

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

**FINANCIAL REPORT
WITH SUPPLEMENTAL INFORMATION
FOR THE YEAR ENDED
JUNE 30, 2004
AND
INDEPENDENT AUDITOR'S REPORT**



*Published by
THE ANN ARBOR BOARD OF EDUCATION*

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR, MICHIGAN

FINANCIAL REPORT WITH SUPPLEMENTAL INFORMATION

**For the Fiscal Year Ended
June 30, 2004**

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PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

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Independent Auditor's Report

To the Board of Education
The Public Schools of the City of Ann Arbor, Michigan

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Public Schools of the City of Ann Arbor, Michigan, as of and for the year ended June 30, 2004, which collectively comprise the School District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Public Schools of the City of Ann Arbor, Michigan's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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 Public Schools of the City of Ann Arbor, Michigan as of June 30, 2004 and the changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 through 10 is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

To the Board of Education
The Public Schools of the City of Ann Arbor, Michigan

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Public Schools of the City of Ann Arbor, Michigan's basic financial statements. The accompanying required supplemental information and other supplemental information, as identified in the table of contents, are not a required part of the basic financial statements. The required supplemental information is information required by the Governmental Accounting Standards Board; the other supplemental information is presented for the purpose of additional analysis. The required supplemental information and the other supplemental information have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report under separate cover dated October 15, 2004 on our consideration of the School District's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

October 15, 2004

Plante & Moran, PLLC

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED JUNE 30, 2004

This section of the annual financial report presents a discussion and analysis of the School District's financial performance during the year ended June 30, 2004. It is to be read in conjunction with the District's financial statements, which immediately follow this section.

Using this Annual Report

This annual report consists of a series of financial statements and notes to those statements. These statements are organized so the reader can understand the Ann Arbor Public Schools financially, as a whole. The *District-wide Financial Statements* provide information about the activities of the whole School District, presenting both an aggregate view of the School District's finances and a long-term view of those finances. The *Fund (Governmental) Financial Statements* provide the next level of detail. For governmental activities, these statements tell how services were financed in the short-term as well as what remains for future spending. The fund financial statements look at the School District's operations in more detail than the government-wide financial statements by providing information about the School District's most significant funds - the General Fund and the Sinking Fund with all other funds presented in one column as a nonmajor fund. The remaining statements, the *Statement of Fiduciary Net Assets* and the *Statement of Changes in Fiduciary Net Assets*, present financial information about activities for which the School District acts solely as an agent for the benefit of students and parents.

Management's Discussion & Analysis (MD&A)
(Required Supplemental Information)

Basic Financial Statements

District-wide Financial Statements

Fund (Governmental) Financial Statements

Notes to the Basic Financial Statements

(Required Supplemental Information)
Budgetary Information for Major Funds

Other Supplemental Information

Reporting the School District as a Whole - District-wide Financial Statements

One of the most important questions asked about the School District is, "As a whole, what is the School District's financial condition as a result of the year's activities?" The Statement of Net Assets (page 11) and the Statement of Activities (page 12), report information on the School District as a whole and its activities in a way that helps the reader answer this question. These statements are prepared to include all assets and liabilities, using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED JUNE 30, 2004

These two statements report the School District's net assets- the difference between assets and liabilities, and are used as one way to measure the School District's financial health, or financial position. Over time, increases or decreases in the School District's net assets - as reported in the Statement of Activities - are one indicator of whether its financial health is improving or deteriorating. The relationship between revenue and expenses is the School District's operating results. However, the School District's goal is to provide services to our students, not to generate profits as do commercial entities. One must consider many other non-financial factors, such as the quality of the education provided and the safety of the schools to assess the overall health of the School District.

The Statement of Net Assets and Statement of Activities report the governmental activities for the School District, which encompass all of the School District's services, including instruction, supporting services, community services, food services, athletic, recreation, child care, debt service and capital projects. Property taxes, unrestricted state aid (foundation allowance revenue), and state and federal grants finance most of these activities.

Reporting the School District's Most Significant Funds - Fund (Governmental) Financial Statements

The School District's governmental fund financial statements (page 13 & 15) provide detailed information about the most significant funds - not the School District as a whole. Some funds are required to be established by State law and by bond covenants. However, the School District establishes individual funds to help control and manage money for particular purposes (the Food Service and Athletics Funds are examples) or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money (like bond funded construction funds used for voter approved capital projects). These funds are identified in the supplemental information starting on page 57. The governmental funds of the School District use the following accounting approach:

Governmental funds - All of the School District's services are reported in governmental funds. Governmental fund reporting focuses on showing how money flows into and out of funds and the balances left at year-end that are available for spending. They are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund financial statements provide a detailed short-term view of the operations of the School District and the services it provides. Governmental fund financial information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the School District's programs. A reconciliation is provided which identifies the differences between governmental financial statements and the Statement of Net Assets and the Statement of Activities.

The School District as Trustee - Reporting the School District's Fiduciary Responsibilities

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

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED JUNE 30, 2004

The School District As A Whole

Recall that the Statement of Net Assets provides the perspective of the School District as a whole. Table 1 provides a summary of the School District's net assets as of June 30, 2004 and 2003, respectively:

TABLE 1

	Governmental Activities	
	(in millions)	
	June 30	
	2004	2003
Current and other assets	\$ 84.7	83.3
Capital assets	117.2	115.4
Total assets	201.9	198.7
Current liabilities	38.7	33.3
Long-term liabilities	46.0	58.0
Total liabilities	84.7	91.3
Net assets:		
Invested in property and equipment, net of related debt	80.9	66.4
Restricted	12.3	8.7
Unrestricted	24.0	32.3
Total net assets	\$ 117.2	107.4

The above analysis focuses on the net assets (Table 1). The School District's net assets were \$117.2 at June 30, 2004, compared with \$107.4 million at June 30, 2003. For June 30, 2004, capital assets, net of related debt was \$80.9 million compared to \$66.4 million from the prior year. Capital assets, net of related debt compares the original cost, less depreciation of the School District's capital assets to long term debt used to finance the acquisition of those assets. Most of the debt will be repaid from voter-approved property taxes collected as the debt service comes due. Restricted net assets are reported separately to show legal constraints from debt covenants and enabling legislation that limit the School District's ability to use those net assets for day-to-day operations. The remaining amount of net assets, \$24.0 million was unrestricted compared to \$32.3 million from the prior year.

The \$24.0 million in unrestricted net assets of governmental activities at June 30, 2004, represents the *accumulated* results of all past years' operations. The unrestricted net asset balance is used to provide working capital and cash flow requirements as well as providing for future uncertainties. The operating results of the General Fund will have a significant impact on the change in unrestricted net assets from year to year.

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED JUNE 30, 2004

The results of this year's operations for the School District as a whole are reported in the Statement of Activities (Table 2), which shows the changes in net assets for fiscal years June 30, 2004 and 2003, respectively.

TABLE 2

	Governmental Activities	
	(in millions)	
	June 30	
Revenue	2004	2003
Program revenue:		
Charges for services	\$ 8.0	7.6
Operating grants and state categoricals	25.6	24.0
General revenue:		
Property taxes	87.4	87.0
State foundation allowance	83.3	84.3
Other	3.8	3.0
Total revenue	<u>208.1</u>	<u>205.9</u>
Functions/Programs Expenses		
Instruction	107.3	104.0
Support services	75.9	68.8
Community services	.8	.6
Food services	3.8	3.8
Athletics	2.8	2.1
Recreation and Community services	5.1	4.8
Interest on long-term debt	.7	1.7
Capital outlay (not capitalized)	.9	.9
Other expenses	.9	.7
Depreciation (unallocated)	.1	.1
Total expenses	<u>198.3</u>	<u>187.5</u>
Increase in net assets	<u>\$ 9.8</u>	<u>18.4</u>

As reported in the Statement of Activities, the cost of all *governmental* activities for the fiscal year ending June 30, 2004 was \$198.3 million compared to \$187.5 million from the prior year. For the year ended June 30, 2004, athletics, food service, recreation and community education and instruction (tuition) were partially funded from those who benefited from the programs (\$8.0 million) or by other governments and organizations that subsidized certain programs with grants and contributions (\$25.6 million). The remaining "public benefit" portion of the governmental activities was funded with \$87.4 million in taxes, \$83.3 million in state Foundation Allowance, and \$3.8 million in other revenues, such as, interest, rentals and general revenue.

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED JUNE 30, 2004

The School District experienced an increase in net assets of \$9.8 million due to the reduction in long-term debt of \$10.6 million (funded with debt property tax collections).

The School District's Funds

As noted earlier, the School District uses funds to help it control and manage money for particular purposes. Looking at funds helps the reader consider whether the School District is being accountable for the resources taxpayers and others provide to it and may provide more insight into the School District's overall financial health.

As the School District completed this year, the governmental funds reported a combined fund balance of \$57.3 million compared with \$60.5 million from the prior year, which is a decrease of \$3.2 million from the prior year. The primary reasons for the decrease relates to the General Fund. The Board approved a reduction to the general fund (fund equity) of \$2.6 million, to offset excess expenditures over revenues for fiscal year 2004. The remaining amount of the decrease resulted from less than expected revenue, due to the State's proration of foundation revenue and uncollected real property tax revenue.

The Sinking Fund and the other nonmajor governmental funds remained stable from the prior years, showing a total net increase of approximately \$.8 million. Within this group the Sinking Fund added \$3.1 million in fund equity in anticipation of future capital outlay. The Millage and Capital Needs Fund utilized about \$3 million of fund equity on planned projects.

The General Fund fund balance is necessary for cash flow needs, due to the delayed receipt of revenue. Over 18% of the State aid foundation (or approximately \$16.4 million) is received in July and August, after the District's fiscal year end of June 30th, and after the majority of the General Fund expenditures have occurred. In addition, the School District does not receive its first State aid payment for the new fiscal year until October 20, 2004. However, the School District's new fiscal operations begin July 1. An analysis of cash flow requirements indicate that the District maintain a portion of its General Fund fund balance equal to approximately two State aid payments to cover two months of operations without State aid revenue. State aid revenue represents approximately 56% of the District's total General Fund revenue. The fund balance is also used to fund future expenditures, which may exceed current budget or for unforeseen increases in expenditures or reductions in revenue.

General Fund Budgetary Highlights

Over the course of the year, the School District revised its budget as new financial information was obtained. State law requires that the budget be amended to insure that expenditures do not exceed appropriations and available fund equity. The final amendment to the budget was adopted during the third quarter financial review. A schedule showing the School District's original and final budget amounts compared with amounts actually paid and received is provided in the required supplemental information (page 30).

There were revisions made to the 2003-2004 General Fund original budget. Budgeted revenue increased approximately \$54,000 due to the State's Golden Apple awards for Logan (\$21,329), Haisley (\$11,712), Mitchell (\$11,376) and AA Open (\$9,821) Elementary Schools.

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED JUNE 30, 2004

Total budgeted expenditures and other financing uses, remained the same, approximately \$165.5 million. However, there were realignments of budget within account functions/codes.

There were no significant variances between the final budget amounts and actual, except as identified above under the section "School District's Funds".

Capital Asset and Debt Administration

Capital Assets

At June 30, 2004, the School District had \$237.3 million invested in a broad range of capital assets, including land, buildings and equipment compared with \$230.5 million from the prior year. Net capital assets represents a net increase (including additions, deductions and depreciation) of approximately \$1.8 million, or 1.6%, from last year.

	June 30	
	2004	2003
Assets not being depreciated - Land	\$ 2.5	2.5
Land improvements	12.1	9.9
Building and building improvements	201.9	194.8
Equipment	16.8	17.3
Vehicles	6.5	6.0
Total capital assets	<u>237.3</u>	<u>230.5</u>
Less accumulated depreciation	<u>122.6</u>	<u>115.1</u>
Net capital assets	<u>\$ 117.2</u>	<u>115.4</u>

This year's additions of \$11.7 million included building renovations, vehicles (buses) and equipment. No debt was issued for these additions, however, \$6.1 million was allocated to these purchases from the Millage and Capital Needs Fund, \$6.1 million of the purchases was from the new voter approved 1.5 mill sinking fund levy, \$.3 million was from the General Fund and \$.1 million was from all other funds. Approximately \$.9 million of the capital purchases for all funds were not capitalized and were expensed when received. These capital purchases meet the Michigan Department of Education's definition of a fixed asset (for account code classification), however, the purchase amount is below the District's capitalization threshold of \$10,000. Detailed information about capital assets is presented in the Notes to the Financial Statements (footnote 6).

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED JUNE 30, 2004

Debt

At the end of this year, the School District had \$29.5 million in bonds outstanding versus \$36.7 million last year, or a decrease of 20%. Those bonds consisted of:

TABLE 3

	June 30	
	2004	2003
Bonds financed by tax levy	\$ 29.5	36.7

On August 24, 2004, the District received approximately \$123.4 million for its first installment of the Building and Site Bond issue approved by the voters on June 14, 2004.

The state limits the amount of general obligation debt that schools can issue to 15 percent of the assessed value of all taxable property within the School District's boundaries. If the district issues "Qualified Debt", that is debt backed by the State of Michigan, such obligations are not subject to this debt limit. The School District has no outstanding unqualified general obligation debt as of June 30, 2004.

Economic Factors and Next Year's Budgets and Rates

Elected officials and administration consider many factors when setting the School District's fiscal year budgets. One of the factors affecting the budget is student count. The state foundation revenue is determined by multiplying the blended student count by the foundation allowance per pupil. The blended count for the 2005 fiscal year is 25% of the February 2004 and 75% of the September 2004 student counts. The 2005 budget was adopted in June 2004, based on an estimate of students that will be enrolled in September 2004. Based on the unaudited September 2004 count, enrollment is anticipated to be higher than the estimates used in creating the 2004-05 budget. Once the final student count is validated, and student/teacher placements are finalized, the budget will be amended. It is expected that the additional revenue from the increased pupil count will be offset by additional operating costs to educate those students.

The Foundation Allowance makes up approximately 90% of total General Fund revenue. Under state law a district cannot assess additional property tax revenue for general operations. As a result, district funding is heavily dependent on the State's ability to fund local school operations and the State's School Aid Fund. The State periodically holds a revenue estimating conference to review its revenue forecasts. The last revenue estimating conference was held May, 2004, however, based on the most recent "unofficial" State estimates, funds are still not sufficient to fund the appropriation for the foundation increase for the 2004-05 fiscal year. The legislature may revise the appropriation and a proration of State aid may occur. The estimated impact on the School District is unknown. However, in the 2005 budget, the District anticipated a foundation allowance reduction of approximately \$1.2 million (or \$74/pupil). State law requires the School District to amend the budget if actual district resources are not sufficient to fund

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED JUNE 30, 2004

original appropriations. Since property taxes for operations and unrestricted state aid constitute the vast majority of district operating revenue sources, annually the Board of Education and Administration must evaluate the needs of the district and balance those needs with state prescribed available unrestricted resources.

In addition, the 2005 budget assumptions assumed that a portion of the undesignated fund equity would be used to cover recurring operational expenditures over revenue of approximately \$8.2 million. However, on September 14, 2004, the voters approved a seven-year, countywide special education millage. The millage will provide approximately \$2.2 million in additional revenue to the District for the 2004-05 school year. Thus, the amount of fund equity expected for recurring operational expenditures, for 2005, is approximately \$6.0 million. The School District designated \$6.0 million of the General Fund fund balance to cover operations for the 2004-5 school year.

There are two other future developments that will impact the District's operating budget in fiscal year 2006 and beyond. The Office of Retirement Services' has published reports indicating that the employer's contribution to the State's retirement plan is expected to rise significantly due to an increase in health care and prescription medication costs (an impact of approximately 2% or \$ 2.3 million to the District) for fiscal year 2006. Also, as mentioned above, the voters approved a bond issue in June 2004, to construct a third comprehensive high school and hi-tech magnet component. The school is expected to open in fiscal year 2008. The original operating cost was estimated to be approximately \$3.8 million and will be funded from general operating revenue.

As stated in the prior year Management's Discussion and Analysis, even if the State revenues rebound in the next several years, the District will need to significantly realign its operating budget to maintain current educational programs and fund the new comprehensive high school

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

STATEMENT OF NET ASSETS JUNE 30, 2004

		Governmental Activities
ASSETS:		
Cash on hand and in interest bearing accounts	Note 2	\$ 763,109
Investments	Note 2	51,593,428
Restricted Assets	Note 2 & 3	11,570,054
Accounts receivable		446,569
Grants receivable		1,653,166
Due from other governmental units		16,412,622
Taxes receivable	Note 5	1,954,958
Other assets		83,715
Inventories		186,469
Capital assets less accumulated depreciation of \$122,563,821	Note 6	117,235,242
		<hr/>
Total Assets		<u>\$ 201,899,332</u>
 LIABILITIES:		
Accounts payable and accrued expenses		\$ 5,285,431
Salaries payable		11,519,693
Payroll taxes and withholding payable		5,638,261
Deferred revenue	Note 7	4,030,233
Other liabilities		102,043
Long-term liabilities	Note 10	
Bonds and other obligations, due within one year		12,071,063
Bonds and other obligations, due in more than one year		46,008,956
		<hr/>
Total Liabilities		<u>84,655,680</u>
 NET ASSETS:		
Invested in capital assets, net of related debt		80,944,145
Restricted for:		
Debt Service		2,708,529
Capital projects		9,581,762
Unrestricted		24,009,216
		<hr/>
Total Net Assets		<u>117,243,652</u>
		<hr/>
Total Liabilities and Net Assets		<u>\$ 201,899,332</u>

The Notes to Financial Statements are an
Integral Part of this Statement

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

STATEMENT OF ACTIVITIES YEAR ENDED JUNE 30, 2004

Functions/Programs	Expenses	Program Revenues		Governmental
		Charges for Services	Operating Grants and Categoryals	Activities Net (Expense) Revenue and Changes in Net Assets
Primary government - Governmental activities				
Instruction	\$ 107,330,420	137,997	12,065,006	(95,127,417)
Support services	75,937,751		11,842,970	(64,094,781)
Community services	767,842		244,516	(523,326)
Food services	3,821,021	2,419,306	1,366,152	(35,563)
Athletics	2,772,654	231,294		(2,541,360)
Recreation and Community Education	5,098,908	5,211,522		112,614
Interest on long-term debt	737,971			(737,971)
Capital outlay (not capitalized)	879,066		77,034	(802,032)
Other expenses	857,941			(857,941)
Depreciation (unallocated)	132,111			(132,111)
Total primary government - Governmental activities	\$ 198,335,685	8,000,119	25,595,678	(164,739,888)
General revenues:				
Taxes:				
				59,001,260
				12,168,348
				7,041,735
				9,162,913
				83,335,267
				651,306
				3,213,128
			Total general revenues	174,573,957
				9,834,069
				107,409,583
				117,243,652

The Notes to Financial Statements are an
Integral Part of this Statement

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET WITH STATEMENT OF NET ASSETS JUNE 30, 2004

Amounts reported for governmental activities in the statement of net assets are different because:

Total fund balance - governmental funds	\$ 57,336,607
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	239,799,063
Accumulated depreciation is	<u>(122,563,821)</u>
	117,235,242
Property tax receivable not available to provide current financial resources therefore deferred in the governmental funds	1,841,856
Liabilities not due and payable in the current period and are not reported in the governmental funds:	
Bonds payable	(35,200,000)
Compensated absences	(16,380,293)
Risk management	(4,998,663)
Legal actions	(1,500,000)
Accrued interest payable is not included as a liability in governmental activities, it is not reported in governmental funds until paid	(1,091,097)
	<hr/>
Net assets of governmental activities	<u>\$ 117,243,652</u>

The Notes to Financial Statements are an
Integral Part of this Statement

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

GOVERNMENTAL FUNDS STATEMENT OF REVENUE, EXPENDITURES AND CHANGES IN FUND BALANCES YEAR ENDED JUNE 30, 2004

	Combined General	Sinking Fund	Nonmajor Governmental Funds	Total Governmental Funds
REVENUES:				
Local sources	\$ 60,171,221	9,228,640	29,290,324	98,690,185
State sources	91,691,940		228,523	91,920,463
Federal sources	5,669,348		1,137,629	6,806,977
Interdistrict sources	10,072,823			10,072,823
Total Revenues	<u>167,605,332</u>	<u>9,228,640</u>	<u>30,656,476</u>	<u>207,490,448</u>
EXPENDITURES:				
Current:				
Education				
Instruction	98,623,671			98,623,671
Support services	68,506,021		4,287,442	72,793,463
Community services	767,842			767,842
Food service			3,821,021	3,821,021
Athletics			2,772,654	2,772,654
Recreation and Community Education			5,098,908	5,098,908
Debt service principal			4,957,313	4,957,313
Debt service interest, paying agent fees and other			6,253,688	6,253,688
Capital outlay	308,157	6,090,162	6,173,308	12,571,627
Total Expenditures	<u>168,205,691</u>	<u>6,090,162</u>	<u>33,364,334</u>	<u>207,660,187</u>
OTHER FINANCING SOURCES (USES):				
Operating transfers in	17,919		2,606,573	2,624,492
Operating transfers out	(3,321,195)		(17,919)	(3,339,114)
Payments to other school districts	(143,319)			(143,319)
Proceeds from the defeasement of debt			27,664,725	27,664,725
Payment to bond escrow agent			(29,873,725)	(29,873,725)
Total Other Financing Uses	<u>(3,446,595)</u>	<u>0</u>	<u>379,654</u>	<u>(3,066,941)</u>
Net Change in Fund Balances	(4,046,954)	3,138,478	(2,328,204)	(3,236,680)
FUND BALANCES, BEGINNING OF THE YEAR	<u>40,932,993</u>	<u>5,845,074</u>	<u>13,795,220</u>	<u>60,573,287</u>
FUND BALANCES, END OF THE YEAR	<u>\$ 36,886,039</u>	<u>8,983,552</u>	<u>11,467,016</u>	<u>57,336,607</u>

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

RECONCILIATION OF THE STATEMENT OF REVENUE, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES YEAR ENDED JUNE 30, 2004

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

Net Change in Fund Balances - Total Governmental Funds **\$ (3,236,680)**

Governmental funds report all capital outlays as expenditures; in the statement of activities, the cost associated with assets greater than \$10,000 are allocated over their useful lives as depreciation

Depreciation expense	(9,871,625)
Capital outlays (actually capitalized and not expensed)	11,692,561

Tax revenue reported in the statement of activities that is not available to provide current financial resources and therefore is deferred revenue in the governmental funds	1,841,856
--	-----------

Prior year tax revenue reported in the statement of activities that was not available in fiscal year 2003 and therefore was deferred revenue in the governmental funds	(1,162,550)
--	-------------

Payments of bond principal and accreted interest of capital appreciation bonds are expenditures in the governmental funds, but not in the statement of activities where changes are recorded as a current or non-current liability	12,625,000
--	------------

Compensated absences are reported as expenditures when financial resources are used in governmental funds, but not in the statement of activities where changes are recorded as a liability	(1,592,563)
---	-------------

Workers' compensation is reported as an expenditure when financial resources are used in governmental funds, but not in the statement of activities where changes are recorded as a liability	(518,960)
---	-----------

Accrued interest is recorded in the statement of activities when incurred; it is not reported in governmental funds until paid	(1,091,097)
--	-------------

Prior year accrued interest was recorded in the statement of activities in fiscal year 2003 and was not reported in the governmental funds until paid	1,148,127
---	-----------

Change in Net Assets of Governmental Activities **\$ 9,834,069**

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

STATEMENT OF FIDUCIARY NET ASSETS AND STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS AS OF AND FOR THE YEAR ENDED JUNE 30, 2004

Statement of Fiduciary Net Assets As of June 30, 2004

		<u>Private - Purpose Trust</u>	<u>Student Activities</u>
ASSETS:			
Cash on hand and in interest bearing accounts	Note 2	\$ 17,320	4,193
Investments	Note 2	88,700	2,685,000
Accounts receivable		3,024	6,404
Due from other funds	Note 4		87,043
Other assets			<u>2,109</u>
Total Assets		<u>\$ 109,044</u>	<u>2,784,749</u>
LIABILITIES:			
Accounts payable and accrued expenses		\$	248,319
Salaries payable			35,725
Payroll taxes and withholdings payable			7,473
Due to student groups			<u>2,493,232</u>
Total Liabilities		<u>0</u>	<u>2,784,749</u>
NET ASSETS:			
Reserved for scholarships		109,044	
Unreserved, undesignated			
Total Net Assets		<u>\$ 109,044</u>	

Statement of Changes in Fiduciary Net Assets For the Year Ended June 30, 2004

		<u>Private - Purpose Trust</u>
ADDITIONS:		
Private donations		\$ 14,821
Interest		866
Total Additions		<u>15,687</u>
DEDUCTIONS:		
Scholarships awarded		<u>11,800</u>
Changes in Net Assets		3,887
Net Assets -- Beginning		<u>105,157</u>
Net Assets -- Ending		<u>\$ 109,044</u>

The Notes to Financial Statements are an
Integral Part of this Statement

PUBLIC SCHOOLS OF THE CITY OF ANN ARBOR

NOTES TO THE FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

FINANCIAL REPORTING ENTITY

The Public Schools of the City of Ann Arbor (the "School District") is subject to the oversight responsibility of a Board of Education consisting of nine elected citizens of the School District. Each member is elected for a term of three years. The primary responsibilities of the Board of Education include review of the School District's annual budget, approval of School District policies and selection and evaluation of the School District's Superintendent.

The accounting policies of the School District conform to generally accepted accounting principles (GAAP). The School District is the primary unit of government and has no component units pursuant to the requirements of Governmental Accounting Standards Board ("GASB") Statement No. 14. The School District is not included in any other governmental "reporting entity" as defined in GASB Statement 14.

The School District receives funding from local, State and Federal government sources and must comply with all the requirements of these funding source entities.

The School District's financial statements include all funds, departments and other operations. The School District's Board of Education has oversight responsibility and approves budgets of the Recreation and Community Services Fund. Accordingly, for the 2003-04 school year, these funds are considered part of the primary government.

DISTRICT-WIDE FINANCIAL STATEMENTS

The district-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the primary government. The district-wide financial statements include capital assets, net of accumulated depreciation, and long-term obligations.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenue includes 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes, unrestricted state aid and inter-governmental payments and other items not properly identified as program revenues are reported as general revenue.

The district-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants, categorical aid and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

As a general rule, the effect of inter-fund activity has been eliminated from the district-wide financial statements.

FUND-BASED FINANCIAL STATEMENTS

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

Property taxes, received within 60 days, unrestricted state aid, inter-governmental grants and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenue of the current fiscal period. All other revenue items are considered to be available only when the School District receives cash.

Employee compensated absences, unemployment and self-insurance liabilities expected to be liquidated with current financial resources are accrued in the appropriate governmental fund.

The fund financial statements focus on major funds rather than fund types. The School District reports the following major governmental funds:

General Fund - The General Fund is the District's primary operating fund. It accounts for all resources, including Grant Programs, except those required to be accounted for in another fund.

Sinking Fund - The Sinking Fund is used to account for construction and repair of buildings. The School District has complied with the applicable provisions of section 1212(I) of the State of Michigan School Code.

Additionally, the following fund types are reported as a combined non-major fund in the governmental financial statements and as an individual fund type in the supplemental information:

Special Revenue Funds - The Special Revenue Funds are used to account for the proceeds of specific revenue sources (other than expendable trusts or major capital projects) that are restricted to expenditures for specified purposes. Special Revenue Funds include the following funds:

School Services Funds

The School Services Funds are used to account for the operation of Food Services and Athletic programs.

Recreation and Community Services Fund

The Recreation Fund is used to account for the operations of recreational programs offered jointly with the City of Ann Arbor.

Debt Service Fund - The Debt Service Fund is used to account for the accumulation of resources for, and the payment of, bond principal, interest and paying agent fees.

Capital Projects Fund - The Capital Projects Fund is used to account for financial resources to be used for the acquisition of land and construction or acquisition of buildings and equipment. The Capital Projects Fund includes the 2004 Bond issue, the 1995 Bond issue and the Millage and Capital Needs Fund. The Millage and Capital Needs Fund is also used to purchase school buses, technology hardware and textbooks. For the 2004 and 1995 bond issuances, the School District has complied with the applicable provisions of section 1351a of the Revised School Code. The projects for which the 1995 bonds were issued was considered substantially complete on June 30, 2002 and the cumulative expenditures recognized for the construction period were \$ 53,210,459.

Fiduciary Funds - Fiduciary funds are used to account for assets held by the School District in a trustee capacity or as an agent. Fiduciary fund statements are reported using the economic resources measurement focus and the accrual basis of accounting. Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of the results of operations.

Student Activities Agency Fund - The Student Activities Agency Fund is used to account for assets held as agent for various student activities.

Private Purpose (Scholarship) Trust Fund - The Trust Fund is used to account for donated assets which will be awarded to students or awarded to support student learning. Private purpose trust funds are used to account for resources legally held in trust for the benefit of individuals and organizations outside the District.

Each fund is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that are comprised of assets, liabilities, fund balance, revenues and expenditures. School resources are allocated to and accounted for in individual funds based upon the purposes for which they are spent and the means by which spending activities are controlled.

BASIS OF ACCOUNTING

Budgetary Data

Unliquidated encumbrances at the end of the year are carried forward to the subsequent year. The budget for the fiscal year 2004-2005 will be increased by an amount sufficient to cover the unliquidated encumbrances carried forward. Budgets for various Grant Programs are prepared using a different fiscal year than that of the School District. Accordingly, Grant Programs revenues and expenditures are not considered in the accompanying required supplementary information- budgetary comparison schedule – major funds.

Investments

Investments consist generally of short-term cash equivalents, treasury notes, investment pools and U.S. Governmental Agency instruments. They are recorded at fair value, based on quoted market prices, or estimated fair value.

Inventories

Inventories are valued at cost using the first-in, first-out method. Inventory recorded in the General Fund consists of transportation supplies for the School District. The Food Service Fund inventory consists of food, paper goods and United State Department of Agriculture Commodities. The inventory items are recorded as expenditures at the time of use in their respective funds. For the Schedule of Expenditures of Federal Awards (SEFA), commodities are recorded as expenditures when received from the Government.

Capital Assets

Capital assets, which include land, buildings, equipment and vehicles are reported in the applicable district-wide statements. Capital assets are defined by the School District as assets with an initial individual cost of more than \$10,000 and an estimated useful life in excess of 5 years. Such assets are recorded at historical cost or estimated historical cost when purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. Costs of normal repair and maintenance that do not add to the value or materially extend asset life are not capitalized. The District does not have infrastructure type assets.

Buildings, equipment and vehicles are depreciated using the straight line method over the following useful lives:

Buildings and additions	20 - 50 years
Buses and other vehicles	5 - 10 years
Equipment	5 - 20 years

Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

Restricted Assets

The unspent bond proceeds of the Capital Projects Funds require amounts to be set aside for construction. In addition, the unspent property taxes levied in the Debt Service funds are required to be set aside for future bond principal and interest payments. These amounts have been classified as restricted assets.

Fund Equity – In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

2. CASH AND INVESTMENTS

Cash and investments at June 30, 2004 are comprised of the following:

	Governmental Activities	Fiduciary Funds	Total Primary Government
Cash and cash equivalents	\$ 763,109	21,513	784,622
Investments	51,593,428	2,773,700	54,367,128
Restricted assets	11,570,054		11,570,054
Total	<u>\$ 63,926,591</u>	<u>2,795,213</u>	<u>66,721,804</u>

The breakdown between deposits and investments for the school district follows:

Deposits (checking, savings, and certificates of deposit)	\$ 28,819,017
Investments in securities, mutual funds, etc.	37,890,405
Petty cash (cash on hand)	12,382
Total Cash and Investments	<u>\$ 66,721,804</u>

Deposits - At year end, the carrying value of the School District's cash deposits and certificates of deposit was \$28,831,399 representing bank balances totaling \$30,961,273 less outstanding checks plus other net reconciling items. Of the carrying value of the deposits, \$28,030,700 is held in certificates of deposit and classified as investments on the School District's balance sheet. Of the bank balance, \$462,209 was covered by Federal depository insurance or held directly by the School District. The remaining \$30,499,064 was uninsured and uncollateralized. Current banking laws do not require collateralization.

Investments - State statutes and School District policy authorize the School District to invest in obligations of the U.S. Treasury, agencies and instrumentalities, commercial paper (rated at Prime by at least two of the major rating agencies, and maturing not more than 270 days after the date of purchase), bankers' acceptances, repurchase agreements, certificates of deposit in state or national banks, savings and loan associations or credit unions and investment pools authorized by Act No. 367 of the Public Acts of 1982.

The pooled investments consist of a Michigan School District Liquid Asset Fund of \$402,083, The Bank One School District Operating Trust Fund of \$8,439,490, The National City Bank Corporate Government Investment Fund of \$345,000, and The Standard Federal Bank Public Funds Money Market of \$28,703,832. The Michigan School District Liquid Asset Fund is an investment pool available to Michigan School Districts that invest their money in investments which are allowable according to state

statutes and district policies. The School District investment and money market funds (identified above) are comprised of commonly held debt securities as allowed by the School District's investment policy. Money market funds and pooled investments are not categorized because they are not evidenced by securities that exist in physical or book entry form.

3. RESTRICTED ASSETS

The balances of the restricted asset accounts are as follows:

	Governmental Activities
Unspent bond proceeds and related interest	\$ 763,321
Unspent debt service property taxes levied	1,275,435
Unspent sinking fund property taxes levied	9,531,298
Total	<u>\$ 11,570,054</u>

4. INTERFUND RECEIVABLES/PAYABLES AND TRANSFERS TO/FROM OTHER FUNDS

Interfund balances are transfers from the General Fund which, represent reimbursements of current year operating costs. Transfers to the General Fund are for various current year costs, such as, administration and overhead, recreation business service fees, return of unused budget and tax adjustments.

Fund Due From	Fund Due To				Totals
	Major		Nonmajor	Fiduciary	
	Combined General	Sinking	Debt	Student Activities	
<u>Nonmajor Funds:</u>					
Combined General	\$	207,737	1,432,890	87,043	1,727,670
Capital Planning		309,268			309,268
2004 Bond		165,230			165,230
Food Service		21,033			21,033
Athletics		93,772			93,772
Recreation		71,276			71,276
	<u>\$</u>	<u>660,579</u>	<u>207,737</u>	<u>1,432,890</u>	<u>87,043</u>
					<u>2,388,249</u>

Funds:	Transfers In		Transfers Out		Total
			Other Governmental Funds	Fiduciary Student Activities	
General	\$	17,919	(2,606,573)	(714,622)	(3,321,195)
Other governmental		2,606,573	(17,919)		(17,919)
Fiduciary		714,622			
Total	<u>\$</u>	<u>3,339,114</u>	<u>(2,624,492)</u>	<u>(714,622)</u>	<u>(3,339,114)</u>

Transfers To/From Other Funds	
Operating transfers in	\$ 2,624,492
Operating transfers out	(3,339,114)
Student Activities Agency Fund (Transfer from General Fund)	714,622
Total	<u>\$ -0-</u>

5. TAXES RECEIVABLE

Property taxes are levied on July 1 and December 1 on the taxable valuation of property as of the preceding March 1st. Taxes are considered delinquent on March 1st of the following year. At that time, penalties and interest are assessed and the total obligation is added to the county tax rolls.

Delinquent real property taxes are collected via the delinquent tax revolving fund which is operated by the County of Washtenaw. At June 30, 2004, delinquent real property taxes receivable is \$314,583 and is recorded in the general fund.

Delinquent personal property taxes are collected and forwarded to the School District by the tax collection agencies. At June 30, 2004, delinquent personal property taxes receivable is \$1,640,375 and is recorded in the general fund.

Any amounts not collected, including any other receivables, are deemed immaterial.

6. CAPITAL ASSETS

Capital asset activity of the School District's Governmental activities is as follows:

	Balance July 1, 2003	Additions	Disposals and Adjustments	Balance June 30, 2004
Land – not depreciated	\$ 2,477,822			2,477,822
Capital assets being depreciated:				
Land Improvements	9,939,050	2,258,153	134,880	12,062,323
Buildings and Building Improvements	194,829,695	7,744,186	576,778	201,997,103
Vehicles	6,014,592	803,779	363,120	6,455,251
Equipment	17,345,731	886,443	1,425,610	16,806,564
Subtotal	228,129,068	11,692,561	2,500,388	237,321,241
Accumulated depreciation:				
Land Improvements	5,229,939	597,238	134,880	5,692,297
Buildings and Building Improvements	95,580,734	6,755,208	576,778	101,759,164
Vehicles	3,661,111	695,988	363,120	3,993,979
Equipment	10,720,800	1,823,191	1,425,610	11,118,381
Subtotal	115,192,584	9,871,625	2,500,388	122,563,821
Net capital assets being depreciated	112,936,484	1,820,936		114,757,420
Net capital assets	\$ 115,414,306	1,820,936		117,235,242

Depreciation expense was charged to activities of the school district (primary government) as follows:

Governmental activities	
Instruction	\$ 8,706,749
Support	1,032,765
Unallocated	132,111
Total governmental activities	<u>\$ 9,871,625</u>

Construction Commitments – The School District has active construction projects at year end. At year end, the School District's commitments with contractors totaled \$ 9,069,992.

7. DEFERRED REVENUE

Deferred revenues at June 30, 2004 consist of the following:

	Funds		Total
	Major	Nonmajor	
	<u>General</u>		
<u>Unavailable:</u>			
Delinquent personal and real property taxes not available to finance 2003/04 operations	\$ 1,841,856		1,841,856
<u>Unearned:</u>			
Grant Programs receipts in excess of current year expenditures	144,389		144,389
Local receipts in excess of current year expenditures		17,350	17,350
State receipts in excess of current year expenditures	35,706		35,706
Foundation revenue in excess of current year expenditures	3,832,788		3,832,788
TOTAL	<u>\$ 5,854,739</u>	<u>17,350</u>	<u>5,872,089</u>

8. COMPENSATED ABSENCES

The liability for compensated absences reported in the government-wide statements consists of unpaid, accumulated termination of employment, vacation and sick leave balances.

Termination Pay

Certain employees are entitled to receive a lump sum payment upon termination of employment with the School District. The amount is generally based on the employees' current wage rate and number of years of service accumulated as of June 30, 2003. Expenditures for accumulated termination pay are budgeted and paid on an annual basis. Total termination pay expense, including related FICA, was \$1,135,643 for the year ended June 30, 2004.

Accumulated Vacation

Employees other than instructors accrue vacation based on number of days worked and seniority. Accumulated vacation days lapse at year-end for School District administrators and unclassified personnel. However, such groups are permitted to carry over a maximum of twenty unused vacation days. All other non-instructor employee groups accrue vacation days during the current fiscal year.

Sick Leave

School District employees are entitled to accumulate unused sick leave days. Subject to variations among different classes of personnel, employees with ten or more years of service who retire or terminate employment are paid a per diem rate for one-half of their accumulated sick leave days, up to a maximum of 100 days.

The following table details the portion of accumulated termination, vacation and sick leave pay considered a liability for all School District employees at June 30, 2004, included in the Government wide statements and the portion of fund balance designated to fund future payments, included in the fund financial statements:

	<u>Major Funds</u> Combined	<u>Nonmajor Funds</u>	Total
Termination Pay	\$ 12,206,615	216,485	12,423,100
Vacation Pay	1,065,710	60,136	1,125,846
Sick Pay	2,596,548	235,862	2,832,410
Total Compensated Absences	<u>\$ 15,868,873</u>	<u>512,483</u>	<u>16,381,356</u>
Designation of fund balance	<u>\$ 4,667,099</u>	<u>20,414</u>	<u>4,687,513</u>

9. CONTINGENT LIABILITIES

Risk Management

Generally accepted accounting principals require an amount to be determined for claims that have occurred but have not yet been reported (IBNR) as of the date of the financial statements. IBNR claims include (a) known loss events that are expected to later be presented as claims, (b) unknown loss events that are expected to become claims, and (c) expected future development on claims already reported.

The School District has a self-insurance plan for workers' compensation claims. Under the plan, the maximum claim loss of the School District is limited to a percentage of normal workers' compensation insurance premiums for the contractual period. The estimated potential liability under the plan for pending cases (including IBNR) was approximately \$5.0 million at June 30, 2004, representing the total estimated workers' compensation claims not covered by insurance. The School District's workers' compensation expenditure, for the general fund, was \$270,933 for the year ended June 30, 2004, which included employee light duty payments of \$12,480 and associated benefits of \$8,718. A portion of the General Fund fund balance totaling \$800,000 has been designated for subsequent years risk management expenditures.

Changes in the balances of potential claims of the District during the past two fiscal years, are as follows:

	<u>6 / 3 0 / 0 4</u>	<u>6 / 3 0 / 0 3</u>
Potential claims, including IBNR, beginning fiscal year	\$ 4,479,703	4,938,779
Prior year authorized claim payments	(234,118)	(386,744)
Increase(decrease) in IBNR	62,362	(208,860)
Increase (decrease) in authorized claims	690,716	136,528
Potential claims, including IBNR, end of fiscal year	<u>\$ 4,998,663</u>	<u>4,479,703</u>

In addition, the School District is exposed to various risks of loss related to property loss, torts, errors and omissions, as well as medical benefits provided to employees. The School District has purchased commercial insurance for these potential losses. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

Legal Actions

The School District is a party to several legal actions. In the opinion of management the School District has adequate insurance to cover most of the legal actions and does not believe that settlement of any legal actions will materially affect the School District's operations or financial position. A portion of the General Fund fund balance totaling \$1.5 million has been designated for settlements, since such liability is expected to be paid from revenues of subsequent years.

Property Tax Appeals

Several appeals of property tax assessments are currently pending before the Michigan Tax Tribunal. The School District would become liable to refund any taxes collected due to over-assessment. The state equalized value (SEV) and/or taxable value (TV) under appeal within the City of Ann Arbor, the School District's primary source of property tax levies, was approximately \$143.4 million, as of June 30, 2004. Management is unable to estimate the amount in property tax revenues which could be subject to refund, if the tax tribunal determines an over-assessment.

10. GENERAL LONG-TERM OBLIGATIONS

The District issues bonds, notes and other contractual commitments to provide for the acquisition and construction of major capital facilities and the acquisition of certain equipment. General obligation bonds are direct obligations and pledge the full faith and credit of the District. Other long-term obligations include compensated absences, claims and judgments, termination benefits and certain risk liabilities.

The following is a summary of all general long-term obligations outstanding as of June 30, 2004 and bonded debt activity for the year then ended.

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
GOVERNMENTAL ACTIVITIES:					
BOND ISSUES:					
Bonds financed by tax levy:					
6.3% - 7.6%, 1990 CAB Bonds due through 2005	6,018,584	0	3,131,313	2,887,271	2,887,271
4.75% - 5.0%, 1995 Serial Bonds due through 2014	30,645,000	0	30,645,000	0	0
2.0% - 5.0%, 2003 Refin. Bonds due through 2014	0	26,610,000	0	26,610,000	3,480,000
TOTAL BONDS	36,663,584	26,610,000	33,776,313	29,497,271	6,367,271
CAPITAL APPRECIATION BONDS (interest)	11,161,416	0	5,458,687	5,702,729	5,702,729
					Due at June 30th
TERMINATION PAY (Note 8)	11,992,872	1,445,426	1,015,198	12,423,100	705
ACCUMULATED VACATION PAY (Note 8)	932,293	251,931	58,378	1,125,846	280
SICK LEAVE (Note 8)	1,933,394	961,083	62,067	2,832,410	78
RISK MANAGEMENT (Note 9)	4,479,703	753,078	234,118	4,998,663	0
LEGAL ACTIONS (Note 9)	1,500,000	719,095	719,095	1,500,000	0
	68,663,262	30,740,613	41,323,856	58,080,019	12,071,063

The requirements by fiscal year to amortize obligations outstanding except workers' compensation claims, compensated absences and legal actions as of June 30, 2004, are as follows:

	Total Debt	Total Interest and Paying Agents Fees	Total Requirements
2004-05	\$ 6,367,271	6,637,504	13,004,775
2005-06	2,285,000	865,175	3,150,175
2006-07	2,330,000	819,475	3,149,475
2007-08	2,380,000	767,050	3,147,050
2008-09	2,445,000	707,550	3,152,550
2004-09	15,807,271	9,796,754	25,604,025
2009-10	2,515,000	634,200	3,149,200
2010-11	2,595,000	558,750	3,153,750
2011-12	2,720,000	429,000	3,149,000
2012-13	2,860,000	293,000	3,153,000
2013-14	3,000,000	150,000	3,150,000
2009-14	13,690,000	2,064,950	15,754,950
	\$ 29,497,271	11,861,704	41,358,975

Advance and Current Refundings – During the year, the District issued \$26.6 million in general obligation bonds with an average interest rate of 3.4%. The proceeds of these bonds were used to advance refund \$28.6 million of outstanding 1995 bonds with an average interest rate of 4.9%. The net proceeds of \$27.7 million (after payment of \$.2 million in underwriting fees, insurance and other issuance costs) plus an additional \$2.2 million of 1995 Debt fund monies, were used to purchase U.S. government securities and were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the original bonds. As a result, the bonds are considered to be defeased and the liability for the bonds have been removed from the District's long-term obligations. The advance refunding reduced total debt service payments by approximately \$3.2 million, which represents an economic gain of approximately \$2.2 million.

11. BUDGETARY DATA

Annual budgets are legally required by State statute for the General and Special Revenue Funds. In addition, the District adopts a budget for the millage portion of the Capital Projects Fund on an annual basis and adopts a budget for the bond portion of the Capital Projects Fund upon receipt of the bond proceeds. Each year before the start of the fiscal year on July 1, the formal budget is adopted through resolution by the Board of Education. The budget is adopted at a departmental level. The District cannot exceed total expenditures within the General, Special Revenue and Capital Project Funds without Board approval.

The policy of the Board of Education is to preserve as a minimum general fund balance (cash) an amount which is no less than an amount equal to 1/6 of the total operating costs of the School District. As of June 30, 2004, total operating costs and unreserved, undesignated fund balance (including designation for cash flow) are \$165,061,440 and \$22,439,735, respectively. The undesignated fund balance necessary to adhere to the Board of Education Policy is approximately \$28.4 million.

Cash Flow Designation – The School District designates a portion of the General Fund fund balance for cash flow. The School District receives its first State aid payment, for the new fiscal year, on October 20th. However, the School District's new fiscal year and operations begin July 1st. An analysis of cash flow requirements indicate that the District maintain a portion of its General Fund fund balance equal to approximately two State aid payments to cover two months of operations without State aid revenue.

Budget Appropriation – The School District designated a portion of the General Fund fund balance to cover operations for the 2004-05 school year. As detailed in the FY 2004/2005 Approved Budget, the School District expected to use approximately \$8.2 million of its General Fund fund equity to cover recurring operational expenditures for the fiscal year 2005. However, on September 14, 2004, the voters approved a seven-year countywide special education millage. The millage will provide approximately \$2.2 million in additional revenue to the District for the 2004-05 school year. The \$6.0 million represents the amount of fund equity the District expects to use (as of the date of this report) for fiscal year 2005.

All budget information is presented as was originally adopted by the Board of Education on June 18, 2003 or as subsequently amended. The General Fund budget was adjusted during the year as follows:

	As Originally Adopted	Adjustments During the Year	Final Budget
Revenue and other financing sources	\$ 162,838,576	54,238	162,892,814
Expenditures and other financing uses	(165,460,705)		(165,460,705)
NET BUDGET BALANCE	<u>\$ (2,622,129)</u>	<u>54,238</u>	<u>(2,567,891)</u>

The General, Grant, Food Service, 1995 Debt Service, Millage and Capital Needs, 2004 Capital Project Bond and 1995 Capital Project Bond Funds had excess of expenditures over revenues and other financing sources in the amount of \$4,028,223, \$18,731, \$42,301, \$701,672, \$2,943,367, \$165,230 and \$12,596 respectively, for the year ended June 30, 2004. The Food Service and 2004 Bond Funds also had a fund deficit of \$264,602, and \$165,230, respectively at June 30, 2004.

12. DEFINED BENEFIT PENSION PLAN

Plan Description - The School District participates in the Michigan Public School Employees' Retirement System (MPSERS), a statewide, cost-sharing, multiple-public employer defined benefit retirement system governed by the State of Michigan that covers substantially all employees of the District. The system provides retirement, survivor and disability benefits to plan members and their beneficiaries. The Michigan Public School Employees' Retirement System issues a comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for the MPSERS. Ten year historical trend information showing the MPSERS's progress in accumulating sufficient assets to pay benefits when due is presented in the MPSERS's September 30, 2002 financial report. The report is available to the public and may be obtained by writing to MPSERS at 7150 Harris Drive, P.O. Box 30673, Lansing, MI 48909.

Participation Policy - Employees first hired on or after January 1, 1990 and returning members who did not work between January 1, 1987 and December 31, 1989 are required to participate in the Member Investment Plan ("MIP"). Such employees are required to make contributions based on a graduated contribution scale: 3% of the first \$5,000 in wages, 3.6% of \$5,001 through \$15,000, and 4.3% of all wages over \$15,000. Employees hired prior to the dates listed above, participate in the Basic MPSERS plan and make no contributions. However, Basic plan members, who elected to participate in the MIP MPSERS plan, make fixed rate contributions of 3.9% of annual compensation. Participation in the MIP entitles employees to additional retirement benefits in excess of the Basic MPSERS plan. If a member leaves MPSERS before a retirement benefit has vested, the member's contributions to MIP, plus earnings, if any, are refundable.

Post Employment Benefits - Under the MPSERS Act, all retirees participating in the MPSERS Pension Plan have the option of continuing health, dental and vision coverage. Retirees having these coverages contribute an amount equivalent to the monthly cost for Part B Medicare and 10 percent of the monthly premium amount for the health, dental and vision coverages. Required contributions for post-employment health care benefits are included as part of the District's total contribution to the MPSERS plan discussed below.

Funding Policy - Employer contributions to the system result from the effects of the School Finance Reform Act. Employer contributions are required for all District employees. Each school district contributes the full actuarial funding contribution amount to fund pension benefits, plus an additional amount to fund retiree health care benefit amounts on a cash disbursement basis. Actuarial valuations are prepared annually to determine MPSERS's actuarial liabilities and the employer contributions required to fund the System in accordance with the actuarial reserve funding provisions of the governing State Statute. The most recent actuarial valuation as of September 30, 2002 included a total of 476,030 members of MPSERS. The actuarial value of MPSERS's assets amounted to approximately \$38.38 billion on September 30, 2002. The actuarially computed value of vested benefits as compared with plan assets is not determined on a district basis by MPSERS.

The pension benefit rate for the School District totaled 12.99% for the period July 1, 2003 through June 30, 2004 of the covered payroll. The School District's total payroll subject to the plan for the year ended June 30, 2004 was \$115,454,763. The required contributions for covered employees for the years ended June 30, 2004, 2003 and 2002 were \$14,996,796, \$14,254,739 and \$13,119,271, respectively. The District's 2004 contribution represented 2.15% of the total state-wide employer contributions.

The System's assets do not include any securities of the School District, nor was the System involved in any loan transactions with the School District.

13. SUBSEQUENT EVENT

On August 24, 2004, the District received approximately \$123.4 million for its first installment of the \$205.5 million Building and Site Bond issue approved by the voters on June 14, 2004. On that date, the voters also approved a 5 year, 1.0 mill sinking fund to begin July, 2005.

On September 14, 2004, the voters approved a seven-year, countywide special education millage. The millage will provide approximately \$2.2 million in additional revenue to the District for the 2004-05 school year.
