

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FINANCIAL SECTION

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VAVRINEK, TRINE, DAY & CO., LLP
Certified Public Accountants

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INDEPENDENT AUDITOR'S REPORT

Governing Board
Modesto City Schools
Modesto, 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 Modesto City Schools (the District) as of and for the year ended June 30, 2018, 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 *2017-2018 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 Entity'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 Entity'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 Modesto City Schools, as of June 30, 2018, 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 and Note 16 to the financial statements, in 2018, the District adopted new accounting guidance, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. 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 management's discussion and analysis on pages 5 through 13, budgetary comparison schedule on page 75, schedule of changes in the District's total OPEB liability and related ratios on page 76, schedule of the District's proportionate share of the net OPEB liability - MPP program on page 77, schedule of the District's proportionate share of the net pension liability on page 78, and the schedule of District contributions on page 79, 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 Modesto City Schools' basic financial statements. The accompanying supplementary information such as the combining and individual non-major 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 (Uniform Guidance)* as listed in 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.

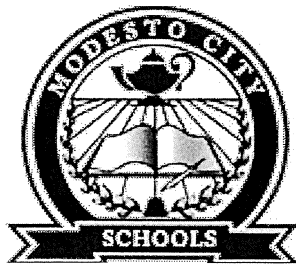
Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2018, on our consideration of the Modesto City Schools' 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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Modesto City Schools' 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 Modesto City Schools' internal control over financial reporting and compliance.

Varinck, Trine, Day & Co. LLP

Fresno, California
December 17, 2018

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MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of Modesto City Schools (the District) annual financial report presents our discussion and analysis of the District's financial performance during the fiscal year that ended on June 30, 2018. Please read it in conjunction with the District's financial statements, which immediately follow this section.

Board of Education

Amy Elliott Neumann
President

John Walker
Vice President

Chad Brown
Board Member

Steven Grenbeaux
Board Member

Adolfo Lopez
Board Member

Cindy Marks
Board Member

Dr. Charlene G. West
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Administration

Craig Rydquist
Interim Superintendent

Marla Mack
Associate Superintendent
Educational Services

Tim Zearley
Associate Superintendent
Business Services
Chief Business Official

Mark Herbst
Assistant Superintendent
SELPA



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OVERVIEW OF THE FINANCIAL STATEMENTS

The Financial Statements

The financial statements presented herein include all of the activities of the District and its component units using the integrated approach as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 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. They present governmental activities. 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 *Governmental Activities* are prepared using the current financial resources measurement focus and modified accrual basis of accounting.

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

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

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

The *Fiduciary Funds* are trust and agency funds. Trust funds focus reporting on net position and changes in net position, and agency funds report only a balance sheet and do not have a measurement focus.

Reconciliation of the Fund Financial Statements to the Government-Wide Financial Statements is provided to explain the differences created by the integrated approach.

The Primary unit of the government is the Modesto City Schools.

MODESTO CITY SCHOOLS

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2018

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 them. Net position is the difference between assets and liabilities, which is one way to measure the District's financial health, or financial position. Over time, increases or decreases in the District's net position will serve as a useful indicator of whether the financial position of the District is improving or deteriorating. Other factors to consider are changes in the District's property tax base and the condition of the District's facilities.

The relationship between revenues and expenses is the District's *operating results*. Since the governing 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 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*, we present the District's activities as follows:

Governmental Activities - The District reports all of its services 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 U.S. Department of Education.

MODESTO CITY SCHOOLS

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2018

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.

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. Proprietary funds are reported in the same way that all activities are reported in the *Statement of Net Position* and the *Statement of Revenues, Expenses, and Changes in Fund Net Position*. We use internal service funds (the other component of proprietary funds) to report activities that provide services for the District's Self-Insurance Program. The internal service fund is reported with governmental activities in the government-wide financial statements.

THE DISTRICT AS A TRUSTEE

Reporting the Districts 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 the *Fiduciary Funds - Statement of Net Position* and the *Fiduciary Funds - Statement of Changes in 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

- Experienced a decrease in enrollment of 209 at the K-8 level and an increase of 141 at 9-12 level.
- This was the fourth year of Local Control and Accountability Plan (LCAP) development, adoption and implementation. The LCAP components include increased and improved services to targeted students, parent and public input in development, and alignment with spending, services and goals.
- Receipt of Mandate One-Time Funding, approximately \$147 per ADA.
- Multi-Year Collective Bargaining Agreements were settled for 2016-2017 and 2017-2018. The 2016-2017 negotiated cost of living increases were paid in fall of 2017, resulting in prior year pay increases paid within 2017-2018.
- Implementation of one-to-one student devices pilot program at junior high sites.
- Coordinated Early Intervening Services (CEIS) no longer required from IDEA Part B funds.

MODESTO CITY SCHOOLS

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2018

THE DISTRICT AS A WHOLE

Net Position

The District's net position was \$30 million for the fiscal year ended June 30, 2018. Of this amount, \$38 million was restricted. Restricted net position is reported separately to show legal constraints from debt covenants and enabling legislation that limit the governing board's ability to use net position for day-to-day operations. Our analysis below, in summary form, focuses on the net position (Table 1) and change in net position (Table 2) of the District's governmental activities.

Table 1.

(Amounts in millions)

	Governmental Activities		
	2018	2017, as Restated	Change
Assets			
Current and other assets	\$ 195	\$ 203	\$ (8)
Capital assets	369	361	8
Total Assets	<u>564</u>	<u>564</u>	<u>-</u>
Deferred Outflows of Resources	<u>128</u>	<u>75</u>	<u>53</u>
Liabilities			
Current liabilities	41	42	(1)
Long-term liabilities	201	212	(11)
Aggregate net pension liability	367	308	59
Total Liabilities	<u>609</u>	<u>562</u>	<u>47</u>
Deferred Inflows of Resources	<u>53</u>	<u>45</u>	<u>8</u>
Net Position			
Net investment in capital assets	246	233	13
Restricted	38	44	(6)
Unrestricted	(254)	(245)	(9)
Total Net Position	<u>\$ 30</u>	<u>\$ 32</u>	<u>\$ (2)</u>

The \$30 million in net position represents the accumulated results of all past years' operations. Unrestricted net position – the part of net position that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements – decreased by 3.67 percent (\$(254) million compared to \$(245) million).

Changes in Net Position

The results of this year's operations for the District as a whole are reported in the *Statement of Activities*. Table 2 takes the information from the Statement, rounds off the numbers, and rearranges them slightly so you can see our total revenues for the year.

MODESTO CITY SCHOOLS

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2018

Table 2

(Amounts in millions)	Governmental Activities		
	2018	2017	Change
Revenues			
Program revenues:			
Charges for services	\$ 7	\$ 7	\$ -
Operating grants and contributions	90	99	(9)
General revenues:			
Federal and State aid not restricted	246	241	5
Property taxes	76	72	4
Other general revenues	3	1	2
Total Revenues	422	420	2
Expenses			
Instruction	279	268	11
Pupil services	50	42	8
Administration	21	19	2
Plant services	44	41	3
Other	30	29	1
Total Expenses	424	399	25
Change in Net Position	\$ (2)	\$ 21	\$ (23)

Governmental Activities

As reported in the *Statement of Activities*, the cost of all of our governmental activities this year was \$424 million. However, the amount that our taxpayers ultimately financed for these activities through local taxes was only \$76 million because the cost was paid by those who benefited from the programs (\$7 million) or by other governments and organizations who subsidized certain programs with grants and contributions (\$90 million). The District paid for the remaining "public benefit" portion of our governmental activities with \$246 million in Federal and State funds, and with \$3 million in other revenues, like interest and general entitlements.

In Table 3, we have presented the cost and net cost of each of the District's largest functions: instruction, pupil services, administration, plant services, and all other services. 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.

MODESTO CITY SCHOOLS

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2018

Table 3

(Amounts in millions)	Total Cost of Services		Net Cost of Services	
	2018	2017	2018	2017
Instruction	\$ 279	\$ 268	\$ 230	\$ 225
Pupil services	50	42	27	20
Administration	21	19	19	17
Plant services	44	41	42	25
All other services	30	29	10	7
Total	\$ 424	\$ 399	\$ 328	\$ 294

THE DISTRICT'S FUNDS

As the District completed this year, our governmental funds reported a combined fund balance of \$145 million, which is a decrease of \$9 million from last year (Table 4).

Table 4

(Amounts in millions)	Balances	
	June 30, 2018	June 30, 2017
General	\$ 89	\$ 99
Special Reserve Capital Outlay	28	27
Non-Major Funds	28	28
Total	\$ 145	\$ 154

The decrease in the General Fund was due primarily to the \$10 million in transfers out. The Special Reserve Capital Outlay Fund increased primarily due to an \$8 million transfer in from the General Fund. The Special Revenue Funds reported a decrease of \$1 million and the Debt Service Funds reported an increase of \$1 million, resulting in the District's non-major governmental funds remaining stable.

General Fund Budgetary Highlights

Over the course of the year, the District revises its budget as it attempts to deal with unexpected changes in revenue and expenditures. The final amendment to the budget was adopted on June 25, 2018. A schedule showing the District's original and final budget amounts compared with amounts actually paid and received is provided in the annual report.

The District budgeted a decrease in the General Fund of approximately \$24.8 million. Even though revenues and other sources were \$0.8 million more than budgeted, expenditures and other uses were approximately \$14.8 million less than budgeted, the fund decreased approximately \$9.3 million.

MODESTO CITY SCHOOLS

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2018

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2018, the District had \$369 million in a broad range of capital assets (net of depreciation), including land, buildings, furniture, and equipment. This represents an increase of \$8 million over the prior year (Table 5).

Table 5

(Amounts in millions)

	Governmental Activities	
	2018	2017
Land and construction in progress	\$ 56	\$ 48
Buildings and improvements	301	302
Equipment	12	11
Total	\$ 369	\$ 361

More detailed information about the capital assets is presented in Notes to Financial Statements.

Long-Term Obligations

At the end of this year, the District had \$201 million in long-term obligations outstanding versus \$212 million last year, a decrease of 5.19 percent (Table 6).

Table 6

(Amounts in millions)

	Governmental Activities	
	2018	2017, as Restated
General obligation bonds (financed with property taxes)	\$ 100	\$ 104
Capital leases	6	8
Qualified school construction bonds	16	16
Other postemployment benefits	77	82
Other	2	2
Total	\$ 201	\$ 212

The District's Elementary and High School general obligation bond ratings are Standard & Poor's A+, Stable Outlook and Fitch Rating AA-, Stable Outlook. The State limits the amount of general obligation debt that districts can issue to 1.25 percent of the assessed value of all taxable property within the district's boundaries. We present more detailed information about our long-term obligations in the Notes to Financial Statements.

MODESTO CITY SCHOOLS

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2018

Net Pension Liability (NPL)

As of June 30, 2015, the District implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, which required the District to recognize its proportionate share of the unfunded pension obligation for CalSTRS and CalPERS. As of June 30, 2018, the District reported Deferred Outflows from pension activities of \$125 million, Deferred Inflows from pension activities of \$46 million, and a Net Pension Liability of \$367 million. We present more detailed information regarding our net pension liability in the Notes to Financial Statements.

SIGNIFICANT ACCOMPLISHMENTS OF FISCAL YEAR 2017-2018 ARE NOTED BELOW:

The District completed the following significant projects in 2017-2018:

- Culinary Arts Renovation Phase II – Downey High School
- Special Needs Restroom Replacement – Beyer High School
- Metal Building and Bus Drop-off Zone – Beyer High School
- Agricultural Metal Building and Farm – Gregori High School
- Paving Replacement – Corporation Yard
- Floor Remediation and Concrete Polishing – Beyer and Davis High Schools
- Joint Agricultural Facility Improvements – Church Street
- Parking Improvements – Beard, Bret Harte and Garrison Elementary Schools
- Front Parking Lot Replacement – Sonoma Elementary School

The District began the following significant projects in 2017-2018:

- Cafeteria and Portable Classroom Replacement – Burbank Elementary School
- Agricultural Shop Improvements – Davis High School
- Agricultural Shop Improvements – Downey High School
- HVAC Mechanical System Upgrades – Sonoma Elementary School
- Relocatable Classroom Replacement and Additions – Kirschen Elementary School
- Relocatable Classroom Replacement and Additions – Roosevelt Jr. High School
- Relocatable Classroom Replacement and Additions – Downey High School
- Upgrade Cafeteria Walk-In Cooler Boxes – Davis, Downey, and Johansen High Schools
- Repaving – Burbank and Shackelford Elementary Schools
- Repaving – Davis and Downey High Schools
- Greenhouse Addition – Davis, Downey, and Gregori High Schools
- Gymnasium HVAC Upgrade – Beyer, Davis, and Downey High Schools
- Fire Clean-up, Demolition, and Temporary Housing – Bret Harte Elementary School
- Asphalt Seal – Beard, Garrison, Bret Harte, Sonoma, Wright, Gregori

MODESTO CITY SCHOOLS

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2018

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

In considering the District Budget for the 2018-2019 year, the Governing Board and staff continued to improve upon the oversight requirements of the Local Control Funding Formula (LCFF).

The adoption of the District's annual Local Control and Accountability Plan (LCAP) includes implementation of new programs and further expansion of existing programs. Some areas of expansion include Dual Language Academy, Language Institute, Advancement Via Individual Determination (AVID), Remediation & Intervention Services, Mental Health and Support Services. The LCAP also includes the implementation of one-to-one devices at all junior high sites, Intervention Center Teachers added at junior high sites, a Behavioral Support Specialist and additional technology support staff. The District plans to continue increasing and improving services to targeted students by meeting the goals identified through the LCAP process.

The 2018-2019 budget year marks the year of full LCFF implementation, two years ahead of the Governor's original projected schedule. While the impact of full funding results in additional dollars in the current year, the District recognizes that LCFF increases in future years will be limited to cost of living adjustments (COLA). Projections demonstrate that the COLA in future years may not be sufficient to cover the costs of pension reform, minimum wage increases, step and column costs and collective bargaining demands; while absorbing the impacts of declining enrollment and maintaining valuable student programs. The Governing Board and staff will continue to monitor these impacts through multi-year projection and trend analysis.

The District will once again be receiving Mandate One-Time funding in 2018-2019, estimated at \$184 per ADA.

The Governing Board voted to place Measures D and E, a \$131 million package of school improvement bond measures, on the November 2018 ballot to repair and upgrade our aging elementary and junior high education facilities. If approved by voters, the funding would be used for improving emergency and security systems, improving accessibility for students with disabilities, equipping classrooms with modern learning technology and repairing and updating outdated classrooms, science labs, cafeterias and restrooms.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, students, and 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 Tim Zearley, Associate Superintendent, Business Services, at Modesto City Schools District, 426 Locust Street, Modesto, California, 95351, 209-574-1594, or e-mail at Zearley.T@monet.k12.ca.us.

MODESTO CITY SCHOOLS

STATEMENT OF NET POSITION JUNE 30, 2018

	Governmental Activities
ASSETS	
Deposits and investments	\$ 180,201,288
Receivables	11,991,863
Prepaid expenses	1,557,798
Deferred charges-insurance	85,959
Stores inventories	1,095,997
Capital assets not being depreciated	55,611,141
Capital assets being depreciated	485,466,610
Accumulated depreciation	(172,370,155)
Total Assets	563,640,501
DEFERRED OUTFLOWS OF RESOURCES	
Deferred outflows of resources related to other postemployment benefits (OPEB) liability	2,826,682
Deferred outflows of resources related to pensions	125,027,871
Total Deferred Outflows of Resources	127,854,553
LIABILITIES	
Accounts payable	28,742,819
Interest payable	78,269
Unearned revenue	4,076,552
Claims liability	7,854,000
Long-term obligations:	
Current portion of long-term obligations other than pensions	14,484,961
Noncurrent portion of long-term obligations other than pensions	186,374,220
Total Long-Term Obligations	200,859,181
Aggregate net pension liability	367,172,615
Total Liabilities	608,783,436
DEFERRED INFLOWS OF RESOURCES	
Deferred inflows of resources related to other postemployment benefits (OPEB) liability	6,611,036
Deferred inflows of resources related to pensions	45,833,388
Total Deferred Inflows of Resources	52,444,424
NET POSITION	
Net investment in capital assets	245,997,491
Restricted for:	
Debt service	16,995,244
Capital projects	1,404,115
Educational programs	13,221,619
Other activities	6,582,690
Unrestricted	(253,933,965)
Total Net Position	\$ 30,267,194

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

MODESTO CITY SCHOOLS

STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2018

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenues and Changes in Net Position Governmental Activities
		Charges for Services and Sales	Operating Grants and Contributions	
Governmental Activities:				
Instruction	\$ 227,573,813	\$ 804,349	\$ 37,749,319	\$ (189,020,145)
Instruction-related activities:				
Supervision of instruction	16,912,660	60,783	8,247,850	(8,604,027)
Instructional library, media, and technology	6,492,981	22	389,310	(6,103,649)
School site administration	27,536,316	124,925	1,540,485	(25,870,906)
Pupil services:				
Home-to-school transportation	8,464,452	8,525	3,384,400	(5,071,527)
Food services	15,680,613	1,632,635	12,098,323	(1,949,655)
All other pupil services	26,060,201	44,383	5,788,343	(20,227,475)
Administration:				
Data processing	9,405,921	871	15,745	(9,389,305)
All other administration	11,906,729	100,734	2,270,789	(9,535,206)
Plant services	44,443,678	100,730	2,473,833	(41,869,115)
Ancillary services	4,002,808	-	191,842	(3,810,966)
Community services	8,309,404	52,183	7,254,692	(1,002,529)
Enterprise services	3,140,051	3,134,750	(2,224)	(7,525)
Interest on long-term obligations	7,162,557	-	-	(7,162,557)
Other outgo	7,007,849	461,922	8,418,859	1,872,932
Total Governmental Activities	\$ 424,100,408	\$ 6,526,812	\$ 89,821,566	(327,752,030)
General revenues and subventions:				
Property taxes, levied for general purposes				62,987,479
Property taxes, levied for debt service				10,381,146
Taxes levied for other specific purposes				3,000,981
Federal and State aid not restricted to specific purposes				245,849,460
Interest and investment earnings				781,037
Interagency revenues				44,848
Miscellaneous				2,253,105
Subtotal, General Revenues				325,298,056
Change in Net Position				(2,453,974)
Net Position - Beginning as Restated				32,721,168
Net Position - Ending				\$ 30,267,194

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

MODESTO CITY SCHOOLS

GOVERNMENTAL FUNDS BALANCE SHEET JUNE 30, 2018

	General Fund	Special Reserve Capital Outlay Fund	Non-Major Governmental Funds
ASSETS			
Deposits and investments	\$ 104,839,668	\$ 30,549,258	\$ 28,728,242
Receivables	9,418,625	2,000	2,520,931
Due from other funds	1,664,937	63,232	18,815
Prepaid expenditures	1,013,435	-	163
Stores inventories	863,591	-	232,406
Total Assets	\$ 117,800,256	\$ 30,614,490	\$ 31,500,557
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 24,152,513	\$ 2,383,567	\$ 1,661,377
Due to other funds	747,954	8,814	1,500,586
Unearned revenue	3,344,233	-	732,319
Total Liabilities	28,244,700	2,392,381	3,894,282
Fund Balances:			
Nonspendable	1,927,026	-	233,069
Restricted	12,975,234	-	24,995,365
Committed	-	-	2,377,841
Assigned	17,662,975	28,222,109	-
Unassigned	56,990,321	-	-
Total Fund Balances	89,555,556	28,222,109	27,606,275
Total Liabilities and Fund Balances	\$ 117,800,256	\$ 30,614,490	\$ 31,500,557

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

Total Governmental Funds
<hr/>
\$ 164,117,168
11,941,556
1,746,984
1,013,598
1,095,997
<hr/>
<u><u>\$ 179,915,303</u></u>

\$ 28,197,457
2,257,354
4,076,552
<hr/>
34,531,363
<hr/>
2,160,095
37,970,599
2,377,841
45,885,084
56,990,321
<hr/>
145,383,940
<hr/>
<u><u>\$ 179,915,303</u></u>

MODESTO CITY SCHOOLS

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET POSITION JUNE 30, 2018

Total Fund Balance - Governmental Funds		\$ 145,383,940
Amounts Reported for Governmental Activities in the Statement of Net Position are Different Because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported as assets in governmental funds.		
The cost of capital assets is	\$ 541,077,751	
Accumulated depreciation is	<u>(172,370,155)</u>	
Net Capital Assets		368,707,596
In governmental funds, unmatured interest on long-term obligations is recognized in the period when it is due. On the government-wide financial statements, unmatured interest on long-term obligations is recognized when it is incurred.		(78,269)
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 assets and liabilities of the internal service fund are included with governmental activities.		8,789,635
Expenditures relating to issuance of debt were recognized on the modified accrual basis, but are amortized over the life of the debt on the accrual basis. The balance to amortize is reported on the Statement of Net Position as deferred charges.		85,959
Deferred outflows of resources related to pensions represent a consumption of net position in a future period and is not reported in the District's funds. Deferred outflows of resources related to pensions at year-end consist of:		
Pension contributions subsequent to measurement date	33,441,755	
Net change in proportionate share of net pension liability	19,437,639	
Difference between projected and actual earnings on pension plan investments	3,478,323	
Differences between expected and actual experience in the measurement of the total pension liability.	4,588,271	
Changes of assumptions	<u>64,081,883</u>	
Total Deferred Outflows of Resources Related to Pensions		125,027,871

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

MODESTO CITY SCHOOLS

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET POSITION, Continued JUNE 30, 2018

Deferred inflows of resources related to pensions represent an acquisition of net position that applies to a future period and is not reported in the District's funds. Deferred inflows of resources related to pensions at year-end consist of:

Net change in proportionate share of net pension liability	\$ (32,898,288)	
Difference between projected and actual earnings on pension plan investments	(7,100,917)	
Differences between expected and actual experience in the measurement of the total pension liability.	(4,650,337)	
Changes of assumptions	<u>(1,183,846)</u>	
Total Deferred Inflows of Resources Related to Pensions		\$ (45,833,388)

Deferred outflows of resources related to OPEB represent a consumption of net position in a future period and is not reported in the District's funds. Deferred outflows of resources related to OPEB at year-end consist of OPEB contributions subsequent to measurement date.

2,826,682

Deferred inflows of resources related to OPEB represent a acquisition of net position in a future period and is not reported in the District's funds. Deferred inflows of resources related to OPEB at year-end consist of OPEB change of assumptions.

(6,611,036)

Net pension liability is not due and payable in the current period, and is not reported as a liability in the funds.

(367,172,615)

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

General obligation bonds	99,667,499	
Compensated absences	813,706	
Capital leases	6,205,439	
Qualified school construction bonds	16,420,000	
Teacher retirement incentive	662,213	
Gregori traffic mitigation settlement	417,167	
Other postemployment benefits (OPEB) liability	<u>76,673,157</u>	
Total Long-Term Obligations		(200,859,181)
Total Net Position - Governmental Activities		<u>\$ 30,267,194</u>

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

MODESTO CITY SCHOOLS

GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES FOR THE YEAR ENDED JUNE 30, 2018

	General Fund	Special Reserve Capital Outlay Fund	Non-Major Governmental Funds
REVENUES			
Local Control Funding Formula	\$ 295,401,578	\$ -	\$ 3,000,000
Federal sources	22,826,417	-	19,115,092
Other State sources	45,283,927	-	7,015,417
Other local sources	5,836,488	3,243,329	13,794,399
Total Revenues	369,348,410	3,243,329	42,924,908
EXPENDITURES			
Current			
Instruction	207,346,571	-	4,013,379
Instruction-related activities:			
Supervision of instruction	13,892,911	-	2,522,719
Instructional library, media and technology	6,268,739	-	-
School site administration	26,486,597	-	144,421
Pupil services:			
Home-to-school transportation	8,618,132	-	-
Food services	19,281	-	14,925,222
All other pupil services	25,187,974	-	66,402
Administration:			
Data processing	9,251,914	-	-
All other administration	10,145,404	-	1,452,347
Plant services	36,617,163	3,669	3,418,881
Ancillary services	3,902,202	-	-
Community services	4,097,542	-	3,808,996
Other outgo	7,007,849	-	-
Enterprise services	305,534	-	-
Facility acquisition and construction	8,587,722	9,201,377	3,969,073
Debt service			
Principal	3,941,177	-	10,095,803
Interest and other	377,261	150,288	1,001,816
Total Expenditures	372,053,973	9,355,334	45,419,059
Excess (Deficiency) of Revenues Over Expenditures	(2,705,563)	(6,112,005)	(2,494,151)
Other Financing Sources (Uses)			
Transfers in	1,071,328	7,924,070	2,815,972
Other sources	2,779,950	-	-
Transfers out	(10,435,073)	(1,091,143)	(351,042)
Net Financing Sources (Uses)	(6,583,795)	6,832,927	2,464,930
NET CHANGE IN FUND BALANCES	(9,289,358)	720,922	(29,221)
Fund Balance - Beginning	98,844,914	27,501,187	27,635,496
Fund Balance - Ending	\$ 89,555,556	\$ 28,222,109	\$ 27,606,275

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

Total Governmental Funds	
\$	298,401,578
	41,941,509
	52,299,344
	22,874,216
	<u>415,516,647</u>
	211,359,950
	16,415,630
	6,268,739
	26,631,018
	8,618,132
	14,944,503
	25,254,376
	9,251,914
	11,597,751
	40,039,713
	3,902,202
	7,906,538
	7,007,849
	305,534
	21,758,172
	14,036,980
	1,529,365
	<u>426,828,366</u>
	<u>(11,311,719)</u>
	11,811,370
	2,779,950
	<u>(11,877,258)</u>
	2,714,062
	<u>(8,597,657)</u>
	153,981,597
\$	<u><u>145,383,940</u></u>

MODESTO CITY SCHOOLS

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, 2018

Total Net Change in Fund Balances - Governmental Funds **\$ (8,597,657)**
Amounts Reported for Governmental Activities in the Statement of Activities are Different Because:

Capital outlays to purchase or build capital assets are reported in governmental funds as expenditures; however, for governmental activities, those costs are shown in the Statement of Net Position and allocated over their estimated useful lives as annual depreciation expenses in the Statement of Activities.

This is the amount by which capital outlays exceed depreciation in the period.

Capital outlays	\$ 19,233,369	
Depreciation expense	<u>(11,511,071)</u>	
Net Expense Adjustment		7,722,298

In governmental funds, the entire proceeds from the disposal of capital assets are reported as revenue, however, in the Statement of Activities, only the gain or loss from disposals are reported. (76,349)

Some of the capital assets acquired year were financed with capital leases. The amount financed by the leases is reported in the governmental funds as a source of financing. On the other hand, the capital leases are not revenues in the Statement of Activities, but rather constitute long-term obligations in the Statement of Net Position. (2,779,950)

In the Statement of Activities, certain operating expenses - compensated absences (vacations) and special termination benefits (early retirement) 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). This year, there were special termination benefits paid in excess of the amounts earned in the amount of \$4,800. Vacation earned was less than the amounts paid or used by \$167,389. 172,189

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. (9,571,766)

In the governmental funds, OPEB costs are based on employer contributions made to OPEB plans during the year. However, in the Statement of Activities, OPEB expense is the net effect of all changes in the deferred outflows, deferred inflows and net OPEB liability during the year. 1,120,544

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

MODESTO CITY SCHOOLS

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, 2018

Payment of costs for insurance on certificates of participation or bonds is an expenditure in the governmental funds, but is recorded as a deferred charge and amortized on the Statement of Net Position over the live of the debt. The amount of insurance amortized during the year was:	\$ (9,732)
Payment of principal on long-term obligations is an expenditure in the governmental funds, but it reduces long-term obligations in the Statement of Net Position and does not affect the Statement of Activities:	
General obligation bonds	9,965,000
Capital lease obligations	3,941,177
The District entered into a settlement agreement with Stanislaus County regarding traffic mitigation impacts related to the District's construction of Gregori High School in Salida. The settlement agreement is reported as a long-term obligation on the Statement of Net Position but is not recorded in the fund financial statements.	130,803
Interest on long-term obligations in the Statement of Activities differs from the amount reported in the governmental funds because interest is recorded as an expenditure in the funds when it is due, and thus requires the use of current financial resources. In the Statement of Activities, however, interest expense is recognized as the interest accrues, regardless of when it is due. The additional interest reported in the Statement of Activities includes additional accumulated interest that was accreted on the District's capital appreciation general obligation bonds and accrued interest payable.	(5,623,460)
An internal service fund is used by the District's management to charge the costs of certain health and welfare insurance programs to the individual funds. The net revenue of the Internal Service Fund is reported with governmental activities.	1,152,929
Change in Net Position of Governmental Activities	<u><u>\$ (2,453,974)</u></u>

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

MODESTO CITY SCHOOLS

PROPRIETARY FUNDS STATEMENT OF NET POSITION JUNE 30, 2018

	Self Insurance Internal Service Fund
ASSETS	
Current Assets	
Deposits and investments	\$ 16,084,120
Receivables	50,307
Due from other funds	665,907
Prepaid expenses	544,200
Total Current Assets	17,344,534
LIABILITIES	
Current Liabilities	
Accounts payable	545,362
Due to other funds	155,537
Claim liabilities	7,854,000
Total Current Liabilities	8,554,899
NET POSITION	
Restricted	\$ 8,789,635

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

MODESTO CITY SCHOOLS

PROPRIETARY FUNDS

STATEMENT OF REVENUES, EXPENSES, AND CHANGES

IN FUND NET POSITION

FOR THE YEAR ENDED JUNE 30, 2018

	Self Insurance Internal Service Fund
OPERATING REVENUES	
Local and intermediate sources	\$ 12,097,016
OPERATING EXPENSES	
Claims and related costs	7,097,842
Insurance	2,994,166
Payroll costs	398,816
Professional and contract services	692,972
Supplies and materials	80,689
Facility rental	22,797
Total Operating Expenses	11,287,282
Operating Income	809,734
NONOPERATING REVENUES	
Interest income	277,307
Transfers in	65,888
Total Nonoperating Revenues	343,195
Change in Net Position	1,152,929
Total Net Position - Beginning	7,636,706
Total Net Position - Ending	\$ 8,789,635

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

MODESTO CITY SCHOOLS

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2018

	Self Insurance Internal Service Fund
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash receipts from premiums	\$ 11,976,409
Cash payments to employees for services	(398,816)
Cash payments for claims and related costs	(10,703,498)
Net Cash Provided by Operating Activities	<u>874,095</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Nonoperating transfers	<u>65,888</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest on investments	<u>277,307</u>
Net Increase in Cash and Cash Equivalents	1,217,290
Cash and Cash Equivalents - Beginning	14,866,830
Cash and Cash Equivalents - Ending	<u><u>\$ 16,084,120</u></u>
 RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Operating income	\$ 809,734
Changes in assets and liabilities:	
Receivables	(2,261)
Due from other funds	(118,346)
Accounts payable	9,431
Due to other funds	155,537
Claim liabilities	20,000
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u><u>\$ 874,095</u></u>

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

MODESTO CITY SCHOOLS

FIDUCIARY FUNDS STATEMENT OF NET POSITION JUNE 30, 2018

	Scholarship Trusts	Agency Funds
ASSETS		
Deposits and investments	\$ 1,301,581	\$ 2,900,253
LIABILITIES		
Due to student groups		
Elementary Schools Combined Account	-	394,494
Beyer High School	-	170,336
Davis High School	-	281,200
Downey High School	-	401,843
Enochs High School	-	159,525
Gregori High School	-	226,070
Johansen High School	-	193,606
Modesto High School	-	1,073,179
Total Liabilities	-	2,900,253
NET POSITION-RESTRICTED		
Elementary Schools Combined Account	25,946	-
Beyer High School	22,944	-
Davis High School	181,326	-
Downey High School	66,009	-
Enochs High School	2,000	-
Gregori High School	1,250	-
Johansen High School	15,448	-
Modesto High School	986,658	-
Total Net Position	\$ 1,301,581	\$ -

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

MODESTO CITY SCHOOLS

FIDUCIARY FUNDS

STATEMENT OF CHANGES IN NET POSITION FOR THE YEAR ENDED JUNE 30, 2018

	Scholarship Trusts
ADDITIONS	
Private donations and scholarship earnings	
Elementary Schools Combined Account	\$ 626
Beyer High School	27,516
Davis High School	4,905
Downey High School	22,041
Enochs High School	1,750
Gregori High School	-
Johansen High School	2,500
Modesto High School	37,109
Total Additions	96,447
DEDUCTIONS	
Scholarships awarded and other expenditures	
Elementary Schools Combined Account	67,931
Beyer High School	14,800
Davis High School	2,456
Downey High School	16,160
Enochs High School	-
Gregori High School	7,250
Johansen High School	1,500
Modesto High School	51,317
Total Deductions	161,414
Change in Net Position	(64,967)
Net Position - Beginning	1,366,548
Net Position - Ending	\$ 1,301,581

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

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity

The Modesto City School District and Modesto High School District (the District) were established in 1871, under the laws of the State of California. The Districts operate under the name Modesto City Schools and under a locally-elected seven-member Board form of government and provide educational services to grades K - 12 as mandated by the State and/or Federal agencies. The Modesto City School District operates twenty-two elementary schools and four junior high schools. The Modesto High School District operates seven high schools and an alternative education school.

A reporting entity is comprised of the primary government. The primary government of the District consists of all funds, departments, boards, and agencies that are not legally separate from the District. For Modesto City Schools, 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 non-major 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.

One fund currently defined as a special revenue fund in the California State Accounting Manual (CSAM) does not meet the GASB Statement No. 54 special revenue fund definition. Specifically, Fund 17, Special Reserve Non-Capital Fund, is not substantially composed of restricted or committed revenue sources. While this fund is authorized by statute and will remain open for internal reporting purposes, this fund functions effectively as an extension of the General Fund, and accordingly has been consolidated with the General Fund for presentation in these audited financial statements. As a result, the General Fund reflects an increase in fund balance of \$7,795,729.

Special Reserve Capital Outlay Fund The Special Reserve Capital Outlay Fund exists primarily to provide for the accumulation of General Fund monies for capital outlay purposes (*Education Code* Section 42840).

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

Non-Major 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, that compose a substantial portion of the inflows of the fund, and that are reasonably expected to continue. 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 that are restricted or committed 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 revenues that are restricted or committed for deferred maintenance purposes (*Education Code* Section 17582).

Capital Project Funds The Capital Project funds are used to account for financial resources to be used for 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 approval (*Education Code* Sections 17620-17626 and *Government Code* Section 65995 et seq.). 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).

Debt Service Funds The Debt Service funds are used to account for the accumulation of resources for, and the payment of, principal and interest on general long-term obligations.

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).

Debt Service Fund The Debt Service Fund is used to account for the accumulation of Federal resources for the payment of interest on qualified school construction bonds.

Proprietary Funds Proprietary funds are used to account for activities that are more business-like than government-like in nature. Proprietary funds are generally intended to be self-supporting and are classified as enterprise or internal service. The District has the following proprietary fund:

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

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 that accounts for workers' compensation, property, liability, and dental coverage.

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 two classifications: scholarship 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.

Trust funds are used to account for the assets held by the District under a trust agreement for individuals, private organizations, or other governments and are therefore, not available to support the District's own programs. The District's trust funds are scholarship funds. Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. Such funds have no equity accounts since all assets are due to individuals or entities at some future time. The District's agency fund accounts for student body activities (ASB).

Basis of Accounting - Measurement Focus

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

The government-wide statement of activities presents a comparison between expenses, both direct and indirect, and program revenues for each governmental function, and exclude 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. Program revenues include charges paid by the recipients of the goods or services offered by the programs and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues. The comparison of program revenues and expenses identifies the extent to which each program or business segment is self-financing or draws from the general revenues of the District. 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 are either externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. The net position restricted for other activities result from special revenue funds and the restrictions on their use.

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

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

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 balances 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 assets. 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. Generally, available is defined as collectible within 60 days. However, to achieve comparability of reporting among California districts and so as not to distort normal revenue patterns, with specific respect to reimbursement grants and corrections to 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 apportionments, interest, certain grants, and other local sources.

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

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.

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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 60 days. Principal and interest on long-term obligations, which has 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 entity-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 June 30, 2018, 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 (Expenses)

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

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 funds and expenses in the proprietary 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 \$15,000. The District does not possess any infrastructure. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized, but are expensed as incurred.

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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. Donated capital assets are capitalized at estimated fair market value on the date donated.

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

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

Interfund Balances

On fund financial statements, receivables and payables resulting from short-term interfund loans are classified as "interfund receivables/payables". These amounts are eliminated in the governmental activities column of the Statement of Net Position, except for the net residual amounts due between governmental activities, which are presented as internal balances.

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 as long-term obligations.

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.

Accounts Payable and Long-Term Obligations

Accounts payable and long-term obligations are reported in the government-wide financial statements. In general, governmental fund accounts payable that are paid in a timely manner and in full from current financial resources are reported as obligations of the funds.

Debt Issuance Costs

In the government-wide financial statements, long-term obligations are reported as liabilities in the applicable governmental activities statement of net position. Debt issuance costs related to prepaid insurance costs are amortized over the life of the debt using the straight-line method. In governmental fund financial statements, debt issuance costs related to prepaid insurance costs are recognized in the current period. The face amount of the debt is reported as other financing sources.

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Deferred Outflows/Inflows of Resources

In addition to assets, the Statement of Net 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 pension related items and for OPEB related items.

In addition to liabilities, the Statement of Net 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 and for OPEB 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.

Postemployment Benefits Other Than Pensions (OPEB)

For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the CalSTRS Medicare Premium Payment (MPP) Program and additions to/deductions from the MPP's fiduciary net position have been determined on the same basis as they are reported by the MPP. For this purpose, the MPP recognizes benefit payments when due and payable in accordance with the benefit terms. Investments are reported at fair value, except for money market investments and participating interest-earning investment contracts that have a maturity at the time of purchase of one year or less, which are reported at cost.

Fund Balances - Governmental Funds

As of June 30, 2018, 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.

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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 Official may assign amounts for specific purposes.

Unassigned - all other spendable amounts.

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

The governing board adopted a minimum fund balance policy for the General Fund in order to protect the district against revenue shortfalls or unpredicted one-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. The government-wide financial statements report \$38,203,668 of restricted net position.

Interfund Activity

Transfers between governmental activities in the government-wide financial statements are reported in the same manner as general revenues.

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. Interfund transfers are eliminated in the governmental activities column of the Statement of Activities.

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NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

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.

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 Stanislaus bills and collects the taxes on behalf of the District. Local property tax revenues are recorded when received.

Change in Accounting Principles

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. 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 District has implemented the provisions of this Statement as of June 30, 2018.

In March 2017, the GASB issued Statement No. 85, *Omnibus 2017*. The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). Specifically, this Statement addresses the following topics:

- Blending a component unit in circumstances in which the primary government is a business-type activity that reports in a single column for financial statement presentation;
- Reporting amounts previously reported as goodwill and "negative" goodwill;
- Classifying real estate held by insurance entities;
- Measuring certain money market investments and participating interest-earning investment contracts at amortized cost;

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- Timing of the measurement of pension or OPEB liabilities and expenditures recognized in financial statements prepared using the current financial resources measurement focus;
- Recognizing on behalf payments for pensions or OPEB in employer financial statements;
- Presenting payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB;
- Classifying employer-paid member contributions for OPEB;
- Simplifying certain aspects of the alternative measurement method for OPEB; and
- Accounting and financial reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans.

The District has implemented the provisions of this Statement as of June 30, 2018.

In May 2017, the GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*. The primary objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

The District has implemented the provisions of this Statement as of June 30, 2018.

New Accounting Pronouncements

In November 2016, the GASB issued Statement No. 83, *Certain Asset Retirement Obligations*. This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.

This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities. Laws and regulations may require governments to take specific actions to retire certain tangible capital assets at the end of the useful lives of those capital assets, such as decommissioning nuclear reactors and dismantling and removing sewage treatment plants. Other obligations to retire tangible capital assets may arise from contracts or court judgments. Internal obligating events include the occurrence of contamination, placing into operation a tangible capital asset that is required to be retired, abandoning a tangible capital asset before it is placed into operation, or acquiring a tangible capital asset that has an existing ARO.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Early implementation is encouraged.

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NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

In January 2017, the GASB issued Statement No. 84, *Fiduciary Activities*. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all State and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Early implementation is encouraged.

In June 2017, the GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

The requirements of this Statement are effective for the reporting periods beginning after December 15, 2019. Early implementation is encouraged.

In April 2018, the GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*. The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt.

This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established.

This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses.

For notes to financial statements related to debt, this Statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Early implementation is encouraged.

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NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

In June 2018, the GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged. The requirements of this Statement should be applied prospectively.

NOTE 2 - DEPOSITS AND INVESTMENTS

Summary of Deposits and Investments

Deposits and investments as of June 30, 2018, are classified in the accompanying financial statements as follows:

Governmental funds	\$ 164,117,168
Internal service fund	16,084,120
Subtotal Deposits and Investments, Statement of Net Position	180,201,288
Fiduciary funds	4,201,834
Total Deposits and Investments	<u>\$ 184,403,122</u>

Deposits and investments as of June 30, 2018, consist of the following:

Cash on hand and in banks	\$ 6,484,765
Cash in revolving	50,500
Investments	177,867,857
Total Deposits and Investments	<u>\$ 184,403,122</u>

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NOTES TO FINANCIAL STATEMENTS

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Policies and Practices

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

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

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 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.

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NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

General Authorizations

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

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

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 does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The District manages its exposure to interest rate risk by investing in the County Pool which purchases a combination of shorter term and longer term investments and which also times cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

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Segmented Time Distribution

Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations is provided by the following schedule that shows the distribution of the District's investments by maturity:

Investment Type	Fair Value	12 Months or Less	13 - 24 Months	25 - 60 Months	More Than 60 Months
County Pool	\$ 171,696,366	\$ 171,696,366	\$ -	\$ -	\$ -
Guarantee Investment Contract (GIC)	5,950,377	-	-	-	5,950,377
Local Agency Investment Fund (LAIF)	215,996	215,996	-	-	-
Total	<u>\$ 177,862,739</u>	<u>\$ 171,912,362</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,950,377</u>

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. California law also allows financial institutions to secure public deposits by pledging first trust deed mortgage notes having a value of 150 percent of the secured public deposits and letters of credit issued by the Federal Home Loan Bank of San Francisco having a value of 105 percent of the secured deposits. As of June 30, 2018, \$4,038,901 of the District's bank balance 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.

Custodial Credit Risk - Investments

This is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in possession of an outside party. Of the investment in Guarantee Investment Contract (GIC) of \$5,950,377, the District has a custodial credit risk exposure of \$5,950,377 because the related securities are uninsured, unregistered and held by the brokerage firm which is also the counterparty for these securities. The District does not have a policy limiting the amount of securities that can be held by counterparties.

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

NOTE 3 - 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 reasonably 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.

Uncategorized - Investments in the Stanislaus County Treasury Investment Pool and Local Agency Investment Funds are not measured using the input levels above because the District's 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.

The District's fair value measurements are as follows at June 30, 2018:

Investment Type	Fair Value	Fair Value Measurements Using			Uncategorized
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
Government Investment					
Contract (GIC)	\$ 5,950,377	\$ 5,950,377	\$ -	\$ -	\$ -
County Pool	171,696,366	-	-	-	171,696,366
Local Agency Investment					
Fund (LAIF)	215,996	-	-	-	215,996
Total	<u>\$177,862,739</u>	<u>\$ 5,950,377</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$171,912,362</u>

All assets have been valued using a market approach, with quoted market prices.

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NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

NOTE 4 - RECEIVABLES

Receivables at June 30, 2018, consist of intergovernmental grants, entitlements, and local sources. All receivables are considered collectible in full.

	General Fund	Special Reserve Capital Outlay Capital	Non-Major Governmental Funds	Total Governmental Funds	Self Insurance Fund	Total Governmental Activities
Federal Government						
Categorical aid	\$ 3,424,242	\$ -	\$ 1,790,073	\$ 5,214,315	\$ -	\$ 5,214,315
State Government						
State grants and other entitlements	2,258,572	-	556,328	2,814,900	-	2,814,900
Local sources	3,735,811	2,000	174,530	3,912,341	50,307	3,962,648
Total	<u>\$ 9,418,625</u>	<u>\$ 2,000</u>	<u>\$ 2,520,931</u>	<u>\$11,941,556</u>	<u>\$ 50,307</u>	<u>11,991,863</u>

NOTE 5 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2018, is as follows:

	Balance July 1, 2017	Additions	Deductions	Balance June 30, 2018
Governmental Activities				
Capital Assets not being depreciated				
Land	\$ 19,991,733	\$ -	\$ -	\$ 19,991,733
Construction in progress	28,267,709	17,205,030	9,853,331	35,619,408
Total Capital Assets Not Being Depreciated	<u>48,259,442</u>	<u>17,205,030</u>	<u>9,853,331</u>	<u>55,611,141</u>
Capital Assets being depreciated				
Land improvements	39,062,767	6,307,981	-	45,370,748
Buildings and improvements	415,136,332	3,545,350	905,438	417,776,244
Furniture and equipment	20,683,202	2,028,339	391,923	22,319,618
Total Capital Assets Being Depreciated	<u>474,882,301</u>	<u>11,881,670</u>	<u>1,297,361</u>	<u>485,466,610</u>
Less Accumulated Depreciation				
Land improvements	12,851,823	1,955,493	-	14,807,316
Buildings and improvements	139,761,847	8,315,348	866,985	147,210,210
Furniture and equipment	9,466,426	1,240,230	354,027	10,352,629
Total Accumulated Depreciation	<u>162,080,096</u>	<u>11,511,071</u>	<u>1,221,012</u>	<u>172,370,155</u>
Governmental Activities Capital Assets, Net	<u>\$361,061,647</u>	<u>\$17,575,629</u>	<u>\$ 9,929,680</u>	<u>\$368,707,596</u>

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

Depreciation expense was charged to governmental functions as follows:

Governmental Activities

Instruction	\$ 9,327,031
Instructional library, media, and technology	13,569
School site administration	66,973
Home-to-school transportation	466,591
Food services	615,181
Community services	265,830
All other general administration	199,596
Data processing	130,943
Plant services	425,357
Total Depreciation Expenses, Governmental Activities	<u>\$ 11,511,071</u>

NOTE 6 - 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 resulted from one fund owing another. Interfund receivable and payable balances at June 30, 2018, are as follows:

	Interfund Receivables	Interfund Payables
Major Governmental Funds		
General	\$ 1,664,937	\$ 747,954
Special Reserve Capital Outlay	63,232	8,814
Total Major Governmental Funds	<u>1,728,169</u>	<u>756,768</u>
Non-Major Governmental Funds		
Adult Education	55	-
Child Development	10,960	419,616
Cafeteria	657	1,061,123
Deferred Maintenance	7,143	-
Capital Facilities	-	19,847
Total Non-Major Governmental Funds	<u>18,815</u>	<u>1,500,586</u>
Self Insurance	665,907	155,537
Total All Governmental Funds	<u>\$ 2,412,891</u>	<u>\$ 2,412,891</u>

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

The Child Development Non-Major Governmental Fund owes the General Fund for indirect costs.	\$ 419,616
The Self Insurance Fund owes the General Fund for payroll adjustments.	52
The Self Insurance Fund owes the General Fund for revenues posted in error to the Self Insurance Fund.	155,269
The Self Insurance Fund owes the General Fund for June vehicle work orders.	216
The Cafeteria Non-Major Governmental Fund owes the General Fund for June vehicle work orders.	3,330
The Cafeteria Non-Major Governmental Fund owes the General Fund for indirect costs.	726,238
The Cafeteria Non-Major Governmental Fund owes the General Fund for miscellaneous transfers.	328,779
The Cafeteria Non-Major Governmental Fund owes the General Fund for use tax from taxable sales and catering.	2,776
The Capital Facilities Non-Major Governmental Fund owes the General Fund for developer fee administration charges.	19,847
The Special Reserve Capital Outlay Fund owes the General Fund for golf cart purchases.	8,814
The General Fund owes the Child Development Non-Major Governmental Fund for CDP preschool slots for special education children.	10,960
The General Fund owes the Cafeteria Non-Major Governmental Fund for catering.	657
The General Fund owes the Special Reserve Capital Outlay Fund for vehicle replacement.	49,976
The General Fund owes the Special Reserve Capital Outlay Fund for equipment replacement.	13,256
The General Fund owes the Self Insurance Fund for 1:1 device transfer.	65,889
The General Fund owes the Self Insurance Fund for annual property and liability transfer.	600,000
The General Fund owes the Adult Education Non-Major Governmental Fund CSEA release time credits.	55
The General Fund owes the Deferred Maintenance Non-Major Governmental Fund for miscellaneous expenditures.	7,143
The General Fund owes the Self Insurance Fund for payroll transfer.	18
Total	<u>\$ 2,412,891</u>

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

Operating Transfers

Interfund transfers are used to (1) move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them, (2) move receipts restricted to debt service from the funds collecting the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations. Interfund transfers for the year ended June 30, 2018, consist of the following:

The General Fund transferred to the Debt Service Non-Major Governmental Fund for the annual sinking fund deposit.	\$ 400,000
The General Fund transferred to the Special Reserve Capital Outlay Fund for the bus replacement reserve contribution.	450,000
The General Fund transferred to the Special Reserve for Capital Outlay Fund for high school district facility improvements.	2,000,000
The General Fund transferred to the Special Reserve for Capital Outlay Fund for the Wilson cafeteria project.	5,000,000
The General Fund transferred to the Special Reserve Capital Outlay Fund for the bus replacement contribution.	142,690
The General Fund transferred to the Special Reserve Capital Outlay Fund for the White Fleet replacement contribution.	275,000
The General Fund transferred to the Special Reserve Capital Outlay Fund for the Reprographics equipment replacement contribution.	13,255
The General Fund transferred to the Special Reserve Capital Outlay Fund for the annual Downey auditorium replacement contribution.	10,288
The General Fund transferred to the Special Reserve Capital Outlay Fund for the annual Modesto auditorium replacement contribution.	23,431
The General Fund transferred to the Special Reserve Capital Outlay Fund for the annual Johansen auditorium replacement contribution.	9,406
The General Fund transferred to the Self Insurance Fund for 1:1 student device insurance.	65,888
The General Fund transferred to the Deferred Maintenance Non-Major Governmental Fund for routine repair and maintenance.	2,000,000
The General Fund transferred to the Child Development Non-Major Governmental Fund for slot fees for special education students.	45,115
The Capital Facilities Non-Major Governmental Fund transferred to the Debt Service Fund for the annual sinking fund deposit,	2,416
The Capital Facilities Non-Major Governmental Fund transferred to the General Fund for administration fees.	19,847
The Cafeteria Non-Major Governmental Fund transferred to the General Fund for the NSC cost for routine restricted maintenance projects.	328,779
The Special Reserve Capital Outlay Fund transferred to the General Fund for the purchase of replacement buses.	722,702
The Special Reserve Capital Outlay Fund transferred to the Debt Service Non-Major Governmental Fund for the annual sinking fund deposit.	368,441
Total	<u>\$ 11,877,258</u>

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

NOTE 7 - PREPAID EXPENDITURES (EXPENSES)

Prepaid expenditures (expenses) at June 30, 2018, consist of the following:

	Governmental Activities
General vendors - General Fund	\$ 1,013,435
General vendors - Non-Major Governmental Funds	163
Dental insurance - Internal Service Fund	544,200
Total Governmental Activities	<u>\$ 1,557,798</u>

NOTE 8 - ACCOUNTS PAYABLE

Accounts payable at June 30, 2018, consists of the following:

	General Fund	Special Reserve Capital Outlay Fund	Non-Major Governmental Funds	Total Governmental Funds	Self Insurance Fund	Total Governmental Activities
Vendor payables	\$ 9,899,538	\$ 2,383,567	\$ 1,090,175	\$ 13,373,280	\$ 545,362	\$ 13,918,642
Salaries and benefits	12,629,025	-	571,202	13,200,227	-	13,200,227
LCFF apportionment	1,623,950	-	-	1,623,950	-	1,623,950
Total	<u>\$24,152,513</u>	<u>\$ 2,383,567</u>	<u>\$ 1,661,377</u>	<u>\$ 28,197,457</u>	<u>\$ 545,362</u>	<u>\$ 28,742,819</u>

NOTE 9 - UNEARNED REVENUE

Unearned revenue at June 30, 2018, consists of the following:

	General Fund	Non-Major Governmental Funds	Total
Federal financial assistance	\$ -	\$ 576,494	\$ 576,494
State categorical aid	3,344,233	155,825	3,500,058
Total	<u>\$ 3,344,233</u>	<u>\$ 732,319</u>	<u>\$ 4,076,552</u>

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

NOTE 10 - LONG-TERM OBLIGATIONS

Summary

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

	Balance July 1, 2017, as restated	Additions	Deductions	Balance June 30, 2018	Due in One Year
General obligation bonds:					
Elementary bonds	\$ 20,780,543	\$ 1,115,305	\$ 2,130,000	\$ 19,765,848	\$ 2,200,000
High school district bonds	83,228,496	4,508,155	7,835,000	79,901,651	8,225,000
Compensated absences - net	981,095	-	167,389	813,706	-
Capital leases	7,366,666	2,779,950	3,941,177	6,205,439	4,049,961
Qualified school construction bonds	16,420,000	-	-	16,420,000	-
Compensation benefits	662,213	-	-	662,213	-
Teacher retirement incentive	4,800	-	4,800	-	-
Gregori traffic mitigation	547,970	-	130,803	417,167	10,000
Net other postemployment benefits (OPEB) liability	81,578,055	-	4,904,898	76,673,157	-
Total	<u>\$211,569,838</u>	<u>\$ 8,403,410</u>	<u>\$19,114,067</u>	<u>\$200,859,181</u>	<u>\$14,484,961</u>

The general obligation bonds are paid by the Bond Interest and Redemption Fund with local tax revenue. Payments on the capital leases and Gregori traffic mitigation are made from various District funds. Payments on compensated absences, compensation benefits, and other postemployment benefits are made from the fund for which the related employee worked. Payments on the teacher retirement incentive are made from 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, 2017	Interest Accreted	Redeemed	Bonds Outstanding June 30, 2018
Elementary School bonds:							
5/2/02	5/1/27	4.8-5.93	\$16,998,337	\$ 20,780,543	\$ 1,115,305	\$ 2,130,000	\$ 19,765,848
High School bonds:							
5/2/02	5/1/27	3.79-5.95	64,996,180	83,228,496	4,508,155	7,835,000	79,901,651
Total				<u>\$104,009,039</u>	<u>\$ 5,623,460</u>	<u>\$ 9,965,000</u>	<u>\$ 99,667,499</u>

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

Debt Service Requirements to Maturity

2002 Modesto City Elementary School District Series A

Payments of the 2002 Modesto City Elementary School District Series A General Obligation Bonds commenced in August 2009.

The bonds mature through 2027 as follows:

<u>Fiscal Year</u>	<u>Final Maturity</u>	<u>Accreted Obligation</u>	<u>Interest to Accrete</u>
2019	\$ 2,200,000	\$ 2,190,000	\$ 10,000
2020	2,280,000	2,144,842	135,158
2021	2,360,000	2,095,648	264,352
2022	2,440,000	2,044,617	395,383
2023	2,525,000	1,994,734	530,266
2024-2027	14,020,000	9,296,007	4,723,993
Total	<u>\$ 25,825,000</u>	<u>\$ 19,765,848</u>	<u>\$ 6,059,152</u>

2002 Modesto High School District Series A

Payments of the 2002 Modesto High School District Series A General Obligation Bonds commenced in August 2005.

The bonds mature through 2027 as follows:

<u>Fiscal Year</u>	<u>Final Maturity</u>	<u>Accreted Obligation</u>	<u>Interest to Accrete</u>
2019	\$ 8,225,000	\$ 8,187,599	\$ 37,401
2020	8,630,000	8,118,419	511,581
2021	9,060,000	8,045,170	1,014,830
2022	9,660,000	8,094,671	1,565,329
2023	10,245,000	8,093,493	2,151,507
2024-2027	59,440,000	39,362,299	20,077,701
Total	<u>\$ 105,260,000</u>	<u>\$ 79,901,651</u>	<u>\$ 25,358,349</u>

Compensated Absences

The long-term portion of compensated absences for the District at June 30, 2018, amounted to \$813,706.

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

Capital Leases

The District has entered into agreements to lease various facilities and equipment. Such agreements are, in substance, purchases (capital leases) and are reported as capital lease obligations. The District's liability on lease agreements with options to purchase is summarized below:

	Total
Balance, July 1, 2017	\$ 7,366,666
Additions	2,779,950
Payments	3,941,177
Balance, June 30, 2018	<u>\$ 6,205,439</u>

The capital leases have minimum lease payments as follows:

Year Ending June 30,	Lease Payment
2019	\$ 4,318,438
2020	1,908,357
2021	315,381
2022	30,145
Total	<u>6,572,321</u>
Less: Amount Representing Interest	366,882
Present Value of Minimum Lease Payments	<u>\$ 6,205,439</u>

Qualified School Construction Bonds Payable

Qualified School Construction Bonds (QSCB) are authorized by the federal government through the American Recovery and Reinvestment Act (ARRA) of 2009. The bonds provide federal tax credits for bondholders in lieu of interest in order to significantly reduce an issuer's cost of borrowing. The ARRA provides for an allocation to each state, along with separate allocations for large school districts.

On June 1, 2010, Modesto City Schools issued Qualified School Construction Bonds in the amount of \$16,420,000. The proceeds from the Bonds were used to finance improvements to public high schools within the District. A portion of the proceeds were used for the final phase of construction of Joseph A. Gregori High School. The Qualified School Construction Bonds bear an interest rate of 7.00 percent per annum and mature on June 1, 2027. The District is receiving an IRS subsidy rate of 5.57 percent therefore the effective rate to the District is 1.43 percent. The District is required to make annual payments into a trustee escrow account for the benefit of the owners of the bonds. The payments are calculated to generate sufficient revenues to pay principal of and interest on the bonds when due. As of June 30, 2018, the balance in the escrow account is \$5,950,377 and is reported in the District's Debt Service Fund.

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

Compensation Benefits

The District entered into collective bargaining agreements with the certificated personnel to provide retirees a One-Year Final Compensation Benefit if certain requirements are met. Upon calculation of the benefit liability for each retiree by California State Teachers' Retirement System (CalSTRS), the liability is paid by the District to CalSTRS. Currently, 22 individuals qualify for this benefit. At June 30, 2018, the obligation was \$662,213.

Teacher Retirement Incentive Liability

The District offered retirement incentives in the amount of \$30,000 to employees that were at least 55 years of age and had 25 year of CalSTRS credible service. The liability was paid in full as of June 30, 2018.

Gregori Traffic Mitigation Settlement

The District entered into a settlement agreement with Stanislaus County as payment in full for the resolution of traffic mitigation impacts related to the construction of Gregori High School in Salida. The Resolution Agreement obligates the District to pay the sum of \$855,600 over an unspecified period of time. The obligation amount is solely limited to the amount of commercial school impact developer fees ("Commercial Fees") the Modesto High School District collects and retains pursuant to the authority granted by *Education Code* Section 17620 et seq. and *Government Code* Section 65995 et seq. within its boundaries commencing from the effective date of this Agreement. At the end of each Fiscal Year, the Modesto High School District will account for the amount of Commercial Fees collected for that time period. After deducting a three percent administrative fee from the amount collected and retained, the Modesto High School District will forward said amount to the County by September 15 of the following fiscal year, and deduct that amount from the outstanding balance still due. The County agrees that the County may not accelerate the District's obligation to pay the Fee Amount. The amount paid during the fiscal year ended June 30, 2018, totaled \$130,803. The remaining obligation totals \$417,167.

Net Other Postemployment Benefit (OPEB) Liability

For the fiscal year ended June 30, 2018, the District reported net OPEB liability, deferred outflows of resources, deferred inflows of resources, and OPEB expense for the following plans:

OPEB Plan	Net OPEB Liability	Deferred Outflows of Resources	Deferred Inflows of Resources	OPEB Expense
District Plan	\$ 74,477,262	\$ 2,826,682	\$ 6,611,036	\$ 4,549,369
Medicare Premium Payment (MPP) Program	2,195,895	-	-	(93,060)
Total	<u>\$ 76,673,157</u>	<u>\$ 2,826,682</u>	<u>\$ 6,611,036</u>	<u>\$ 4,456,309</u>

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2018

The details of each plan are as follows:

District Plan

Plan Administration

The District's governing board administers the Postemployment Benefits District Plan (the Plan). The Plan is a single-employer defined benefit plan that is used to provide postemployment benefits other than pensions (OPEB) for eligible retirees and their spouses. No assets are accumulated in a trust that meets the criteria in paragraph 4 of GASB Statement No. 75.

Plan Membership

At June 30, 2017, the Plan membership consisted of the following:

Inactive employees or beneficiaries currently receiving benefits payments	877
Active employees	<u>2,846</u>
Total	<u><u>3,723</u></u>

Benefits Provided

The Plan provides medical and dental insurance benefits to eligible retirees and their spouses. Benefits are provided through a third-party insurer, and the full cost of benefits is covered by the Plan. The District's governing board has the authority to establish and amend the benefit terms as contained within the negotiated labor agreements.

Contributions

The benefit payment requirements of the Plan members and the District are established and may be amended by the District, the Modesto Teachers Association (MTA), the local California Service Employees Association (CSEA), and unrepresented groups. The benefit payment is based on projected pay-as-you-go financing requirements as determined annually through the agreements with the District, MTA, CSEA, and the unrepresented groups. For fiscal year 2017-2018, the District paid \$2,750,171 in benefits.

Total OPEB Liability of the District

The District's total OPEB liability of \$74,477,262 was measured as of June 30, 2017, by an actuarial study prepared as of that date.

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

Actuarial Assumptions

The total OPEB liability in the June 30, 2017 actuarial valuation was determined using the following assumptions, applied to all periods included in the measurement, unless otherwise specified:

Inflation	2.75 percent
Salary increases	3.00 percent, average, including inflation
Investment rate of return	3.58 percent, net of OPEB plan investment expense, including inflation
Healthcare cost trend rates	5.00 percent for 2017

The discount rate was based on the Bond Buyer 20-bond General Obligation Index.

Mortality rates were based on the 2009 CalSTRS Mortality Table for certificated employees and the 2014 CalPERS Active Mortality for Miscellaneous Employees Table for classified employees. Mortality rates vary by age and sex. (Unisex mortality rates are not often used as individual OPEB benefits do not depend on the mortality table used.) If employees die prior to retirement, past contributions are available to fund benefits for employees who live to retirement. After retirement, death results in benefit termination or reduction. Although higher mortality rates reduce service costs, the mortality assumption is not likely to vary from employer to employer.

The actual assumptions used in the June 30, 2017 valuation were based on the results of an actual experience study for the period July 1, 2016 to June 30, 2017.

Changes in the Total OPEB Liability

	Total OPEB Liability
Balance at June 30, 2016	\$ 79,289,100
Service cost	2,935,337
Interest	2,220,549
Changes of assumptions	(7,217,553)
Benefit payments	(2,750,171)
Net change in total OPEB liability	(4,811,838)
Balance at June 30, 2017	<u>\$ 74,477,262</u>

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

Sensitivity of the Total OPEB Liability to Changes in the Discount Rate

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

Discount Rate	Total OPEB Liability
1% decrease (2.58%)	\$ 84,636,741
Current discount rate (3.58%)	74,477,262
1% increase (4.58%)	66,071,236

Sensitivity of the Total OPEB Liability to Changes in the Healthcare Cost Trend Rates

The following presents the total OPEB liability of the District, as well as what the District's total OPEB liability would be if it were calculated using healthcare cost trend rates that are one percent lower or higher than the current healthcare costs trend rates:

Healthcare Cost Trend Rates	Total OPEB Liability
1% decrease (4.0%)	\$ 70,997,702
Current healthcare cost trend rate (5.0%)	74,477,262
1% increase (6.0%)	78,241,435

OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources related to OPEB

For the year ended June 30, 2018, the District recognized OPEB expense of \$4,549,369. At June 30, 2018, the District reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
OPEB contributions subsequent to measurement date	\$ 2,826,682	\$ -
Changes of assumptions	-	6,611,036
Total	\$ 2,826,682	\$ 6,611,036

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

Amounts reported as deferred inflows of resources related to the change of assumptions will be recognized in OPEB expense as follows:

Year Ended June 30,	Deferred Outflows/(Inflows) of Resources
2019	\$ (606,517)
2020	(606,517)
2021	(606,517)
2022	(606,517)
2022	(606,517)
Thereafter	(3,578,451)
Total	<u>\$ (6,611,036)</u>

Medicare Premium Payment (MPP) Program

Plan Description

The Medicare Premium Payment (MPP) Program is administered by the California State Teachers' Retirement System (CalSTRS). The MPP Program is a cost-sharing multiple-employer other postemployment benefit plan (OPEB) established pursuant to Chapter 1032, Statutes 2000 (SB 1435). CalSTRS administers the MPP Program through the Teachers' Health Benefits Fund (THBF).

A full description of the MPP Program regarding benefit provisions, assumptions (for funding, but not accounting purposes), and membership information is listed in the June 30, 2016 annual actuarial valuation report, Medicare Premium Payment Program Actuarial Valuation. This report and CalSTRS audited financial information are publicly available reports that can be found on the CalSTRS website under Publications at: <http://www.calstrs.com/member-publications>.

Benefits Provided

The MPP Program pays Medicare Part A premiums and Medicare Parts A and B late enrollment surcharges for eligible members of the State Teachers Retirement Plan (STRP) Defined Benefit (DB) Program who were retired or began receiving a disability allowance prior to July 1, 2012 and were not eligible for premium free Medicare Part A. The payments are made directly to the Centers for Medicare and Medicaid Services (CMS) on a monthly basis.

The MPP Program is closed to new entrants as members who retire after July 1, 2012, are not eligible for coverage under the MPP Program.

The MPP Program is funded on a pay-as-you go basis from a portion of monthly District benefit payments. In accordance with California *Education Code* Section 25930, benefit payments that would otherwise be credited to the DB Program each month are instead credited to the MPP Program to fund monthly program and administrative costs. Total redirections to the MPP Program are monitored to ensure that total incurred costs do not exceed the amount initially identified as the cost of the program.

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to the OPEB

At June 30, 2018, the District reported a liability of \$2,195,895 for its proportionate share of the net OPEB liability for the MPP Program. The net OPEB liability was measured as of June 30, 2016, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of that date. The District's proportion of the net OPEB liability was based on a projection of the District's long-term share of contributions to the OPEB Plan relative to the projected contributions of all participating school districts, actuarially determined. The District's proportionate share for the measurement period June 30, 2017 and June 30, 2016, respectively, was 0.5220 percent, and 0.4891 percent, resulting in a net increase in the proportionate share of 0.0329 percent.

For the year ended June 30, 2018, the District recognized OPEB expense of \$(93,060).

Actuarial Methods and Assumptions

The total OPEB liability for the MPP Program as of June 30, 2016, was determined based on a financial reporting actuarial valuation that used the June 30, 2016 assumptions presented in the table below. The June 30, 2017 total OPEB liability was determined by applying update procedures to the financial reporting actuarial valuation as of June 30, 2016, and rolling forward the total OPEB liability to June 30, 2017, using the assumptions listed in the following table:

Measurement Date	June 30, 2017	June 30, 2016
Valuation Date	June 30, 2016	June 30, 2016
Experience Study	July 1, 2010 through June 30, 2016	July 1, 2010 through June 30, 2015
Actuarial Cost Method	Entry age normal	Entry age normal
Investment Rate of Return	3.58%	2.85%
Medicare Part A Premium Cost Trend Rate	3.70%	3.70%
Medicare Part B Premium Cost Trend Rate	4.10%	4.10%

For the valuation as of June 30, 2016, CalSTRS used custom mortality tables based on RP2000 Series tables issued by the Society of Actuaries, adjusted to fit CalSTRS specific experience through June 30, 2015. For the valuation as of June 30, 2017, CalSTRS changed the mortality assumptions based on the July 1, 2010 through June 30, 2015, experience study adopted by the board in February 2017. CalSTRS now uses a generational mortality assumption, which involves the use of a base mortality table and projection scales to reflect expected annual reductions in mortality rates at each age, resulting in increases in life expectancies each year into the future. The base mortality tables are CalSTRS custom tables derived to best fit the patterns of mortality among the members. The projection scale was set equal to 110 percent of the ultimate improvement factor from the Mortality Improvement Scale (MP-2016) table, issued by the Society of Actuaries.

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

Assumptions were made about future participation (enrollment) into the MPP Program because CalSTRS is unable to determine which members not currently participating meet all eligibility criteria for enrollment in the future. Assumed enrollment rates were derived based on past experience and are stratified by age with the probability of enrollment diminishing as the members' age increases. This estimated enrollment rate was then applied to the population of members who may meet criteria necessary for eligibility and are not currently enrolled in the MPP Program. Based on this, the estimated number of future enrollments used in the financial reporting valuation was 571 or an average of 0.32 percent of the potentially eligible population (177,763).

The MPP Program is funded on a pay-as-you-go basis with contributions generally being made at the same time and in the same amount as benefit payments and expenses coming due. Any funds within the MPP Program as of June 30, 2017 and 2016, were to manage differences between estimated and actual amounts to be paid and were invested in the Surplus Money Investment Fund, which is a pooled investment program administered by the State Treasurer.

Discount Rate

The discount rate used to measure the total OPEB liability as of June 30, 2017 and 2016 was 3.58 percent and 2.85 percent, respectively. The MPP Program is funded on a pay-as-you-go basis as described in Note 1, and under the pay-as-you-go method, the OPEB Plan's fiduciary net position was not projected to be sufficient to make projected future benefit payments. Therefore, a discount rate of 3.58 percent and 2.85 percent, which is the Bond Buyer 20-Bond GO Index from Bondbuyer.com as of June 30, 2017 and 2016, respectively, was applied to all periods of projected benefit payments to measure the total OPEB liability.

Sensitivity of the District's Proportionate Share of the Net OPEB Liability to Changes in the Discount Rate

The following presents the District's proportionate share of the net OPEB 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 OPEB Liability
1% decrease (2.58%)	\$ 2,431,009
Current discount rate (3.58%)	2,195,895
1% increase (4.58%)	1,967,197

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

Sensitivity of the District's Proportionate Share of the Net OPEB Liability to Changes in the Medicare Costs Trend Rates

The following presents the District's proportionate share of the net OPEB 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:

Medicare Costs Trend Rate	Net OPEB Liability
1% decrease (2.7% Part A and 3.1% Part B)	\$ 1,984,328
Current medicare costs trend rate (3.7% Part A and 4.1% Part B)	2,195,895
1% increase (4.7% Part A and 5.1% Part B)	2,405,350

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

NOTE 11 - FUND BALANCES

Fund balances are composed of the following elements:

	General Fund	Special Reserve Capital Outlay Fund	Non-Major Governmental Funds	Total
Nonspendable				
Revolving cash	\$ 50,000	\$ -	\$ 500	\$ 50,500
Stores inventories	863,591	-	232,406	1,095,997
Prepaid expenditures	1,013,435	-	163	1,013,598
Total Nonspendable	1,927,026	-	233,069	2,160,095
Restricted				
Legally restricted programs	12,975,234	-	-	12,975,234
Adult education programs	-	-	127,812	127,812
Capital projects	-	-	1,404,115	1,404,115
Childcare programs	-	-	118,573	118,573
Food services	-	-	6,349,621	6,349,621
Debt service	-	-	16,995,244	16,995,244
Total Restricted	12,975,234	-	24,995,365	37,970,599
Committed				
Adult education programs	-	-	111,535	111,535
Deferred maintenance projects	-	-	2,266,306	2,266,306
Total Committed	-	-	2,377,841	2,377,841
Assigned				
Carryover obligations	1,395,676	-	-	1,395,676
Curriculum delivery reserve fund	7,308,965	-	-	7,308,965
MCS managers retiree benefit reserve	273,980	-	-	273,980
CSEA retiree benefit fund	212,783	-	-	212,783
Capital projects/maintenance	-	28,222,109	-	28,222,109
LCAP supplemental and concentration	8,471,571	-	-	8,471,571
Total Assigned	17,662,975	28,222,109	-	45,885,084
Unassigned				
Reserve for economic uncertainties	11,563,364	-	-	11,563,364
Remaining unassigned	45,426,957	-	-	45,426,957
Total Unassigned	56,990,321	-	-	56,990,321
Total	\$ 89,555,556	\$ 28,222,109	\$ 27,606,275	\$ 145,383,940

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

NOTE 12 - RISK MANAGEMENT

Workers' Compensation

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Self-Insurance Fund in Modesto City Schools provides workers' compensation insurance for Modesto City Schools, Stanislaus Union School District and Sylvan Union School District. Under this program, the Self-Insurance Fund provides coverage through a Workers' Compensation Insurance Indemnity Fund. Modesto City Schools receives user charges based upon each respective District's covered payroll. Coverage is provided for workers' compensation with \$350,000 per occurrence being self-funded. Costs above the first \$350,000 are covered by an excess insurance policy of up to \$25,000,000. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

Property and Liability

The District received property/casualty loss and general liability insurance coverage under the Self-Insurance Fund. A \$5,000,000 insurance policy is in effect with a deductible per occurrence of up to \$150,000. Costs above the first \$5,000,000 are covered by an excess insurance policy of up to \$445,000,000 through Schools Excess Liability Fund (SELF). Settled claims have not exceeded this coverage in any of the past three fiscal years.

Employee Medical Benefits

The District has contracted with CalPERS to provide employee health benefits.

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 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, 2017 to June 30, 2018:

	Dental	Workers' Compensation	Property and Liability	Total
Liability Balance, June 30, 2017	\$ 122,000	\$ 7,054,000	\$ 658,000	\$ 7,834,000
Claims and changes in estimates	3,140,051	2,364,863	1,240,822	6,745,736
Claims payments	(3,137,051)	(2,539,863)	(1,048,822)	(6,725,736)
Liability Balance, June 30, 2018	<u>\$ 125,000</u>	<u>\$ 6,879,000</u>	<u>\$ 850,000</u>	<u>\$ 7,854,000</u>

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

NOTE 13 - 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, 2018, 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 Pension Liability	Collective Deferred Outflows of Resources	Collective Deferred Inflows of Resources	Collective Pension Expense
CalSTRS	\$ 266,623,151	\$ 93,703,822	\$ 43,169,511	\$ 24,984,384
CalPERS	100,549,464	31,324,049	2,663,877	18,029,137
Total	<u>\$ 367,172,615</u>	<u>\$ 125,027,871</u>	<u>\$ 45,833,388</u>	<u>\$ 43,013,521</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, 2016, annual actuarial valuation report, Defined Benefit Program Actuarial Valuation. This report and CalSTRS audited financial information are publicly 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.

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NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

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, 2018, are summarized as follows:

	STRP Defined Benefit Program	
	On or before December 31, 2012	On or after January 1, 2013
Hire date		
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	10.25%	9.205%
Required employer contribution rate	14.43%	14.43%
Required state contribution rate	9.328%	9.328%

Contributions

Required member, District and State of California contributions 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, 2018, are presented above and the District's total contributions were \$24,065,035.

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

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

At June 30, 2018, 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:

Total net pension liability, including State share:

District's proportionate share of net pension liability	\$ 266,623,151
State's proportionate share of the net pension liability associated with the District	157,732,004
Total	<u>\$ 424,355,155</u>

The net pension liability was measured as of June 30, 2017. 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, 2017 and June 30, 2016, respectively was 0.2883 percent and 0.2750 percent, resulting in a net increase in the proportionate share of 0.0133 percent.

For the year ended June 30, 2018, the District recognized pension expense of \$24,984,384. In addition, the District recognized pension expense and revenue of \$15,877,241 for support provided by the State. At June 30, 2018, 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	\$ 24,065,035	\$ -
Net change in proportionate share of net pension liability	19,257,737	31,418,257
Difference between projected and actual earnings on pension plan investments	-	7,100,917
Differences between expected and actual experience in the measurement of the total pension liability	985,998	4,650,337
Changes of assumptions	49,395,052	-
Total	<u>\$ 93,703,822</u>	<u>\$ 43,169,511</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.

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NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

The deferred 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,	Deferred Inflows of Resources
2019	\$ (5,903,256)
2020	4,467,023
2021	644,119
2022	(6,308,803)
Total	<u>\$ (7,100,917)</u>

The deferred outflows/(inflows) of resources related to the net change in proportionate share of net pension liability, differences between expected and actual experience in the measurement of the total pension liability, and changes of assumptions 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 measurement period is seven years and will be recognized in pension expense as follows:

Year Ended June 30,	Deferred Outflows/(Inflows) of Resources
2019	\$ 5,163,077
2020	5,163,077
2021	5,163,077
2022	5,163,078
2023	3,068,312
Thereafter	9,849,572
Total	<u>\$ 33,570,193</u>

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, 2016, and rolling forward the total pension liability to June 30, 2017. The financial reporting actuarial valuation as of June 30, 2016, used the following methods and assumptions, applied to all prior periods included in the measurement:

Valuation date	June 30, 2016
Measurement date	June 30, 2017
Experience study	July 1, 2010 through June 30, 2015
Actuarial cost method	Entry age normal
Discount rate	7.10%
Investment rate of return	7.10%
Consumer price inflation	2.75%
Wage growth	3.50%

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NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

CalSTRS uses a generational mortality assumption, which involves the use of a base mortality table and projection scales to reflect expected annual reductions in mortality rates at each age, resulting in increases in life expectancies each year into the future. The base mortality tables are CalSTRS custom tables derived to best fit the patterns of mortality among its members. The projection scale was set equal to 110 percent of the ultimate improvement factor from the Mortality Improvement Scale (MP-2016) table, issued by the Society of Actuaries.

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 (Pension Consulting Alliance-PCA) as an input to the process. The actuarial investment rate of return assumption was adopted by the board in February 2017 in conjunction with the most recent experience study. For each future valuation, CalSTRS consulting actuary (Milliman) reviews the return assumption for reasonableness based on the most current capital market assumptions. Best estimates of 20-year geometrically-linked real rates of return and the assumed asset allocation for each major asset class for the year ended June 30, 2017, are summarized in the following table:

Asset Class	Assumed Asset Allocation	Long-Term Expected Real Rate of Return
Global equity	47%	6.30%
Fixed income	12%	0.30%
Real estate	13%	5.20%
Private equity	13%	9.30%
Absolute Return/Risk Mitigating Strategies	9%	2.90%
Inflation sensitive	4%	3.80%
Cash/liquidity	2%	-1.00%

Discount Rate

The discount rate used to measure the total pension liability was 7.10 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 (7.10 percent) and assuming that 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.

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

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 (6.10%)	\$ 391,487,432
Current discount rate (7.10%)	266,623,151
1% increase (8.10%)	165,287,326

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 regarding benefit provisions, assumptions (for funding, but not accounting purposes), and membership information is listed in the June 30, 2016 annual actuarial valuation report, Schools Pool Actuarial Valuation. This report and CalPERS audited financial information are publicly available reports that can be found on the CalPERS website under Forms and Publications at:
<https://www.calpers.ca.gov/page/forms-publications>.

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.

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NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

The CalPERS provisions and benefits in effect at June 30, 2018, are summarized as follows:

	School Employer Pool (CalPERS)	
	On or before December 31, 2012	On or after January 1, 2013
Hire date		
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	7.00%	6.50%
Required employer contribution rate	15.531%	15.531%

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, 2018, are presented above and the total District contributions were \$9,376,720.

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

As of June 30, 2018, the District reported net pension liabilities for its proportionate share of the CalPERS net pension liability totaling \$100,549,464. The net pension liability was measured as of June 30, 2017. 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, 2017 and June 30, 2016, respectively was 0.4212 percent and 0.4332 percent, resulting in a net decrease in the proportionate share of 0.0120 percent.

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NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

For the year ended June 30, 2018, the District recognized pension expense of \$18,029,137. At June 30, 2018, 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	\$ 9,376,720	\$ -
Net change in proportionate share of net pension liability	179,902	1,480,031
Difference between projected and actual earnings on pension plan investments	3,478,323	-
Differences between expected and actual experience in the measurement of the total pension liability	3,602,273	-
Changes of assumptions	14,686,831	1,183,846
Total	<u>\$ 31,324,049</u>	<u>\$ 2,663,877</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 deferred outflows 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,	Deferred Outflows of Resources
2019	\$ (94,251)
2020	4,013,231
2021	1,464,073
2022	(1,904,730)
Total	<u>\$ 3,478,323</u>

The deferred outflows/(inflows) of resources related to the net change in proportionate share of net pension liability, differences between expected and actual experience in the measurement of the total pension liability, and changes of assumptions 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 measurement period is 3.9 years and will be recognized in pension expense as follows:

Year Ended June 30,	Deferred Outflows/(Inflows) of Resources
2019	\$ 5,661,001
2020	5,521,075
2021	4,623,053
Total	<u>\$ 15,805,129</u>

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

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, 2016, and rolling forward the total pension liability to June 30, 2017. The financial reporting actuarial valuation as of June 30, 2016, used the following methods and assumptions, applied to all prior periods included in the measurement:

Valuation date	June 30, 2016
Measurement date	June 30, 2017
Experience study	July 1, 1997 through June 30, 2011
Actuarial cost method	Entry age normal
Discount rate	7.15%
Investment rate of return	7.15%
Consumer price inflation	2.75%
Wage growth	Varies by entry age and service

The mortality table used was developed based on CalPERS-specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB.

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+ 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 rounded 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 equal to the single equivalent rate calculated above and adjusted to account for assumed administrative expenses. 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	47%	5.38%
Global debt securities	19%	2.27%
Inflation assets	6%	1.39%
Private equity	12%	6.63%
Real estate	11%	5.21%
Infrastructure and Forestland	3%	5.36%
Liquidity	2%	-0.90%

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

Discount Rate

The discount rate used to measure the total pension liability was 7.15 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 (6.15%)	\$ 147,940,482
Current discount rate (7.15%)	100,549,464
1% increase (8.15%)	61,234,645

Social Security

As established by Federal law, all public sector employees who are not members of their employer's existing retirement system (CalSTRS) 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 percent of an employee's gross earnings. An employee is required to contribute 6.2 percent of his or her gross earnings to Social Security.

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 \$12,826,987 (9.328 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.

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

NOTE 14 - COMMITMENTS AND CONTINGENCIES

Grants

The District received financial assistance from Federal and State agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the General Fund or other applicable funds. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of the District at June 30, 2018.

Litigation

The District is involved in various litigation 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, 2018.

Operating Leases

The District has entered into various operating leases for buildings and equipment with lease terms in excess of one year. None of these agreements contain purchase options. All agreements contain a termination clause providing for cancellation after a specified number of days written notice to lessors, but it is unlikely that the District will cancel any of the agreements prior to the expiration date.

MODESTO CITY SCHOOLS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2018

Construction Commitments

As of June 30, 2018, the District had the following commitments with respect to the unfinished capital projects:

Capital Projects	Remaining Construction Commitment	Expected Date of Completion
Projects with remaining commitments in excess of \$40,000:		
Burbank café and portable classroom replacement	\$ 270,569	August 2018
Replace walk-in boxes - Davis	122,250	August 2018
Replace walk-in boxes - Downey	124,774	August 2018
Replace walk-in boxes - Johansen	101,046	August 2018
Downey agriculture improvements - BP3	168,980	August 2018
Downey greenhouse - BP4	436,473	October 2018
Davis greenhouse - BP4	333,208	October 2018
Gregori greenhouse - BP4	420,007	October 2018
Sonoma mechanical upgrades	497,668	August 2018
Repaving at Burbank	279,264	August 2018
Repaving at Davis	668,819	August 2018
Repaving at Shackelford	782,522	August 2018
Reroofing and HVAC at Lakewood	47,500	August 2018
Reroofing at Reno Ave	121,586	August 2018
Gym HVAC replacement - Beyer	627,346	August 2018
Gym HVAC replacement - Davis	744,097	August 2018
Gym HVAC replacement - Downey	231,241	August 2018
Roosevelt classrooms	1,104,353	August 2018
Downey classrooms	87,409	August 2018
Sitework - Downey - BP3	709,156	August 2018
Compactor containment - Downey - BP4	234,488	October 2018
Compactor containment - Johansen - BP4	85,956	October 2018
Compactor containment - Modesto - BP4	114,365	October 2018
Kirschen classrooms	466,896	August 2018
Prop 39 - Johnson Controls - most school sites	1,847,513	August 2018
Total Estimated Construction Commitments	<u>\$ 10,627,486</u>	

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NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018

Bargaining Units Contributions

The District is committed to providing annual contributions to the Modesto Teachers' Association (MTA), California School Employees Association (CSEA), and MCS Managers, resulting from collective bargaining agreements. The contract agreements establishing these contributions identify that funds are to be used toward reimbursement of medical premium for eligible retirees. Per the negotiated agreements, the contributions are calculated based on contract and subsequent Memorandum of Understanding language.

- MTA - The fixed annual amount of \$648,198 is adjusted based on the cost of CalPERS Administration Fees and Share of Premium Fees for MTA retirees.
- CSEA - The fixed annual amount of \$139,000 is adjusted based on the cost of CalPERS Administration Fees and Share of Premium Fees for CSEA retirees.
- Managers Group - The annual amount is 0.05 percent of the annual gross management salary (less Superintendent's salary) plus \$24,000, which is adjusted based on the cost of CalPERS Administration Fees and Share of Premium Fees for Management retirees.

NOTE 15 - PARTICIPATION IN PUBLIC ENTITY RISK POOLS AND JOINT POWER AUTHORITIES

The District is a member of the Schools Infrastructure Financing Agency (SIFA) and the Salida Area Public Facilities Financing Agency (SAPFFA) joint powers authorities (JPAs). The relationships between the District and the JPAs are such that they are not component units of the District for financial reporting purposes.

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

The District has appointed two members to the governing board of SIFA.

The District has appointed one member to the governing board of SAPFFA.

NOTE 16 - RESTATEMENT OF PRIOR YEAR NET POSITION

The District adopted GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, in the current year. As a result, the effect on the current fiscal year is as follows:

Government-Wide Financial Statements

Net Position - Beginning	\$ 95,940,755
Inclusion of net OPEB liability from the adoption of GASB Statement No. 75	(63,219,587)
Net Position - Beginning as Restated	<u>\$ 32,721,168</u>

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REQUIRED SUPPLEMENTARY INFORMATION

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MODESTO CITY SCHOOLS

GENERAL FUND BUDGETARY COMPARISON SCHEDULE FOR THE YEAR ENDED JUNE 30, 2018

	Budgeted Amounts		Actual	Variances - Favorable (Unfavorable) Final to Actual
	Original	Final		
REVENUES				
Local Control Funding Formula	\$ 294,763,257	\$ 294,976,452	\$ 295,401,578	\$ 425,126
Federal sources	18,568,120	24,576,468	22,826,417	(1,750,051)
Other State sources	21,870,814	45,583,364	45,283,927	(299,437)
Other local sources	2,371,517	3,070,229	5,836,488	2,766,259
Total Revenues ¹	<u>337,573,708</u>	<u>368,206,513</u>	<u>369,348,410</u>	<u>1,141,897</u>
EXPENDITURES				
Current				
Certificated salaries	159,165,132	167,250,462	167,226,009	24,453
Classified salaries	54,499,798	55,690,856	55,591,944	98,912
Employee benefits	61,876,730	75,577,328	73,294,264	2,283,064
Books and supplies	17,841,843	23,160,030	20,208,425	2,951,605
Services and operating expenditures	40,840,705	40,944,662	36,022,057	4,922,605
Other outgo	6,759,207	4,956,093	5,566,292	(610,199)
Capital outlay	815,000	12,761,932	9,826,544	2,935,388
Debt service - principal	3,423,032	3,423,032	3,941,177	(518,145)
Debt service - interest	-	-	377,261	(377,261)
Total Expenditures ¹	<u>345,221,447</u>	<u>383,764,395</u>	<u>372,053,973</u>	<u>11,710,422</u>
Excess (Deficiency) of Revenues Over Expenditures	<u>(7,647,739)</u>	<u>(15,557,882)</u>	<u>(2,705,563)</u>	<u>12,852,319</u>
Other Financing Sources (Uses)				
Transfers in	1,270,169	1,429,169	1,071,328	(357,841)
Other sources	-	2,779,950	2,779,950	-
Transfers out	(3,004,912)	(13,479,048)	(10,435,073)	3,043,975
Net Financing Sources (Uses)	<u>(1,734,743)</u>	<u>(9,269,929)</u>	<u>(6,583,795)</u>	<u>2,686,134</u>
NET CHANGE IN FUND BALANCES	<u>(9,382,482)</u>	<u>(24,827,811)</u>	<u>(9,289,358)</u>	<u>15,538,453</u>
Fund Balance - Beginning	<u>98,844,914</u>	<u>98,844,914</u>	<u>98,844,914</u>	<u>-</u>
Fund Balance - Ending	<u>\$ 89,462,432</u>	<u>\$ 74,017,103</u>	<u>\$ 89,555,556</u>	<u>\$ 15,538,453</u>

¹ Due to the consolidation of Fund 17, Special Reserve Non-Capital Outlay Fund for reporting purposes into the General Fund, additional revenues and expenditures pertaining to these other funds are included in the actual revenues and expenditures, however, are not included in the original and final General Fund budgets.

See accompanying note to required supplementary information.

MODESTO CITY SCHOOLS

SCHEDULE OF CHANGES IN THE DISTRICT'S TOTAL OPEB LIABILITY AND RELATED RATIOS FOR THE YEAR ENDED JUNE 30, 2018

	<u>2018</u>
Total OPEB Liability	
Service cost	\$ 2,935,337
Interest	2,220,549
Changes of assumptions	(7,217,553)
Benefit payments	<u>(2,750,171)</u>
Net change in total OPEB liability	<u>(4,811,838)</u>
Total OPEB liability - beginning	<u>79,289,100</u>
Total OPEB liability - ending	<u><u>\$ 74,477,262</u></u>
 Covered payroll	 <u>N/A ¹</u>
 District's total OPEB liability as a percentage of covered payroll	 <u>N/A ¹</u>

¹ The District's OPEB Plan is not administered through a trust and contributions are not made based on a measure of pay; therefore, no measure of payroll is presented.

Note: In the future, as data becomes available, ten years of information will be presented.

See accompanying note to required supplementary information.

MODESTO CITY SCHOOLS

SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE NET OPEB LIABILITY - MPP PROGRAM FOR THE YEAR ENDED JUNE 30, 2018

Year ended June 30,	2018
District's proportion of the net OPEB liability	0.5220%
District's proportionate share of the net OPEB liability	\$ 2,195,895
District's covered-employee payroll	N/A ¹
District's proportionate share of the net OPEB liability as a percentage of it's covered-employee payroll	N/A ¹
Plan fiduciary net position as a percentage of the total OPEB liability	0.01%

¹ As of June 30, 2012, active members are no longer eligible for future enrollment in the MPP Program; therefore, the covered payroll disclosure is not applicable.

Note: In the future, as data becomes available, ten years of information will be presented.

See accompanying note to required supplementary information.

MODESTO CITY SCHOOLS

SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY FOR THE YEAR ENDED JUNE 30, 2018

	2018	2017
CalSTRS		
District's proportion of the net pension liability	0.2883%	0.2750%
District's proportionate share of the net pension liability	\$ 266,623,151	\$ 222,420,923
State's proportionate share of the net pension liability associated with the District	157,732,004	126,620,264
Total	\$ 424,355,155	\$ 349,041,187
District's covered - employee payroll	\$ 155,167,170	\$ 149,835,890
District's proportionate share of the net pension liability as a percentage of its covered - employee payroll	171.83%	148.44%
Plan fiduciary net position as a percentage of the total pension liability	69%	70%
CalPERS		
District's proportion of the net pension liability	0.4212%	0.4332%
District's proportionate share of the net pension liability	\$ 100,549,464	\$ 85,562,699
District's covered - employee payroll	\$ 54,541,489	\$ 52,025,559
District's proportionate share of the net pension liability as a percentage of its covered - employee payroll	184.35%	164.46%
Plan fiduciary net position as a percentage of the total pension liability	72%	74%

Note : In the future, as data becomes available, ten years of information will be presented.

See accompanying note to required supplementary information.

<u>2016</u>	<u>2015</u>
<u>0.3345%</u>	<u>0.3092%</u>
\$ 225,190,926	\$ 180,662,657
<u>119,101,175</u>	<u>109,091,913</u>
<u>\$ 344,292,101</u>	<u>\$ 289,754,570</u>
<u>\$ 144,744,707</u>	<u>\$ 138,828,800</u>
<u>155.58%</u>	<u>130.13%</u>
<u>74%</u>	<u>77%</u>
<u>0.4334%</u>	<u>0.4282%</u>
<u>\$ 63,877,115</u>	<u>\$ 48,616,259</u>
<u>\$ 47,934,627</u>	<u>\$ 45,099,100</u>
<u>133.26%</u>	<u>107.80%</u>
<u>79%</u>	<u>83%</u>

MODESTO CITY SCHOOLS

SCHEDULE OF DISTRICT CONTRIBUTIONS FOR THE YEAR ENDED JUNE 30, 2018

	2018	2017
CalSTRS		
Contractually required contribution	\$ 24,065,035	\$ 19,520,030
Contributions in relation to the contractually required contribution	24,065,035	19,520,030
Contribution deficiency (excess)	\$ -	\$ -
District's covered - employee payroll	\$ 166,770,859	\$ 155,167,170
Contributions as a percentage of covered - employee payroll	14.43%	12.58%
CalPERS		
Contractually required contribution	\$ 9,376,720	\$ 7,574,722
Contributions in relation to the contractually required contribution	9,376,720	7,574,722
Contribution deficiency (excess)	\$ -	\$ -
District's covered - employee payroll	\$ 60,374,219	\$ 54,541,489
Contributions as a percentage of covered - employee payroll	15.531%	13.888%

Note : In the future, as data becomes available, ten years of information will be presented.

See accompanying note to required supplementary information.

2016	2015
\$ 16,077,391	\$ 12,853,330
16,077,391	12,853,330
<u>\$ -</u>	<u>\$ -</u>
\$ 149,835,890	\$ 144,744,707
<u>10.73%</u>	<u>8.88%</u>
\$ 6,163,468	\$ 5,642,385
6,163,468	5,642,385
<u>\$ -</u>	<u>\$ -</u>
\$ 52,025,559	\$ 47,934,627
<u>11.847%</u>	<u>11.771%</u>

MODESTO CITY SCHOOLS

NOTE TO REQUIRED SUPPLEMENTARY INFORMATION JUNE 30, 2018

NOTE 1 - PURPOSE OF SCHEDULES

Budgetary Comparison Schedule

The District employs budget control by object codes and by individual appropriation accounts. Budgets are prepared on the modified accrual basis of accounting in accordance with accounting principles generally accepted in the United State of America as prescribed by the Governmental Accounting Standards Board and provisions of the California *Education Code*. The governing board is required to hold a public hearing and adopt an operating budget no later than July 1 of each year. 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.

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 Changes in the District's Total OPEB Liability and Related Ratios

This schedule presents information on the District's changes in the total OPEB liability, including beginning and ending balances and the total OPEB liability. In the future, as data becomes available, ten years of information will be presented.

Schedule of the District's Proportionate Share of the Net OPEB Liability - MPP Program

This schedule presents information on the District's proportionate share of the net OPEB Liability - MPP Program and the plans' fiduciary net position. In the future, as data becomes available, ten years of information will be presented.

Changes in Benefit Terms - There were no changes in the benefit terms since the previous valuation.

Changes of Assumptions - The plan rate of investment return assumption was changed from 2.85 percent to 3.58 percent since the previous valuation.

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.

Changes in Benefit Terms - There were no changes in benefit terms since the previous valuations for both CalSTRS and CalPERS.

Changes of Assumptions - The CalSTRS plan rate of investment return assumption was changed from 7.60 percent to 7.10 percent since the previous valuation. The CalPERS plan rate of investment return assumption was changed from 7.65 percent to 7.15 percent since the previous valuation.

MODESTO CITY SCHOOLS

NOTE TO REQUIRED SUPPLEMENTARY INFORMATION **JUNE 30, 2018**

Schedule of District 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.

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SUPPLEMENTARY INFORMATION

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MODESTO CITY SCHOOLS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED JUNE 30, 2018

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF EDUCATION			
Passed Through California Department of Education:			
Adult Basic Education and ESL	84.002A	14508	\$ 38,656
Adult Secondary Education	84.002	13978	7,180
Title I - Part A, Basic	84.010	14329	11,783,828
Title I - Part C, Migrant Education - Regular	84.011	14326	69,736
Title I - Part G, Advanced Placement Fee Program	84.330B	14831	12,362
Title II - Supporting Effective Education	84.367	14341	1,398,398
Title III - English Language Acquisition - LEP	84.365	14346	821,038
Title III - English Language Acquisition - IEP	84.365	15146	61,440
Special Education Cluster			
Special Education - Basic Local Assistance	84.027	13379	6,584,172
Special Education - Local Assistance - Private School	84.027	10115	7,072
Special Education - Preschool Grants	84.173	13430	145,241
Special Education - Preschool Local Entitlement	84.027A	13682	421,725
Special Education - Preschool Staff Development	84.173A	13431	1,206
Special Education - Mental Health Allocation Plan	84.027A	14468	332,172
Special Education - Alternate Dispute Resolution	84.173A	13007	22,052
Subtotal Special Education Cluster			<u>7,513,640</u>
Special Education - Early Intervention Programs	84.181	23761	91,745
Vocational Education - Technology Secondary II	84.048	14894	456,260
Total U.S. Department of Education			<u>22,254,283</u>
DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Passed Through California Department of Health Care Services:			
CCDF Matching-General Child Development Program	93.596	13609	661,375
Medi-Cal Billing Option	93.778	10013	617,970
Head Start	93.600	10016	3,503,182
Head Start - Training and Technical Assistance	93.600	10016	12,448
Early Head Start	93.600	15291	527,663
Early Head Start - Training and Technical Assistance	93.600	15291	1,380
Total Department of Health and Human Services			<u>5,324,018</u>

See accompanying note to supplementary information.

MODESTO CITY SCHOOLS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS, Continued FOR THE YEAR ENDED JUNE 30, 2018

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF AGRICULTURE			
Passed Through California Department of Education:			
Child Nutrition: Child and Adult Food Care Program	10.558	13666	\$ 452,898
Child Nutrition: Cash in Lieu of Commodities	10.558	13389	23,334
Child Nutrition Cluster:			
National School Lunch	10.555	13391	9,053,820
Especially Needy Breakfast	10.553	13526	2,431,275
Meals Supplements - Snack	10.555	13391	366,118
Seamless Summer	10.559	13004	146,051
Food Distribution - Commodities	10.555	13391	1,035,481
Subtotal Child Nutrition Cluster			<u>13,032,745</u>
Total U.S. Department of Agriculture			<u>13,508,977</u>
Total Expenditures of Federal Awards			<u>\$ 41,087,278</u>

See accompanying note to supplementary information.

MODESTO CITY SCHOOLS

LOCAL EDUCATION AGENCY ORGANIZATION STRUCTURE JUNE 30, 2018

ORGANIZATION

The Modesto City School District and Modesto High School District were established in 1871. The Modesto City School District covers an area of approximately 30 square miles. The Modesto City School District operates 22 elementary schools and four junior high schools. The Modesto High School District covers an area of approximately 280 square miles. The Modesto High School District operates seven high schools and an alternative education school. There were no boundary changes implemented during the year.

GOVERNING BOARD

MEMBER	OFFICE	TERM EXPIRES
Amy Elliott Neumann	President	2019
John Walker	Vice President	2019
Chad Brown	Member	2021
Steven Grenbeaux	Member	2019
Adolfo Lopez	Member	2021
Cindy Marks	Member	2021
Dr. Charlene G. West	Member	2021

ADMINISTRATION

Craig Rydquist	Interim Superintendent
Mike Henderson	Acting Deputy Superintendent, Human Resources
Marla Mack	Associate Superintendent, Educational Services
Tim Zearley	Associate Superintendent, Business Services, CBO
Mark Herbst	Assistant Superintendent, SELPA

See accompanying note to supplementary information.

MODESTO CITY SCHOOLS

SCHEDULE OF AVERAGE DAILY ATTENDANCE FOR THE YEAR ENDED JUNE 30, 2018

	Second Period Report	Annual Report
Regular ADA		
Transitional kindergarten through third	6,211.10	6,215.30
Fourth through sixth	5,076.81	5,076.30
Seventh and eighth	3,105.78	3,095.51
Ninth through twelfth	14,064.93	13,958.99
Total Regular ADA	28,458.62	28,346.10
Special Education, Nonpublic, Nonsectarian Schools		
Transitional kindergarten through third	4.39	4.93
Fourth through sixth	12.75	13.54
Seventh and eighth	9.48	10.17
Ninth through twelfth	39.29	39.66
Total Special Education, Nonpublic, Nonsectarian Schools	65.91	68.30
Extended Year Special Education, Nonpublic, Nonsectarian Schools		
Transitional kindergarten through third	0.09	0.09
Fourth through sixth	0.02	0.02
Seventh and eighth	0.02	0.02
Ninth through twelfth	0.55	0.56
Total Extended Year Special Education, Nonpublic, Nonsectarian Schools	0.68	0.69
Total ADA	28,525.21	28,415.09

See accompanying note to supplementary information.

MODESTO CITY SCHOOLS

SCHEDULE OF INSTRUCTIONAL TIME FOR THE YEAR ENDED JUNE 30, 2018

Grade Level	1986-1987	2017-2018	Number of Days		Status
	Minutes Requirement	Actual Minutes	Traditional Calendar	Multitrack Calendar	
Kindergarten	36,000	36,000	180	N/A	Complied
Grades 1 - 3	50,400				
Grade 1		50,428	180	N/A	Complied
Grade 2		50,428	180	N/A	Complied
Grade 3		50,428	180	N/A	Complied
Grades 4 - 6	54,000				
Grade 4		54,004	180	N/A	Complied
Grade 5		54,004	180	N/A	Complied
Grade 6		54,004	180	N/A	Complied
Grades 7 - 8	54,000				
Grade 7		55,576	180	N/A	Complied
Grade 8		55,576	180	N/A	Complied
Grades 9 - 12	64,800				
Grade 9		65,422	180	N/A	Complied
Grade 10		65,422	180	N/A	Complied
Grade 11		65,422	180	N/A	Complied
Grade 12		65,422	180	N/A	Complied

See accompanying note to supplementary information.

MODESTO CITY SCHOOLS

RECONCILIATION OF ANNUAL FINANCIAL AND BUDGET REPORT WITH AUDITED FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 2018

There were no adjustments to the Unaudited Actual Financial Report which required reconciliation to the audited financial statements at June 30, 2018.

See accompanying note to supplementary information.

MODESTO CITY SCHOOLS

SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2018

	(Adopted Budget)			
	2019 ^{1,3}	2018 ³	2017 ^{3,4}	2016 ³
GENERAL FUND				
Revenues	\$ 378,316,586	\$ 369,282,455	\$ 375,199,818	\$ 348,982,672
Other sources and transfers in	2,301,518	4,336,300	16,557,312	1,425,757
Total Revenues	380,618,104	373,618,755	391,757,130	350,408,429
Expenditures	376,115,497	372,053,973	372,682,676	323,639,548
Other uses and transfers out	8,872,276	13,391,507	3,144,397	19,452,211
Total Expenditures and Other Uses	384,987,773	385,445,480	375,827,073	343,091,759
INCREASE/(DECREASE) IN FUND BALANCE	\$ (4,369,669)	\$ (11,826,725)	\$ 15,930,057	\$ 7,316,670
ENDING FUND BALANCE	\$ 77,390,158	\$ 81,759,827	\$ 93,586,552	\$ 77,656,495
AVAILABLE RESERVES ²	\$ 55,325,128	\$ 56,990,321	\$ 69,939,480	\$ 51,651,626
AVAILABLE RESERVES AS A PERCENTAGE OF TOTAL OUTGO	14.4%	14.8%	18.6%	15.1%
LONG-TERM OBLIGATIONS ⁴	Not Available	\$200,859,181	\$211,569,838	\$142,286,745
AVERAGE DAILY ATTENDANCE AT P-2	28,510	28,525	28,766	28,506

The General Fund balance has increased by \$4,103,332 over the past two years. The fiscal year 2018-2019 budget projects a decrease of \$4,369,669 (5.3 percent). For a district this size, the State recommends available reserves of at least 3.0 percent of total General Fund expenditures, transfers out, and other uses (total outgo).

The District has incurred operating surpluses in two of the past three years but anticipates incurring an operating deficit during the 2018-2019 fiscal year. Total long-term obligations have increased by \$58,572,436 over the past two years due primarily to the implementation of GASB Statement No.75.

Average daily attendance has increased by 19 over the past two years. A decline of 15 ADA is anticipated during fiscal year 2018-2019.

¹ Budget 2019 is included for analytical purposes only and has not been subjected to audit.

² Available reserves consist of all unassigned fund balances including all amounts reserved for economic uncertainties contained within the General Fund.

³ General Fund amounts do not include activity related to the consolidation of the Special Reserve Fund for Other Than Capital Outlay as required by GASB Statement No. 54.

⁴ The balance of long-term obligations for the year ended June 30, 2017, has been restated due to the implementation of GASB Statement No. 75.

See accompanying note to supplementary information.

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MODESTO CITY SCHOOLS

**SCHEDULE OF CHARTER SCHOOLS
FOR THE YEAR ENDED JUNE 30, 2018**

<u>Name of Charter School</u>	<u>Included in Audit Report</u>
Aspire Vanguard College Preparatory Academy (Charter No. 1125)	No

See accompanying note to supplementary information.

MODESTO CITY SCHOOLS

NON-MAJOR GOVERNMENTAL FUNDS COMBINING BALANCE SHEET JUNE 30, 2018

	Adult Education Fund	Child Development Fund	Cafeteria Fund
ASSETS			
Deposits and investments	\$ 72,521	\$ 1,060,282	\$ 6,247,571
Receivables	214,956	526,325	1,639,780
Due from other funds	55	10,960	657
Prepaid expenses	-	-	163
Stores inventories	-	-	232,406
Total Assets	\$ 287,532	\$ 1,597,567	\$ 8,120,577
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 48,185	\$ 375,320	\$ 428,503
Due to other funds	-	419,616	1,061,123
Unearned revenue	-	684,058	48,261
Total Liabilities	48,185	1,478,994	1,537,887
Fund Balances:			
Nonspendable	-	-	233,069
Restricted	127,812	118,573	6,349,621
Committed	111,535	-	-
Total Fund Balances	239,347	118,573	6,582,690
Total Liabilities and Fund Balances	\$ 287,532	\$ 1,597,567	\$ 8,120,577

See accompanying note to supplementary information.

Deferred Maintenance Fund	Capital Facilities Fund	Bond Interest and Redemption Fund	Debt Service Fund	Total Non-Major Governmental Funds
\$ 2,805,226	\$ 1,547,398	\$ 11,044,867	\$ 5,950,377	\$ 28,728,242
-	139,870	-	-	2,520,931
7,143	-	-	-	18,815
-	-	-	-	163
-	-	-	-	232,406
<u>\$ 2,812,369</u>	<u>\$ 1,687,268</u>	<u>\$ 11,044,867</u>	<u>\$ 5,950,377</u>	<u>\$ 31,500,557</u>
\$ 546,063	\$ 263,306	\$ -	\$ -	\$ 1,661,377
-	19,847	-	-	1,500,586
-	-	-	-	732,319
<u>546,063</u>	<u>283,153</u>	<u>-</u>	<u>-</u>	<u>3,894,282</u>
-	-	-	-	233,069
-	1,404,115	11,044,867	5,950,377	24,995,365
2,266,306	-	-	-	2,377,841
<u>2,266,306</u>	<u>1,404,115</u>	<u>11,044,867</u>	<u>5,950,377</u>	<u>27,606,275</u>
<u>\$ 2,812,369</u>	<u>\$ 1,687,268</u>	<u>\$ 11,044,867</u>	<u>\$ 5,950,377</u>	<u>\$ 31,500,557</u>

MODESTO CITY SCHOOLS

NON-MAJOR GOVERNMENTAL FUNDS COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES FOR THE YEAR ENDED JUNE 30, 2018

	Adult Education Fund	Child Development Fund	Cafeteria Fund
REVENUES			
Local Control Funding Formula	\$ -	\$ -	\$ -
Federal sources	45,836	5,182,280	13,032,745
Other State sources	181,984	5,770,610	909,794
Other local sources	624,543	108,302	1,925,368
Total Revenues	852,363	11,061,192	15,867,907
EXPENDITURES			
Current			
Instruction	756,592	3,256,787	-
Instruction-related activities:			
Supervision of instruction	54,194	2,468,525	-
School site administration	144,421	-	-
Pupil services:			
Food services	-	518,392	14,406,830
All other pupil services	16,057	50,345	-
Administration:			
All other administration	-	709,905	731,652
Plant services	45,011	275,659	564,244
Community services	-	3,808,996	-
Facility acquisition and construction	-	-	250,897
Debt service			
Principal	-	-	-
Interest and other	-	-	-
Total Expenditures	1,016,275	11,088,609	15,953,623
Excess (Deficiency) of			
Revenues Over Expenditures	(163,912)	(27,417)	(85,716)
Other Financing Sources (Uses)			
Transfers in	-	45,115	-
Transfers out	-	-	(328,779)
Net Financing Sources (Uses)	-	45,115	(328,779)
NET CHANGE IN FUND BALANCES	(163,912)	17,698	(414,495)
Fund Balance - Beginning	403,259	100,875	6,997,185
Fund Balance - Ending	\$ 239,347	\$ 118,573	\$ 6,582,690

See accompanying note to supplementary information.

Deferred Maintenance Fund	Capital Facilities Fund	Bond Interest and Redemption Fund	Debt Service Fund	Total Non-Major Governmental Funds
\$ 3,000,000	\$ -	\$ -	\$ -	\$ 3,000,000
-	-	-	854,231	19,115,092
-	-	153,029	-	7,015,417
(587)	679,122	10,264,224	193,427	13,794,399
2,999,413	679,122	10,417,253	1,047,658	42,924,908
-	-	-	-	4,013,379
-	-	-	-	2,522,719
-	-	-	-	144,421
-	-	-	-	14,925,222
-	-	-	-	66,402
-	10,790	-	-	1,452,347
2,533,453	514	-	-	3,418,881
-	-	-	-	3,808,996
3,075,329	642,847	-	-	3,969,073
-	130,803	9,965,000	-	10,095,803
-	147,585	-	854,231	1,001,816
5,608,782	932,539	9,965,000	854,231	45,419,059
(2,609,369)	(253,417)	452,253	193,427	(2,494,151)
2,000,000	-	-	770,857	2,815,972
-	(22,263)	-	-	(351,042)
2,000,000	(22,263)	-	770,857	2,464,930
(609,369)	(275,680)	452,253	964,284	(29,221)
2,875,675	1,679,795	10,592,614	4,986,093	27,635,496
\$ 2,266,306	\$ 1,404,115	\$ 11,044,867	\$ 5,950,377	\$ 27,606,275

MODESTO CITY SCHOOLS

NOTE TO SUPPLEMENTARY INFORMATION JUNE 30, 2018

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 amount consists of a QSCB interest payment subsidy received by the District.

	CFDA Number	Amount
Total Federal Revenues From the Statement of Revenues, Expenditures, and Changes in Fund Balances:		\$ 41,941,509
Reconciling item:		
Qualified School Construction Bonds Interest Subsidy	Not Applicable	(854,231)
Total Schedule of Expenditures of Federal Awards		<u>\$ 41,087,278</u>

Local Education Agency Organization Structure

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

Schedule of Average Daily Attendance (ADA)

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

Schedule of Instructional Time

The District has received incentive funding for increasing instructional time as provided by the Incentives for Longer Instructional Day. The District neither met nor exceeded its target funding. 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 1986-1987 requirements as required by *Education Code* Section 46201.

MODESTO CITY SCHOOLS

NOTE TO SUPPLEMENTARY INFORMATION JUNE 30, 2018

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.

Schedule of Charter Schools

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

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

The Non-Major 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 Non-Major Governmental Funds column on the Governmental Funds Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balances.

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INDEPENDENT AUDITOR'S REPORTS

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Certified Public Accountants

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**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
Modesto City Schools
Modesto, 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 Modesto City Schools (the District) as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise Modesto City Schools' basic financial statements, and have issued our report thereon dated December 17, 2018.

Emphasis of Matter - Change in Accounting Principles

As discussed in Note 1 and Note 16 to the financial statements, in 2018, the District adopted new accounting guidance, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. Our opinion is not modified with respect to this matter.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Modesto City Schools' 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 Modesto City Schools' internal control. Accordingly, we do not express an opinion on the effectiveness of Modesto City Schools' 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 Modesto City Schools' 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*.

We noted certain matters that we reported to management of Modesto City Schools in a separate letter dated December 17, 2018.

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.

Vaccined, Trine, Day & Co. LLP

Fresno, California
December 17, 2018



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

Governing Board
Modesto City Schools
Modesto, California

Report on Compliance for Each Major Federal Program

We have audited Modesto City Schools' (the District) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Modesto City Schools' major Federal programs for the year ended June 30, 2018. Modesto City Schools' 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 Modesto City Schools' 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 Modesto City Schools' 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 Modesto City Schools' compliance.

Opinion on Each Major Federal Program

In our opinion, Modesto City Schools 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, 2018.

Report on Internal Control Over Compliance

Management of Modesto City Schools 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 Modesto City Schools' 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 Modesto City Schools' 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 a 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.

Varrinck, Trine, Day & Co. LLP

Fresno, California
December 17, 2018



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INDEPENDENT AUDITOR'S REPORT ON STATE COMPLIANCE

Governing Board
Modesto City Schools
Modesto, California

Report on State Compliance

We have audited Modesto City Schools' (the District) compliance with the types of compliance requirements as identified in the *2017-2018 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 Modesto City Schools' State government programs as noted below for the year ended June 30, 2018.

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 Modesto City Schools' 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 *2017-2018 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 Modesto City Schools' 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 Modesto City Schools' compliance with those requirements.

Unmodified Opinion

In our opinion, Modesto City Schools 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, 2018.

In connection with the audit referred to above, we selected and tested transactions and records to determine the Modesto City Schools' compliance with the State laws and regulations applicable to the following items:

	Procedures Performed
LOCAL EDUCATION AGENCIES OTHER THAN CHARTER SCHOOLS	
Attendance	Yes
Teacher Certification and Misassignments	Yes
Kindergarten Continuance	Yes
Independent Study	Yes
Continuation Education	Yes
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	No (see below)
K-3 Grade Span Adjustment	Yes
Transportation Maintenance of Effort	Yes
Apprenticeship: Related and Supplemental Instruction	No (see below)
SCHOOL DISTRICTS, COUNTY OFFICES OF EDUCATION, AND CHARTER SCHOOLS	
Educator Effectiveness	Yes
California Clean Energy Jobs Act	Yes
After/Before School Education and Safety Program:	
General Requirements	Yes
After School	Yes
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)
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	No (see below)

The District did not offer an Early Retirement Incentive Program during the current year; therefore, we did not perform procedures related to the Early Retirement Incentive Program.

The District does not have any Juvenile Court Schools; therefore, we did not perform procedures related to Juvenile Court Schools.

The District does not have any Middle or Early College High Schools; therefore, we did not perform procedures related to Middle or Early College High Schools.

The District does not offer an apprenticeship program; therefore, we did not perform procedures related to Apprenticeship: Related and Supplemental Instruction.

The District does not offer a Before School Education and Safety Program; therefore, we did not perform procedures related to the Before School Education and Safety Program.

The District does not offer an Independent Study - Course Based program; therefore, we did not perform any procedures related to Independent Study - Course Based.

Additionally, the District does not operate any Charter Schools; therefore, we did not perform procedures for Charter School Programs.

Varinak, Trine, Day & Co. LLP

Fresno, California
December 17, 2018

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS

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MODESTO CITY SCHOOLS

SUMMARY OF AUDITOR'S RESULTS FOR THE YEAR ENDED JUNE 30, 2018

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 Federal programs:	

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
<u>10.553, 10.555, 10.559</u>	<u>Child Nutrition Cluster</u>

Dollar threshold used to distinguish between Type A and Type B programs:	<u>\$ 1,232,618</u>
Auditee qualified as low-risk auditee?	<u>Yes</u>

STATE AWARDS

Type of auditor's report issued on compliance for programs:	<u>Unmodified</u>
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MODESTO CITY SCHOOLS

**FINANCIAL STATEMENT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2018**

None reported.

MODESTO CITY SCHOOLS

**FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2018**

None reported.

MODESTO CITY SCHOOLS

**STATE AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2018**

None reported.

MODESTO CITY SCHOOLS

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2018**

There were no audit findings in the prior year's schedule of financial statement findings.

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Certified Public Accountants

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Governing Board
Modesto City Schools
Modesto, California

In planning and performing our audit of the financial statements of Modesto City Schools (the District) for the year ended June 30, 2018, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

However, during our audit we noted a matter that is an opportunity for strengthening internal controls and operating efficiency. The following item represents a condition noted by our audit that we consider important enough to bring to your attention. This letter does not affect our report dated December 17, 2018, on the government-wide financial statements of the District.

BEYER HIGH SCHOOL - ASSOCIATED STUDENT BODY (ASB)

Inventory Reconciliation

Observation

During our audit, we found that the student store advisor does track individual sales and also periodically takes inventory of sale items, however, there is no reconciliation between the sales and the changes in inventory. Without a reconciliation procedure there is no way to determine if items have gone missing or been stolen.

Recommendation

Whenever inventory is taken by the student store advisor, there should be a procedure to reconcile the changes in inventory to the total sales of that respective time frame. In doing so, the advisor can determine if there are any problems with inventory control.

Prohibited Expenditure

Observation

During our audit, we found that the ASB had created an open purchase order for supplies for a Special Education classroom. According to the site, these funds were spent on class projects for the Functional Living classroom. These types of expenditures should be made by the District, not the ASB.

Recommendation

The site should implement a policy that prohibits the purchase of items classified as prohibited expenditures.

Cash Disbursements

Observation

During our audit, we found that requisitions/reimbursement requests are not dated by the signers. Without a date written by the signor, it is difficult to determine if purchases are approved in advance .

Recommendation

The site should review the cash disbursement procedures outlined in the *ASB Accounting Manual, Fraud Prevention Guide and Desk Reference* published by the Fiscal Crisis & Management Assistance Team (FCMAT) which is available at www.fcmat.org. All purchases must be preapproved by a board-designated official, a student organization representative, and the certificated employee who is the student organization advisor. Each approving signature should be dated by the signer. In order to provide proper controls over spending, the site should take the necessary steps to ensure that expenditures are approved prior to the item being purchased.

MODESTO HIGH SCHOOL - ASSOCIATED STUDENT BODY (ASB)

Prohibited Expenditures

Observation

During our audit, we found one instance where student body funds were issued to a charity. According to the *ASB Accounting Manual, Fraud Prevention Guide and Desk Reference* published by the Fiscal Crisis & Management Assistance Team (FCMAT) which is available at www.fcmat.org, "Donations to nonprofit organizations and students or families in need usually are not allowable because they are considered a gift of public funds, no matter how worthy the cause. ASB funds are legally considered public funds because they are raised through the district's tax identification number and under its nontaxable status."

Recommendation

The Student Body and Clubs should not donate funds to organizations and students or families in need. If the Student Body and Clubs would like to continue to donate funds to nonprofit organizations, a District Board approval must be made. In addition, flyers must be handed out when collecting funds from the Community making them aware that the funds will be donated and will not be used for the well-being of the students. Revenue collected for such an event would need to be separately tracked in the general ledger system and all funds collected must be used for the purpose of the fundraiser. All relevant documentation must be retained for future audit purposes.

Cash Disbursements

Observation

During our audit, we discovered that internal controls over the disbursement process are not consistently adhered to. We noted several instances where other clubs were using the General ASB's purchase order. These purchases were made without pre-approval and there were no purchase orders generated for the specific clubs. The pre-approval process is crucial in that it ensures that expenditures are appropriate and that the ASB and its clubs will not deficit spend their accounts.

California *Education Code* Section 48933(b) states "The funds shall be expended subject to such procedure as may be established by the student body organization subject to the approval of each of the following three persons, which shall be obtained each time before any of the funds may be expended: an employee or official of the school district designated by the governing board, the certificated employee who is the designated adviser of the particular student body organization, and a representative of the particular student body organization."

Recommendation

The District should review the cash disbursement procedures outlined in the *Associated Student Body Accounting Manual, Fraud Prevention Guide and Desk Reference* published by the Fiscal Crisis & Management Assistance Team (FCMAT) which is available at www.fcmat.org. In order to provide proper controls over spending, the site should take the necessary steps to ensure expenditures are approved prior to the item being purchased and by all required persons.

ROOSEVELT JUNIOR HIGH SCHOOL - ASSOCIATED STUDENT BODY (ASB)

Timely Deposits

Observation

During our audit of cash receipts, we found several instances of deposits not being turned into the bank in a timely manner. Some monies received were held longer than 30 days before being deposited which could lead to potential loss or theft.

Recommendation

The site should prepare deposits weekly, if possible. During weeks with high activity, more than one deposit may be needed to ensure proper safeguards of monies collected. The District should review the procedures outlined in the *Associated Student Body Accounting Manual, Fraud Prevention Guide and Desk Reference* published by the Fiscal Crisis & Management Assistance Team (FCMAT) which is available at www.fcmat.org.

HANSHAW MIDDLE SCHOOL - ASSOCIATED STUDENT BODY (ASB)

Inventory Reconciliation

Observation

During our audit, we found that the student store advisor does track individual sales and also periodically takes inventory of sale items, however, there is no reconciliation between the sales and the changes in inventory. Without a reconciliation procedure there is no way to determine if items have gone missing or been stolen.

Recommendation

Whenever inventory is taken by the student store advisor, there should be a procedure to reconcile the changes in inventory to the total sales of that respective time frame. In doing so, the advisor can determine if there are any problems with inventory control.

Account Balances and Transfers

Observation

During our audit, we discovered club accounts with deficit balances. The General ASB account had a negative balance of \$6,885.09 and the Sports account had a negative balance of \$7,331.81. The overall general ledger had a net deficit balance of \$1,673.05. Site administration is aware of this issue and was attempting to rectify the problem.

Recommendation

The site should not allow negative balances to occur within the student body and/or club accounts unless there is substantial evidence to support administrative awareness and approval of the deficit amount(s) and how and when the deficit account(s) are to be replenished. By providing monthly statements that include activity and balances for each club to the respective advisors, and by ensuring that clubs have sufficient funds before authorizing expenditures, deficits can be avoided.

Sub-Receipt Timeliness

Observation

During our audit, we found that deposits from site advisors and teachers to the ASB bookkeeper are not always made in a timely manner. We noted two instances in separate deposits where funds collected by advisors were held for over 30 days before they were deposited with the bookkeeper.

Recommendation

Teacher and advisors should, at a minimum, make their deposits once a week to the ASB bookkeeper in order to minimize the amount of cash held. During weeks of high cash activity, there may be a need to make more than one deposit. In instances where the cash cannot be immediately deposited with the bookkeeper such as afterschool or sporting activities, the funds should be verified by two adult individuals, placed in a locking cash box and locked in the school safe until the funds can be deposited with the bookkeeper.

Bank Deposits

Observation

The site prepares a deposit form for each bank deposit. The form includes all of the receipt numbers included in the deposit along with their individual amounts and from whom they were received. It lists the total dollar amount of cash and of checks, but it also has a line for adjustments. We found several adjustments that were made to increase or decrease deposit amounts but there was no supporting documentation to explain the reasons for the adjustments.

Recommendation

The site should implement procedures to ensure that supporting documentation is retained for adjustments to deposits. If there is no physical supporting documentation, an explanation should be attached to the deposit form. The bookkeeper should have a second responsible party review and sign off on all adjustments.

Governing Board
Modesto City Schools

We will review the status of the current year comments during our next audit engagement.

Vavrinek, Trine, Day & Co. LLP

Fresno, California
December 17, 2018