NEW ISSUE - BOOK ENTRY ONLY

INSURED RATING: S&P: "AAA"
UNDERLYING RATING: S&P: "A-"
(See "RATINGS" herein)

In the opinion of Quint & Thimmig LLP, San Francisco, California, Bond Counsel, under existing law, subject to the District's compliance with certain covenants, interest on the Bonds is excludable from gross income of the owners thereof for federal income tax purposes under section 103 of the Internal Revenue Code of 1986, as amended (the "Code") and, under section 55 of the Code, is not included as an item of tax preference in computing the federal alternative minimum tax for individuals and corporations under the Code but is taken into account in computing an adjustment used in determining the federal alternative minimum tax for certain corporations. In the further opinion of Bond Counsel, the Bonds are "qualified tax-exempt obligations" under section 265(b)(3) of the Code of 1986. In the further opinion of Bond Counsel, such interest is exempt from California personal income taxes.

$4,999,986.80
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)
GENERAL OBLIGATION BONDS
Election of 2006, Series 2007
BANK QUALIFIED

Dated: Date of Delivery **Due: August 1, as set forth on inside cover**

The above-captioned $4,999,986.80 aggregate principal amount of the Middletown Unified School District (Lake County, California) General Obligation Bonds, Election of 2006, Series 2007, are being issued as Series 2007 Current Interest Bonds (the "2007 Current Interest Bonds") and Series 2007 Capital Appreciation Bonds (the "2007 Capital Appreciation Bonds," and together with the 2007 Current Interest Bonds, the "Bonds"). The Bonds are the first series of general obligation bonds authorized at an election conducted within the Middletown Unified School District (the "District") on November 7, 2006, as more fully described herein under the caption "THE BONDS" and are being issued to finance the construction, acquisition, furnishing and equipping of District facilities, and to pay certain costs of issuance associated therewith, as more fully described herein under the caption "THE PROJECT."

The Bonds will be issued on a parity with all other general obligation bonds of the District and will be issued in denominations of $5,000 principal amount or Maturity Value or integral multiples thereof, and are payable as to principal amount, Maturity Value or redemption price at the office of U.S. Bank National Association, Paying Agent for the Bonds (the "Paying Agent"). The Bonds will be issued as current interest bonds (the "Current Interest Bonds") and capital appreciation bonds (the "Capital Appreciation Bonds"). Interest on the Current Interest Bonds is payable on August 1 and February 1 of each year, commencing August 1, 2007. The Capital Appreciation Bonds accrete interest from their date of delivery, compounded semiannually on August 1 and February 1 of each year, commencing August 1, 2007.

The Bonds are issued in fully registered form and, when delivered, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository of the Bonds as described herein under the caption "THE BONDS – Book-Entry Only System."

The Bonds are subject to optional and mandatory redemption prior to maturity as described herein. See "THE BONDS – Optional Redemption" and "–Mandatory Redemption" herein.

The scheduled payment of principal of (or in the case of Capital Appreciation Bonds, the Maturity Value) and interest on the Bonds when due will be guaranteed under an insurance policy (the "Policy") to be issued concurrently with the delivery of the Bonds by FINANCIAL SECURITY ASSURANCE INC. (the "Insurer"). See "BOND INSURANCE" and APPENDIX E – "FORM OF BOND INSURANCE POLICY" herein.

FSA

The Bonds are general obligations of the District only and are not obligations of the County of Lake, the State of California or any of its other political subdivisions. The Board of Supervisors of the County of Lake has the power and is obligated to levy and collect *ad valorem* property taxes for each fiscal year upon the taxable property of the District in an amount at least sufficient, together with other moneys available for such purpose, to pay the principal of, and premium, if any, and interest on each Bond as the same becomes due and payable.

MATURITY SCHEDULE
On Inside Cover

This cover page contains certain information for quick reference only, and is not a summary of the official statement. Investors must read the complete and entire official statement to obtain information essential to the making of an informed investment decision.

The Bonds will be offered when, as and if issued and received by the Underwriter subject to the approval of legality by Quint & Thimmig LLP, Bond Counsel, and certain other conditions. Certain matters will be passed upon for the District and the County by County Counsel, and for the Underwriter by Kutak Rock LLP, as Underwriter's Counsel. The Law Offices of Cameron A. Weist, Scotts Valley, California, will serve as Disclosure Counsel with respect to the Bonds. It is anticipated that the Bonds will be available for delivery in definitive form in New York, New York, through the facilities of DTC on or about March 22, 2007.

PiperJaffray

Dated: March 8, 2007

DATES, PRINCIPAL AMOUNTS, INTEREST RATES AND YIELDS

MATURITY SCHEDULE

SERIES 2007 CURRENT INTEREST BONDS

$725,000 Serial Maturities

Maturity (August 1)	Principal Amount	Interest Rate	Yield	CUSIP†
2011	$105,000	5.000%	3.480%	596877 AD2
2012	110,000	5.000	3.510	596877 AE0
2013	120,000	5.000	3.540	596877 AF7
2014	125,000	5.000	3.570	596877 AG5
2015	130,000	5.000	3.610	596877 AH3
2016	135,000	5.000	3.650	596877 AJ9

$295,000 3.700% Term Bond Due August 1, 2018 – Yield 3.750% CUSIP† No. 596877 AL4
$315,000 3.800% Term Bond Due August 1, 2020 – Yield 3.850% CUSIP† No. 596877 AN0
$335,000 3.850% Term Bond Due August 1, 2022 – Yield 3.900% CUSIP† No. 596877 AQ3
$970,000 4.000% Term Bond Due August 1, 2027 – Yield 4.100% CUSIP† No. 596877 AV2
$920,000 4.100% Term Bond Due August 1, 2031 – Yield 4.200% CUSIP† No. 596877 AZ3

MATURITY SCHEDULE

SERIES 2007 CAPITAL APPRECIATION BONDS

$1,439,986.80 Initial Denominational Amount

Maturity (August 1)	Principal Amount	Accretion Rate*	Reoffering Yield	Reoffering Price	Maturity Value	CUSIP†
2008	$501,438.60	11.675%	3.550%	95.332%	$585,000.00	596877AA8
2009	$470,604.15	11.675	3.550	92.036	615,000.00	596877AB6
2010	$467,944.05	11.675	3.550	88.854	685,000.00	596877AC4

*Approximate.
† CUSIP® A registered trademark of the American Bankers Association. Copyright © 1999-2007 Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. CUSIP® data herein is provided by Standard & Poor's CUSIP® Service Bureau. This data in not intended to create a database and does not serve in any way as a substitute for the CUSIP® Service Bureau. CUSIP® numbers are provided for convenience of reference only. Neither the City nor the Underwriter takes any responsibility for the accuracy of such numbers.

PIPER JAFFRAY & CO. SINCE 1895. MEMBER SIPC AND NYSE.

MIDDLETOWN UNIFIED SCHOOL DISTRICT
Lake County, State of California

BOARD OF EDUCATION

Bill Wright, *President*
Jay Albertson, *Member*
Kim Bladel, *Member*
Jim Comstock, *Member*
Yvette Sloan, *Member*

DISTRICT ADMINISTRATORS

Korby Olson, Superintendent

PROFESSIONAL SERVICES

Bond Counsel

Quint & Thimmig LLP
San Francisco, California

Disclosure Counsel

Law Offices of Cameron A. Weist
Scotts Valley, California

Financial Advisor

Caldwell Flores Winters Inc.
Emeryville, California

Underwriter

Piper Jaffray & Co.
Hermosa Beach, California

Underwriter's Counsel

Kutak Rock LLP
Denver, Colorado

Paying Agent

U.S. Bank National Association
Los Angeles, California

GENERAL INFORMATION ABOUT THIS OFFICIAL STATEMENT

In making an investment decision investors must rely on their own examination of the terms of the offering, including the merits and risks involved. These Bonds have not been recommended by any federal or state securities commission or regulatory authority. Furthermore, neither the foregoing authorities nor Bond Counsel, Disclosure Counsel or Underwriter's Counsel have endeavored to determine investment suitability relating to the Bonds. Any representation to the contrary is a criminal offense.

This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Bonds by a person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale. No dealer, broker, salesperson or other person has been authorized by the District, the County or the Underwriter to give any information or to make any representations other than those contained herein. If given or made, such other information or representations must not be relied upon as having been authorized by the District, the County or the Underwriter.

The Execution and delivery of the Bonds has not been registered under the Securities Act of 1933 in reliance upon an exemption thereunder. This Official Statement is not to be construed as a contract with the purchasers of the Bonds. Statements contained in this Official Statement which involve estimates, projections, forecasts or matters of opinion, whether or not expressly so described herein are intended solely as such and are not to be construed as representations of fact.

The information set forth herein relating to book-entry and to the Depository Trust Company ("DTC"), New York, New York has been obtained from DTC and the information herein relating to the Insurer and to the Insurance Policy has been obtained from the Insurer. Such information is believed to be reliable, but it is not guaranteed as to accuracy or completeness and is not to be construed as representation by the District or respective counsel. All other information set forth herein has been furnished by the District and other sources believed to be reliable. Such information and expression of opinions is not guaranteed as to accuracy or completeness and is not to be construed as a representation by the District, the County or the Underwriter.

When used in this Official Statement and in any continuing disclosure by the District in any press release and in any oral statement made with the approval of an authorized officer of the District or any other entity described or referenced in this Official Statement, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," "forecast," "expect," "intend," and similar expressions identify "forward looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward-looking statements. Any forecast is subject to such uncertainties. Inevitably, some assumptions used to develop the forecasts will not be realized and unanticipated events and circumstances may occur. Therefore, there are likely to be differences between forecasts and actual results, and those differences may be material.

The information and expressions of opinion herein are subject to change without notice and neither the delivery of this Official Statement nor any sale of the Bonds made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the District, the County, the Insurer or DTC since the date hereof. Further, all summaries contained herein of related documents and instruments are expressly made subject to the provisions of such documents and instruments and do not purport to be complete, comprehensive or definitive summaries of any or all of such provisions.

This Official Statement is submitted in connection with the sale of the Bonds and may not be reproduced or used, in whole or in part, for any other purpose.

IN CONNECTION WITH THE OFFERING OF THE BONDS, THE UNDERWRITER MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS OFFERED HEREBY AT LEVELS ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITER MAY OFFER AND SELL THE BONDS TO CERTAIN DEALERS, INSTITUTIONAL INVESTORS AND OTHERS AT PRICES LOWER THAN THE PUBLIC OFFERING PRICES STATED ON THE COVER PAGE THEREOF AND SAID PUBLIC OFFERING PRICES MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITER.

THE BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXCEPTION FROM THE REGISTRATION REQUIREMENTS CONTAINED IN SUCH ACT. THE BONDS HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE.

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OFFICIAL STATEMENT

$4,999,986.80
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)
GENERAL OBLIGATION BONDS
Election of 2006, Series 2007
BANK QUALIFIED

INTRODUCTION

This introduction is not a summary of this official statement (the "Official Statement"). It is only a brief description of and guide to, and is qualified by, more complete and detailed information contained in the entire Official Statement, including the cover page and appendices hereto, and the documents summarized or described herein. A full review should be made of the entire Official Statement. The offering of the Bonds to potential investors is made only by means of the entire Official Statement.

This Official Statement, which includes the cover page and appendices hereto, is provided to furnish information in connection with the sale of $4,999,986.80 principal amount of Middletown Unified School District (Lake County, California), General Obligation Bonds, Election of 2006, Series 2007 (the "Bonds"), as described more fully herein.

The District

The Middletown Unified School District (the "District") provides educational services to a portion of the residents of the County of Lake (the "County"), in the State of California (the "State"). More detailed information regarding the area served by the District and the student population of the District may be found under "MIDDLETOWN UNIFIED SCHOOL DISTRICT," and "DISTRICT FINANCIAL INFORMATION," herein.

Sources of Payment for the Bonds

The Bonds are obligations of the District issued by the Board of Supervisors of the County on behalf of the District, and the Board of Supervisors of the County is empowered and is obligated to annually levy *ad valorem* taxes, without limitation as to rate or amount, upon all property subject to taxation within the District (except certain personal property which is taxable at limited rates), as necessary for payment of interest on and principal of the Bonds. See "SECURITY FOR THE BONDS" and "DISTRICT FINANCIAL INFORMATION" herein.

Purpose of the Issue

Proceeds from the sale of the Bonds will be used for the acquisition, construction, furnishing and equipping of District facilities (collectively, the "Project"), all as further described herein under "THE BONDS – Purpose of Issue" and "THE PROJECT" and as provided in the bond proposition approved at an election of the District, in accordance with the Constitution and laws of the State of California, and to pay costs of issuance of the Bonds.

Authority for the Issue

The Bonds are general obligations of the District. The Bonds are being issued by the District under the provisions of Title 1, Division 1 Part 10, Chapter 1.5 of the Education Code of the State of California (the "Education Code") (commencing with Section 15264) and pursuant to a resolution of the Board of Education of the District adopted on February 23, 2007 (the "District Resolution") and a resolution of the County Board adopted on February 27, 2007 (the "County Resolution").

The Bonds are being issued pursuant to provisions of the State Constitution affected by Proposition 39, the Constitutional initiative passed by voters on November 7, 2000, and were therefore approved by a 55% vote of the electorate at the election conducted within the District on November 7, 2006 (the "Election"). See the caption "Proposition 39" under the heading "CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS" herein.

Financial Guaranty Insurance Policy

Concurrently with the execution and delivery of the Bonds, Financial Security Assurance Inc. (the "Insurer") will issue its Municipal Bond Insurance Policy for the Bonds (the "Insurance Policy" or "Policy") guaranteeing the scheduled payment of the principal (or, in the case of Capital Appreciation Bonds, the Maturity Value) of and interest with respect to the Bonds. See "BOND INSURANCE," and "APPENDIX E – FORM OF BOND INSURANCE POLICY" herein.

The Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law. The Insurer makes no representation regarding the Bonds or the advisability of investing in the Bonds and makes no representation regarding this Official Statement other than the information supplied by the Insurer and presented under the heading "BOND INSURANCE."

Description of the Bonds

Current Interest and Capital Appreciation Bonds. The Bonds will be issued as Series 2007 Current Interest Bonds (the "2007 Current Interest Bonds") and Series 2007 Capital Appreciation Bonds (the "2007 Capital Appreciation Bonds," and together with the 2007 Current Interest Bonds, the "Bonds"). The Current Interest Bonds mature on August 1 in the years indicated on the inside front cover page hereof. The Capital Appreciation Bonds mature on August 1 in the years indicated on the inside front cover page hereof.

The Capital Appreciation Bonds are payable only at maturity, and will not bear interest on a current basis. The maturity value of each Capital Appreciation Bond is equal to its accreted value, being comprised of its initial principal ("denominational") amount plus the compounded interest between the delivery date and its maturity date.

Registration. The Bonds will be issued in fully registered form only, registered in the name of Cede & Co. as nominee of The Depository Trust Company, New York, New York ("DTC"), and will be available to purchasers of the Bonds (the "Beneficial Owners") in the denominations set forth on the cover page hereof, under the book-entry-only system maintained by DTC, only through brokers and dealers who are or act through DTC Participants as described herein. Beneficial Owners will not be entitled to receive physical delivery of the Bonds. See "THE BONDS – Book-Entry-Only System." In event that the book-entry-only system described below is no longer used with respect to the Bonds, the Bonds will be registered in accordance with the Resolution described herein. See "THE BONDS – Transfer and Exchange."

Denominations. Individual purchases of interests in the Bonds will be available to purchasers of the Bonds in the denominations of $5,000 principal amount or $5,000 principal plus compounded interest amounts, or any integral multiple thereof.

Redemption. The Current Interest Bonds maturing on or after August 1, 2018, may be redeemed prior to maturity, at the option of the District, in whole or in part in on any date beginning on August 1, 2017. The Capital Appreciation Bonds are not subject to redemption prior to maturity. See "THE BONDS – Optional Redemption" herein.

Payments. Interest on the Current Interest Bonds accrues from the date of delivery and is payable semiannually on each August 1 and February 1, commencing August 1, 2007. Each Capital Appreciation Bond increases in value by the accumulation of earned interest from its initial principal amount on the date of delivery to its maturity value on the maturity thereof at the approximate yields per annum set forth on the cover page hereof, compounded semiannually on August 1 and February 1 of each year, commencing August 1, 2007, and is payable only at maturity as shown on the cover hereof.

Tax Matters

In the opinion of Quint & Thimmig LLP, San Francisco, California, Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "Code") and is exempt from State of California personal income taxes. In the further opinion of Bond Counsel, interest on the Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating federal corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. See "LEGAL MATTERS" and "TAX MATTERS" herein.

Bank Qualified Obligations

The District has designated the Bonds as "qualified tax-exempt obligations" within the meaning of Section 265(b)(3)(B) of the Internal Revenue Code of 1986, as amended. Pursuant to that section, a qualifying financial institution will be allowed a deduction from its own federal corporate income tax for the portion of interest expense the financial institution is able to allocate to designated "bank qualified" investments.

Professionals Involved in the Offering

With respect to the Bonds, Quint & Thimmig LLP, San Francisco, California, is the District's bond counsel (the "Bond Counsel"), Caldwell Flores Winters Inc., Emeryville, California, is the District's financial advisor (the "Financial Advisor"), and the Law Offices of Cameron A. Weist, Scotts Valley, California, is the District's disclosure counsel (the "Disclosure Counsel"). Kutak Rock LLP will serve as counsel to the Underwriter (the "Underwriter's Counsel"). U.S. Bank National Association, San Francisco, California, will act on behalf of the County as paying agent, registrar and transfer agent (the "Paying Agent"). The Financial

Advisor, Bond Counsel, Disclosure Counsel and Paying Agent will receive compensation from the District contingent upon the sale and delivery of the Bonds.

Offering and Delivery of the Bonds

The Bonds will be offered when, as and if issued by the District and received by the Underwriter, subject to approval as to their legality by Bond Counsel. It is anticipated that the Bonds, in book-entry form, will be available for delivery through DTC in New York, New York on or about March 22, 2007.

Continuing Disclosure

The District will covenant for the benefit of bondholders to make available certain financial information and operating data relating to the District and to provide notices of the occurrence of certain enumerated events, if material, in compliance with S.E.C. Rule 15c2-12(b)(5). See "CONTINUING DISCLOSURE" and Appendix C – Form of Continuing Disclosure Certificate."

Other Information

This Official Statement speaks only as of its date, and the information contained herein is subject to change. Copies of documents referred to herein and information concerning the Bonds are available from the Middletown Unified School District, 20932 Big Canyon Road, Middletown, California 95461, (707) 987-4100. The District may impose a charge for copying, mailing and handling.

This Official Statement is not to be construed as a contract with the purchasers of the Bonds. Statements contained in this Official Statement which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as representations of fact. The summaries and references to documents, statutes and constitutional provisions referred to herein do not purport to be comprehensive or definitive, and are qualified in their entireties by reference to each of such documents, statutes and constitutional provisions.

The information set forth herein, other than that provided by the District, has been obtained from official sources which are believed to be reliable but it is not guaranteed as to accuracy or completeness. The information and expressions of opinions herein are subject to change without notice and neither delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the District since the date hereof. This Official Statement is submitted in connection with the sale of the Bonds referred to herein and may not be reproduced or used, in whole or in part, for any other purpose.

THE BONDS

Authority for Issuance and Security for the Bonds

The Bonds are general obligations of the District. The Bonds are being issued by the District under the provisions of Title 1, Division 1 Part 10, Chapter 1.5 of the Education Code of the State of California (the "Education Code") (commencing with Section 15264) and pursuant to a resolution of the Board of Education of the District adopted on February 23, 2007 (the "District Resolution") and a resolution of the County Board adopted on February 27, 2007 (the "County Resolution").

The Bonds are being issued pursuant to provisions of the State Constitution affected by Proposition 39, the Constitutional initiative passed by voters on November 7, 2000, and were therefore approved by a 55% vote of the electorate at the election conducted within the District on November 7, 2006. See the caption "Proposition 39" under the heading "CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS" herein.

Payment of principal (or, in the case of Capital Appreciation Bonds, the Maturity Value) of and interest on the Bonds will be insured by the Insurance Policy to be issued by the Insurer simultaneously with the delivery of the Bonds. See "BOND INSURANCE," and "APPENDIX E – FORM OF BOND INSURANCE POLICY" herein.

Purpose of Issue

The net proceeds of the Bonds and any other series of general obligation bonds issued under the Authorization will be used for the purposes specified in the District bond proposition submitted at the Election, which include improving the quality of education, upgrading restrooms and plumbing systems, renovating facilities and electrical systems to improve student access to computers/technology, acquiring and constructing classrooms and new schools to reduce overcrowding, making health, safety, and security improvements, improving facilities and qualifying the District for certain State grants. See the caption "THE PROJECT" below.

Description of the Bonds

The Bonds will be issued in denominations of $5,000 principal amount or Maturity Value or any integral multiple thereof, and will mature on the dates and in the principal amounts or Maturity Values and bear interest at the rates per annum, all as set forth on the inside front cover page of this Official Statement. The Bonds will be issued as current interest bonds (the "Current Interest Bonds") and capital appreciation bonds (the "Capital Appreciation Bonds"). The principal of the Current Interest Bonds is payable on the maturity dates of the respective Bonds or the earlier redemption of such Bonds. Interest on the Current Interest Bonds is payable on February 1 and August 1 in each of the years, commencing August 1, 2007, and in the principal amounts, set forth on the inside cover page of this Official Statement. The Capital Appreciation Bonds are payable only at maturity or redemption and will not bear interest on a current basis. The Maturity Value of each Capital Appreciation Bond is equal to its accreted value upon the maturity thereof, being comprised of its issue amount (the "Denominational Amount") and the accreted interest between the delivery date and its respective maturity date.

The Bonds will be issued in fully registered form and, when issued, will be registered in the name of Cede & Co., as registered owner and nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Bonds. So long as Cede & Co. is the registered owner of the Bonds, as nominee of DTC, references herein to the Owners or registered owners shall mean Cede & Co. as aforesaid, and shall not mean the Beneficial Owners (as defined herein) of the Bonds.

So long as Cede & Co. is the registered owner of the Bonds, principal of and interest or premium, if any, on the Bonds are payable by wire transfer or New York Clearing House or equivalent next-day funds or by wire transfer of same day funds by The Bank of New York Trust Company N.A., as paying agent (the "Paying Agent"), to Cede & Co., as nominee for DTC. DTC is obligated, in turn, to remit such amounts to the DTC

Participants (as defined herein) for subsequent disbursement to the Beneficial Owners. Payments of principal, and premium, if any, for any Bonds shall be made only upon the surrender of such Bonds to the Paying Agent. See "APPENDIX D – Book Entry Only System" herein.

Sources and Uses of Funds

The estimated sources and uses of proceeds to be received from the sale of the Bonds are summarized below.

SOURCES AND USES OF FUNDS	
Sources of Funds	
Principal Amount of Bonds	$4,999,986.80
Plus: Net Original Issue Premium	323,047.50
Total Sources	$5,323,034.30
Uses of Funds	
Deposit to Building Fund	$4,999,986.80
Deposit to Debt Service Fund	58,157.81
Costs of Issuance(1)	264,889.69
Total Uses	$5,323,034.30

(1) Includes Underwriter's Discount and the fees and expenses of Bond Counsel, Disclosure Counsel, Financial Advisor, Paying Agent, rating agency, cost of the Policy, printing expenses and other costs related to the issuance of the Bonds.

Investment of District Funds and Bond Proceeds

The proceeds from the sale of the Bonds will be paid to the County for deposit in the Middletown Unified School District General Obligation Bonds (Election of 2006), Series 2007, General Obligation Building Fund (the "Building Fund") and will be kept separate and distinct from all other District and County funds. The proceeds will be used for the purpose for which the Bonds are issued. The accrued interest and any original issue premium received from the sale of the Bonds will be kept separate and apart in the Middletown Unified School District General Obligation Bonds (Election of 2006), Series 2007, General Obligation Debt Service Fund (the "Debt Service Fund") and used only for payments of principal and interest on the Bonds. Interest earned on the investment of monies held in the Debt Service Fund shall be retained in the Debt Service Fund and used to pay Principal and interest on the 2007 Bonds when due. Any amounts on deposit in the Debt Service Fund when there are no longer any bonds outstanding shall be transferred to the District's general fund subject to any conditions set forth in the Certificate as to Arbitrage.

It is anticipated that monies in the Building Fund and the Debt Service Fund will be invested in the Lake County Pooled Surplus Investments Fund.

Optional Redemption

The Capital Appreciation Bonds are not subject to optional redemption. The Current Interest Bonds maturing on or before August 1, 2017 are not subject to redemption prior to their fixed maturity dates. The

Current Interest Bonds maturing on and after August 1, 2018 may be redeemed before maturity, at the option of the District, from any source of available funds, on any date on or after August 1, 2017, as a whole or in part, at a price of par together with interest accrued thereon to the date of redemption.

Mandatory Redemption

The Current Interest Bonds maturing August 1, 2018, shall be subject to mandatory sinking fund redemption in part by lot on August 1 of each year from moneys in the Debt Service Fund established under the County Resolution, at a redemption price equal to the principal amount thereof, together with accrued interest to the date fixed for redemption, without premium, in the years and amounts set forth in the following schedule:

Mandatory Sinking Fund Payment Date (August 1)	Mandatory Sinking Fund Payment
2017	$145,000
2018†	150,000

† Maturity.

The Current Interest Bonds maturing August 1, 2020, shall be subject to mandatory sinking fund redemption in part by lot on August 1 of each year from moneys in the Debt Service Fund established under the County Resolution, at a redemption price equal to the principal amount thereof, together with accrued interest to the date fixed for redemption, without premium, in the years and amounts set forth in the following schedule:

Mandatory Sinking Fund Payment Date (August 1)	Mandatory Sinking Fund Payment
2019	$155,000
2020†	160,000

† Maturity.

The Current Interest Bonds maturing August 1, 2022, shall be subject to mandatory sinking fund redemption in part by lot on August 1 of each year from moneys in the Debt Service Fund established under the County Resolution, at a redemption price equal to the principal amount thereof, together with accrued interest to the date fixed for redemption, without premium, in the years and amounts set forth in the following schedule:

Mandatory Sinking Fund Payment Date (August 1)	Mandatory Sinking Fund Payment
2021	$165,000
2022†	170,000

† Maturity.

The Current Interest Bonds maturing August 1, 2027, shall be subject to mandatory sinking fund redemption in part by lot on August 1 of each year from moneys in the Debt Service Fund established under the County Resolution, at a redemption price equal to the principal amount thereof, together with accrued interest to the date fixed for redemption, without premium, in the years and amounts set forth in the following schedule:

Mandatory Sinking Fund Payment Date (August 1)	Mandatory Sinking Fund Payment
2023	$180,000
2024	185,000
2025	195,000
2026	200,000
2027†	210,000

† Maturity.

The Current Interest Bonds maturing August 1, 2031, shall be subject to mandatory sinking fund redemption in part by lot on August 1 of each year from moneys in the Debt Service Fund established under the County Resolution, at a redemption price equal to the principal amount thereof, together with accrued interest to the date fixed for redemption, without premium, in the years and amounts set forth in the following schedule:

Mandatory Sinking Fund Payment Date (August 1)	Mandatory Sinking Fund Payment
2028	$215,000
2029	225,000
2030	235,000
2031†	245,000

† Maturity.

Selection of Bonds for Redemption

Whenever provision is made for the redemption of Bonds and less than all outstanding Bonds are to be redeemed, the Paying Agent, upon written instruction from the District given at least 60 days prior to the date designated for such redemption, shall select Bonds for redemption at the direction of the District. Within a maturity, the Paying Agent shall select Bonds for redemption by lot. Redemption by lot shall be in such manner as the Paying Agent shall determine; provided, however, that the portion of any Bond to be redeemed in part shall be in the principal amount of $5,000 or any integral multiple thereof.

Notice of Redemption

When redemption is authorized or required pursuant to the County Resolution, the Paying Agent, upon written instruction from the District given at least 60 days prior to the date designated for such redemption, shall give notice (a "Redemption Notice") of the redemption of the Bonds. Such Redemption Notice shall specify: (a) the Bonds or designated portions thereof (in the case of any Bond to be redeemed in part but not in whole) which are to be redeemed, (b) the date of redemption, (c) the place or places where the redemption will be made, including the name and address of the Paying Agent, (d) the redemption price, (e) the CUSIP numbers (if any) assigned to the Bonds to be redeemed, (f) the Bond numbers of the Bonds to be redeemed in whole or in part and, in the case of any Bond to be redeemed in part only, the principal amount of such Bond to be redeemed, and (g) the original issue date, interest rate and stated maturity date of each Bond to be redeemed in whole or in part. Such Redemption Notice shall further state that on the specified date there shall become due and payable upon each Bond or portion thereof being redeemed the redemption price thereof, and that from and after such date, interest on Bonds shall cease to accrue.

The Paying Agent shall take the following actions with respect to such Redemption Notice: (i) at least 30 but not more than 45 days prior to the redemption date, such Redemption Notice shall be given to the respective Owners of Bonds designated for redemption by registered or certified mail, postage prepaid, at their addresses appearing on the Bond Register; (ii) at least two days before the date of the publication, such Redemption Notice shall be given by (1) registered or certified mail, postage prepaid, (2) telephonically confirmed facsimile transmission, or (3) overnight delivery service, to each of the Securities Depositories; and (iii) at least two days before the date of the publication, such Redemption Notice shall be given by (1) registered or certified mail, postage prepaid, or (2) overnight delivery service, to one of the Information Services.

Neither failure to receive any Redemption Notice nor any defect in any such Redemption Notice so given shall affect the sufficiency of the proceedings for the redemption of the affected Bonds. Each check issued or other transfer of funds made by the Paying Agent for the purpose of redeeming Bonds shall bear the CUSIP number identifying, by series and maturity, the Bonds being redeemed with the proceeds of such check or other transfer.

Partial Redemption of Bonds

Upon the surrender of any Bond redeemed in part only, the Paying Agent shall execute and deliver to the Owner thereof a new Bond or Bonds of like tenor and maturity and of authorized denominations equal in transfer amounts to the unredeemed portion of the Bond surrendered. Such partial redemption shall be valid upon payment of the amount required to be paid to such Owner, and the County and the District shall be released and discharged thereupon from all liability to the extent of such payment.

Effect of Notice of Redemption

Notice having been given as required in the County Resolution, and the moneys for redemption (including the interest to the applicable date of redemption) having been set aside in the District's Debt Service Fund, the Bonds to be redeemed shall become due and payable on such date of redemption.

If on such redemption date, money for the redemption of all the Bonds to be redeemed, together with interest to such redemption date, shall be held by the Paying Agent so as to be available therefor on such redemption date, and if notice of redemption thereof shall have been given, then from and after such redemption date, interest on the Bonds to be redeemed shall cease to accrue and become payable.

Transfer and Exchange

Any Bond may be exchanged for Bonds of like tenor, maturity and principal amount upon presentation and surrender at the principal office of the Paying Agent, together with a request for exchange signed by the

Owner or by a person legally empowered to do so in a form satisfactory to the Paying Agent. A Bond may be transferred on the Bond Register only upon presentation and surrender of such Bond at the principal office of the Paying Agent together with an assignment executed by the Owner or a person legally empowered to do so in a form satisfactory to the Paying Agent. Upon exchange or transfer, the Paying Agent shall complete, authenticate and deliver a new Bond or Bonds of like tenor and of any authorized denomination or denominations requested by the Owner equal to the principal amount or Accreted Value of the Bond surrendered and bearing or accreting interest at the same rate and maturing on the same date.

DEBT SERVICE SCHEDULE

The following table summarizes the debt service requirements of the District for the Capital Appreciation Bonds and for the Current Interest Bonds:

Table 1
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)
GENERAL OBLIGATION BONDS

DEBT SERVICE SCHEDULE

	Capital Appreciation Bonds		Current Interest Bonds		
Bond Year Ending August 1	Denominational Amount	Compounded Interest	Principal	Interest	Total Annual Debt Service
2007	$ --	$ --	$ --	$53,231.31	$53,231.31
2008	501,438.60	83,561.40	--	148,552.50	733,552.50
2009	470,604.15	144,395.85	--	148,552.50	763,552.50
2010	467,944.05	217,055.95	--	148,552.50	833,552.50
2011	--	--	105,000.00	148,552.50	253,552.50
2012	--	--	110,000.00	143,302.50	253,302.50
2013	--	--	120,000.00	137,802.50	257,802.50
2014	--	--	125,000.00	131,802.50	256,802.50
2015	--	--	130,000.00	125,552.50	255,552.50
2016	--	--	135,000.00	119,052.50	254,052.50
2017	--	--	145,000.00	112,302.50	257,302.50
2018	--	--	150,000.00	106,937.50	256,937.50
2019	--	--	155,000.00	101,387.50	256,387.50
2020	--	--	160,000.00	95,497.50	255,497.50
2021	--	--	165,000.00	89,417.50	254,417.50
2022	--	--	170,000.00	83,065.00	253,065.00
2023	--	--	180,000.00	76,520.00	256,520.00
2024	--	--	185,000.00	69,320.00	254,320.00
2025	--	--	195,000.00	61,920.00	256,920.00
2026	--	--	200,000.00	54,120.00	254,120.00
2027	--	--	210,000.00	46,120.00	256,120.00
2028	--	--	215,000.00	37,720.00	252,720.00
2029	--	--	225,000.00	28,905.00	253,905.00
2030	--	--	235,000.00	19,680.00	254,680.00
2031	--	--	245,000.00	10,045.00	255,045.00
Totals	$1,439,986.80	$445,013.20	$3,560,000.00	$2,297,911.31	$7,742,911.31

Defeasance

All or any portion of the outstanding maturities of the Bonds may be defeased prior to maturity in the following ways:

(a) Cash: by irrevocably depositing with an independent escrow agent selected by the District an amount of cash which together with amounts then on deposit in the Debt Service Fund is sufficient to pay all Bonds outstanding and designated for defeasance, including all Principal and interest and premium, if any; or

(b) United States Obligations: by irrevocably depositing with an independent escrow agent selected by the District noncallable United States Obligations, together with cash, if required, in such amount as will, in the opinion of an independent certified public accountant, together with interest to accrue thereon and moneys then on deposit in the Debt Service Fund together with the interest to accrue thereon, be fully sufficient to pay and discharge all Bonds outstanding and designated for defeasance (including all Principal and interest represented thereby and prepayment premiums, if any) at or before their maturity date;

then, notwithstanding that any of such Bonds shall not have been surrendered for payment, all obligations of the District with respect to all such designated outstanding Bonds will cease and terminate, except only the obligation of the Paying Agent or an independent escrow agent selected by the District to pay or cause to be paid from funds deposited pursuant to paragraphs (a) or (b) above, to the Owners of such designated Bonds not so surrendered and paid all sums due with respect thereto.

For purposes of the above provisions, "United States Obligations" shall mean:

Direct and general obligations of the United States of America, or obligations that are unconditionally guaranteed as to principal and interest by the United States of America, including (in the case of direct and general obligations of the United States of America) evidences of direct ownership of proportionate interests in future interest or principal payments of such obligations. Investments in such proportionate interests must be limited to circumstances wherein (a) a bank or trust company acts as custodian and holds the underlying United States obligations; (b) the owner of the investment is the real party in interest and has the right to proceed directly and individually against the obligor of the underlying United States obligations; and (c) the underlying United States obligations are held in a special account, segregated from the custodian's general assets, and are not available to satisfy any claim of the custodian, any person claiming through the custodian, or any person to whom the custodian may be obligated; provided that such obligations are rated or assessed "AAA" by Standard & Poor's, a division of The McGraw-Hill Companies, Inc., or "Aaa" by Moody's Investors Service.

Book-Entry Only System

The Bonds will be issued under a book-entry system, evidencing ownership of the Bonds in principal amounts or Maturity Values of $5,000 or integral multiples thereof, with no physical distribution of Bonds made to the public. DTC will act as depository for the Bonds, which will be immobilized in their custody. The Bonds will be registered in the name of Cede & Co., as nominee for DTC. For further information regarding DTC and the book entry system, see Appendix D hereto.

Continuing Disclosure Undertaking

In accordance with the requirements of Rule 15c2-12 (the "Rule") promulgated by the Securities and Exchange Commission, the District will enter into a Continuing Disclosure Certificate (the "Continuing Disclosure Certificate") in the form of Appendix C hereto, on or prior to the sale of the Bonds in which the District will undertake, for the benefit of the Beneficial Owners of the Bonds, to provide certain information as set forth therein. The District is now current on all filings required pursuant to its previous continuing disclosure undertakings, including with respect to any previous delinquencies in such filings.

SECURITY FOR THE BONDS

General

The Bonds are general obligations of the District. The Board of Supervisors of the County is empowered and obligated to annually levy *ad valorem* taxes, without limitation of rate or amount, for the payment of the principal and interest on the Bonds and all Parity Bonds as such principal and interest become due and payable, upon all property subject to taxation by the District (except certain personal property which is taxable at limited rates). Such taxes are required to be levied annually, in addition to all other taxes, during the period that the Bonds and all Parity Bonds are outstanding in an amount sufficient to pay the principal and interest on the Bonds and all Parity Bonds when due. Such taxes, when collected, will be deposited into interest and principal funds established separately for the Bonds and all Parity Bonds, which are maintained by the County and which are created by statute for the payment of principal of and interest on the Bonds and all Parity Bonds when due.

Although the County is obligated to levy an *ad valorem* tax for the payment of the Bonds and the Parity Bonds, and will maintain the interest and principal funds pledged to the repayment of the Bonds and all Parity Bonds, the Bonds are not a debt of the County.

A total of $15,300,000 principal amount of general obligation bonds were authorized at an election of the registered voters of the District held on November 7, 2006, to finance new construction and additions to and modernization of school facilities for the District. The Bonds will constitute the first series issued of the Authorized bonds, and after such issuance, $10,300,013.20 of the Authorization will remain outstanding. Payment of debt service on the Bonds is on parity with payment of debt service on Parity Bonds, as well as any additional general obligation bonds issued in the District. See "Overlapping Debt Obligations" below.

The moneys in the Debt Service Fund, to the extent necessary to pay the principal and interest on the Bonds as the same become due and payable, will be transferred by the County to the Paying Agent, which shall pay the principal and interest on the Bonds.

The amount of the annual *ad valorem* tax levied by the County to repay the Bonds and the Parity Bonds will be determined by the relationship between the assessed valuation of taxable property in the District and the amount of debt service due on the Bonds and the Parity Bonds. A reduction in the assessed valuation of taxable property in the District could result from factors beyond the District's control, such as economic recession, slower growth, or deflation of land values, a relocation out of the District by one or more major property owners, or the complete or partial destruction of such property caused by, among other eventualities, an earthquake, flood or other natural disaster. See "AD VALOREM PROPERTY TAXATION" and "TAX MATTERS" herein.

AD VALOREM PROPERTY TAXATION

The information in this section describes how ad valorem property taxes in general are assessed and levied. For specific information on the property tax base, tax levies and collections in the District, see "DISTRICT TAX BASE INFORMATION" herein.

County Services

School districts within each county use the services of that county for the assessment and collection of property taxes for district purposes. District property taxes, including the *ad valorem* property tax for payment of general obligation bonds of the District, are assessed and collected by the County at the same time and on the same rolls as county, special district and city property taxes.

Property Taxation System

Property tax revenues result from the application of the appropriate tax rate to the total assessed value of taxable property in the District. School districts levy property taxes for payment of voter-approved bonds and receive property taxes for general operating purposes as well.

Local property taxation is the responsibility of various county officers. For each school district located in a county, the County Assessor computes the value of locally assessed taxable property. Based on the assessed value of property and the scheduled debt service on outstanding bonds in each year, the County Auditor-Controller computes the rate of tax necessary to pay such debt service, and presents the tax rolls (including rates of tax for all taxing jurisdictions in the county) to the County Board of Supervisors for approval. The County Treasurer-Tax Collector prepares and mails tax bills to taxpayers and collects the taxes. In addition, the Treasurer-Tax Collector, as ex officio treasurer of each school district located in the County, holds and invests school district funds, including taxes collected for payment of school bonds, and is charged with payment of principal and interest on such bonds when due. Taxes on property in a school district whose boundaries extend into more than one county are administered separately by the county in which the property is located. The State Board of Equalization also assesses certain special classes of property, as described later in this section.

Assessed Valuation

All property is assessed using "full cash value" as defined by Article XIIIA of the California Constitution (the "Constitution"). State law exempts from taxation $7,000 of the full cash value of an owner-occupied dwelling, provided that the owner files and qualifies for such exemption. The State is required to reimburse local agencies for the value of taxes on the exempt $7,000. State law also provides exemptions from *ad valorem* property taxation for certain classes of property based on ownership or use, such as churches, colleges, non-profit hospitals and charitable institutions; the State does not reimburse local agencies for any tax not levied due to these exemptions. State and federal government property also is not taxed, nor is local government property located within the jurisdiction of that local government.

For assessment and collection purposes, property is classified as either "secured" or "unsecured" and is listed accordingly on separate parts of the assessment roll. The "secured roll" is that part of the assessment roll containing State-assessed property and other property having a tax lien on real property which is sufficient, in the opinion of the assessor, to secure payment of the taxes. Unsecured property comprises all other taxable property. Unsecured property is assessed on the "unsecured roll." Every tax levied by a county that becomes a lien on secured property has priority over all present and future private liens arising pursuant to State law on the secured property, regardless of the time of the creation of the other liens. A tax levied on unsecured property does not become a lien against the taxed unsecured property, but may become a lien on other property owned by the taxpayer. Valuation of secured property and a statutory tax lien is established as of January 1 prior to the tax year (the tax year is the July 1 -June 30 fiscal year of the State) of the related tax levy, and the secured and unsecured tax rolls are certified on or before July 1 of the tax year by the County Assessor. New property and improvements are assessed and added to a "supplemental" roll during the year acquired or when improvements are completed, and such property is taxed at the secured or unsecured rate then in effect, as appropriate, for the remaining portion of that year. The next year and thereafter such assets are assessed on the regular tax rolls.

Future growth in assessed valuation allowed under Article XIIIA is allocated on the basis of "situs" among the jurisdictions that serve the tax rate area within which the growth occurs. Local agencies and school districts will share the growth of "base" revenues from the tax rate area. Each year's growth allocation becomes part of each agency's allocation in the following year.

See "DISTRICT TAX BASE INFORMATION" herein for a history of assessed valuation and a list of the largest secured tax payers for the current tax year within the District.

State-Assessed Utility Property

The Constitution provides that the State Board of Equalization (the "SBE") rather than counties assess certain property owned or used by regulated utilities. Such property is grouped and assessed by the SBE as "going concern" operating units, which may cross local tax jurisdiction boundaries, rather than as individual parcels of real or personal property separately assessed. Such utility property is known as "unitary property." The SBE assesses property at "fair market value," determined by various methods and formulae depending on the nature of the property, except that certain railroad property is assessed at a specified percentage of the fair market value determined by the SBE, in conformity with federal law. The SBE assesses values as of January 1 prior to the tax year of the related tax levy. Property tax on SBE-assessed property is then levied and collected by each county in the same manner as county assessed property, but at special county-wide tax rates, and distributed to each taxing agency within that county, subject to certain adjustments, according to the approximate percentage allocated to each taxing agency in the prior year.

Ongoing changes in the California electric utility industry structure and in the way in which components of that industry are regulated and owned, including the sale of electric generation assets to largely unregulated, non-utility companies, may cause property that had been assessed by the SBE to be assessed locally instead. A change in property status from assessment by the SBE to assessment locally or the reverse may result in a change in property tax revenue received by local agencies and an adjustment in *ad valorem* tax rates and debt capacity for any local agency general obligation bonds.

Tax Levies, Collections and Delinquencies

Secured property tax rates are set annually by the first business day of September for the levy of property taxes in that tax year. The levy is payable in two equal installments due November 1 and February 1, and payments become delinquent if not postmarked or paid by end of the business day on December 10 and April 10, respectively. Taxes on unsecured property (personal property and leasehold interests) are levied at the preceding fiscal year's secured tax rate and have a due date set by each county effectively no earlier than July 1 and no later than July 31 of each year. Taxes on unsecured property become delinquent if not postmarked or paid by the end of the business day on August 31, or if added to the unsecured roll after July 31, become delinquent at the end of the month succeeding the month of enrollment.

A 10% penalty attaches to any delinquent payment for secured roll taxes. In addition, property on the secured roll for which taxes are delinquent becomes tax-defaulted. Such property may thereafter be redeemed by payment of the delinquent taxes and the delinquency penalty, plus a redemption penalty of 1.5% per month to the time of redemption. If taxes are unpaid for a period of five years or more, the property is subject to sale at auction by the County Tax Collector.

A 10% penalty attaches to delinquent taxes on property on the unsecured roll, and after the last day of the second month after the 10% penalty attaches, an additional penalty of 1.5% per month begins to accrue and a lien is recorded against the assessee. The taxing authority may collect delinquent unsecured personal property taxes by: (a) a civil action against the taxpayer; (b) filing a certificate of delinquency in the office of the County Clerk specifying certain facts in order to obtain a judgment lien on specific property of the taxpayer; and (c) seizure and sale of personal property, improvements or possessory interests belonging or assessed to the assessee.

Supplemental roll taxes are due on the date the bill is mailed. If the tax bill is mailed within the months of July through October, the first installment shall become delinquent at 5 p.m., or the end of the business day, whichever is later, on December 10 of the same year and the second installment shall become delinquent at 5 p.m., or the end of the business day, whichever is later, on April 10 of the next year; if the bill is mailed within the months of November through June, the first installment shall become delinquent at 5 p.m., or the end of the business day, whichever is later, on the last day of the month following the month in which the bill is mailed and the second installment shall become delinquent at 5 p.m., or the end of the business day, whichever is later, on the last day of the fourth calendar month following the date the first installment is delinquent. A 10% penalty attaches to any delinquent payment for supplemental roll taxes.

All tax due dates and delinquency dates become the next business day if they fall on a day that is not a business day.

Teeter Plan

Under the Alternative Method of Distribution of Tax Levies and Collections and of Tax Sale Proceeds (the "Teeter Plan"), as provided for in Section 4701 *et seq.* of the State Revenue and Taxation Code, each participating local agency levying secured property taxes, including school districts, receives from its county the amount of uncollected taxes credited to its fund, in the same manner as if the amount credited had been collected. In return, the county receives and retains delinquent payments, penalties and interest as collected, which would have been due the local agency. The Teeter Plan, once adopted by a county, remains in effect unless the county board of supervisors orders its discontinuance or unless, prior to the commencement of any fiscal year, the board of supervisors receives a petition for its discontinuance from two-thirds of the participating revenue districts in the county. A board of supervisors may, after holding a public hearing on the matter, discontinue the procedures under the Teeter Plan with respect to any tax levying agency in the county when delinquencies for taxes levied by that agency exceed 3%.

The Teeter Plan applies to the 1% general purpose property tax levy. Whether or not the Teeter Plan also is applied to other tax levies for local agencies, such as the tax levy for general obligation bonds of a local agency, varies by county. The County does apply the Teeter Plan to secured tax levy collections for the bonds. See "DISTRICT TAX BASE INFORMATION – Secured Tax Charges and Delinquencies" herein for a history of property tax collections and delinquencies in the District.

BOND INSURANCE

The Insurer has supplied the following information for inclusion in this Official Statement. No representation is made by the District or the Underwriter as to the accuracy or completeness of this information. Reference is made to Appendix E for a specimen of the Insurer's Policy.

The Insurer is a New York domiciled financial guaranty insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. ("Holdings"). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation, and of Dexia Credit Local, a direct wholly-owned subsidiary of Dexia, S.A. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance, banking and asset management in France, Belgium and other European countries. No shareholder of Holdings or the Insurer is liable for the obligations of the Insurer.

At September 30, 2006, the Insurer's combined policyholders' surplus and contingency reserves were approximately $2,581,107,000 and its total net unearned premium reserve was approximately $1,992,163,000 in accordance with statutory accounting principles. At September 30, 2006, the Insurer's consolidated shareholder's equity was approximately $3,058,987,000 and its total net unearned premium reserve was approximately $1,590,538,000 in accordance with generally accepted accounting principles.

The consolidated financial statements of the Insurer included in, or as exhibits to, the annual and quarterly reports filed after December 31, 2005 by Holdings with the Securities and Exchange Commission are hereby incorporated by reference into this Official Statement. All financial statements of the Insurer included in, or as exhibits to, documents filed by Holdings pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 after the date of this Official Statement and before the termination of the offering of the Bonds shall be deemed incorporated by reference into this Official Statement. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

The Insurance Policy does not protect investors against changes in market value of the Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. The Insurer makes no representation regarding the Bonds or the advisability of investing in the Bonds. The Insurer makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that the Insurer has provided to the District the information presented under this caption for inclusion in the Official Statement.

THE PROJECT

The "Strict Accountability in Local School Construction Bonds Act of 2000," comprising Section 15264 *et seq.* of the Education Code, controls the method by which the District will expend Bond proceeds on its capital improvements. Prior to the Election, the District prepared and submitted to the Board for approval a master list of capital improvement projects to be built, acquired, constructed or installed with the proceeds of the Bonds. The following description includes all elements of the Project List; however, for each series of the Bonds, the District will prioritize among these elements and will not undertake to complete all components of the Project List.

The Project to be constructed, improved, installed or otherwise implemented for the District from the proceeds of the Bonds and the other bonds issued under the Authorization includes certain of the following elements, which were approved by the Board of the District for financing with such proceeds:

High Priority Projects. The District has identified the single most important project as being the construction of a new elementary school, and the current plan is that this would be a new Cannon Elementary School located on a 10-acre site within the Vintage Faire development. Relocating Cannon Elementary School to a new site would not only allow for more elementary classrooms, but would also allow for additional capacity to be available at Middletown Middle School which currently shares a site with Cannon Elementary School. This would occur by converting the existing Cannon Elementary School classrooms and principal's area into classrooms for middle school use. It is estimated that the cost of a new Cannon Elementary School would be approximately $11.57 million (in 2008 dollars), including site development, construction of support facilities and 14 classrooms, and furniture and equipment. The cost of the related conversion projects for Middletown Middle School would be approximately $329,000 (in 2008 dollars).

Other high priority projects include technology/hardware upgrades at all of the regular education schools (except Cannon Elementary School), site improvements (e.g. improved site lighting) and a 64' x 40' addition with a basketball court (and other improvements) to the multi-purpose building at Coyote Valley Elementary School, improvements to the administration/library and multi-purpose buildings at Cobb Elementary School, repairs to six relocatable classrooms at Cobb Elementary School, a new HVAC system for Middletown Middle School's gymnasium, stadium improvements at Middletown High School (including a new all weather track and new bleachers, press box, toilet rooms and snack bar), and remodeling the cafeteria/food service, gymnasium, and administration/classroom buildings at Middletown High School.

The total estimated cost of the high priority projects, in 2008 dollars, is approximately $20.84 million.

Medium Priority Projects. Medium priority projects include various site improvements at Cobb Elementary School, Coyote Valley Elementary School and Middletown High School and a new six-classroom building at Coyote Valley Elementary School.

The total estimated cost of the medium priority projects, in 2008 dollars, is approximately $3.59 million.

Low Priority Projects. Low priority projects include various site improvements at Cobb Elementary School and Coyote Valley Elementary School, replacing eight existing relocatables at Coyote Valley Elementary School, improvements to the gymnasium at Middletown Middle School, installing a synthetic turf field at Middletown High School, and constructing a performing arts center at Middletown High School.

The total estimated cost of the low priority projects, in 2008 dollars, is approximately $9.42 million.

MIDDLETOWN UNIFIED SCHOOL DISTRICT

District Organization

The Middletown Unified School District, a K-12 school district with approximately 1750 students, was established in 1882, and is located in the north eastern Napa Valley in Lake County, approximately 110 miles north of San Francisco. The District provides kindergarten through twelfth grade education services in 3 elementary schools, 1 middle school, 1 high school and 1 alternative school. The District's projected average daily attendance for fiscal year 2006-07 is 1,670 and the District has a 2006-07 assessed valuation of $1,361,163,330.

Board of Education

The District is governed by a Board of Education (the "Board"). The Board consists of 5 members who are elected at-large to overlapping four-year terms at elections held in staggered years. If a vacancy arises during any term, the vacancy is filled by either an appointment by the majority vote of the remaining Board Members or by a special election. The years in which the current terms for each member of the Board expire are set forth below:

Name	Office	Term Expires November
Bill Wright	President	2008
Jay Albertson	Member	2010
Kim Bladel	Member	2008
Jim Comstock	Member	2010
Yvette Sloan	Member	2010

Key Personnel

The Superintendent of the District is responsible for administering the affairs of the District in accordance with the policies of the Board and for the supervision of the District's other key personnel. The biography of the District's Superintendent is as follows:

Dr. Korby Olson, Superintendent. Dr. Olson is in his first year as Superintendent of the District. Prior to becoming Superintendent, he served as a teacher, Principal and Director of Special Education, all in the Middletown Unified School District. In total, he has spent 20 years in the District and 25 years in Education. Dr. Olson is an active member of the Association of California School Administrators serving on the Board of

Directors for three years. Dr. Olson received his Doctorate in Educational Leadership for the University of Southern California, his Masters Degree from Sacramento State and his Bachelor's Degree from CSU, Chico.

District Employees

The District employs approximately 104 full-time and part-time certificated academic professionals as well as 95 full-time classified employees.

The certificated employees of the District have assigned the California Teachers Association ("CTA") as their exclusive bargaining agent. The certificated employees' contract with CTA expires on June 30, 2007. The current contract is currently under negotiation.

The classified employees have assigned California School Employees Association ("CSEA") as their exclusive bargaining agent and the contract with CSEA expires on June 30, 2007. The current contract is currently under negotiation.

Beginning teacher salaries start at approximately $36,400, with a top salary of approximately $59,000, and the average being approximately $50,500.

The table below shows the number of certificated and classified employees in the District during the past five years, and projected for the current year.

Table 2
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)
GENERAL OBLIGATION BONDS

CERTIFICATED AND CLASSIFIED EMPLOYEES

Fiscal Year	Certificated	Classified
2001-02	83	97
2002-03	94	92
2003-04	96	94
2004-05	99	100
2005-06	97	92
2006-07[1]	104	95

[1] Projected.
Source: The District

District Revenues

Under California Education Code Section 42238 and following, each school district is determined to have a target funding level: a "base revenue limit" per student multiplied by the district's student enrollment measured in units of average daily attendance ("ADA"). The base revenue limit is calculated from the district's prior-year funding level, as adjusted for a number of factors, such as inflation, special or increased instructional needs and costs, employee retirement costs, especially low enrollment, increased pupil transportation costs, etc.

Generally, the amount of State funding allocated to each school district is the amount needed to reach that district's base revenue limit after taking into account certain other revenues, in particular, locally generated property taxes. This is referred to as State "equalization aid." To the extent local tax revenues increase due to growth in local property assessed valuation, the additional revenue is offset by a decline in the State's contribution. Enrollment can fluctuate due to factors such as population growth, competition from private, parochial, and public charter schools, inter-district transfers in or out, and other causes. Losses in enrollment will cause a school district to lose operating revenues, without necessarily permitting the district to make adjustments in fixed operating costs.

The principal component of local revenues is a school district's property tax revenues, i.e., each district's share of the local 1% property tax, received pursuant to Sections 75 and following and Sections 95 and following of the California Revenue and Taxation Code. The California Education Code Section 42238(h) itemizes the local revenues that are counted towards the base revenue limit before calculating how much the State must provide in equalization aid. The more local property taxes a district receives, the less State equalization aid it is entitled to; ultimately, a school district whose local property tax revenues exceed its base revenue limit is entitled to receive no State equalization aid, and receives only its special categorical aid, which is deemed to include the "basic aid" of $120 per student per year guaranteed by Article IX, Section 6 of the Constitution. Such districts are known colloquially as "basic aid districts." Districts that receive some equalization aid are commonly referred to as "revenue limit districts." The District is not a Basic Aid District.

The District has experienced slight population and student enrollment growth in the past several years. The table below sets forth the enrollment for Average Daily Attendance ("ADA") for the District for the Fiscal Years ending 2002 through 2006 and a projection for the Fiscal Year ending 2007.

Table 3
MIDDLETOWN UNIFIED SCHOOL DISTRICT
GENERAL OBLIGATION BONDS

ENROLLMENT AND AVERAGE DAILY ATTENDANCE

Fiscal Year	Enrollment	ADA	Base Revenue Limit
2001-02	1,768	1,637	$4,266,229
2002-03	1,776	1,646	4,524,908
2003-04	1,848	1,712	4,349,389
2004-05	1,834	1,708	5,125,299
2005-06	1,754	1,680	5,317,258
2006-07[1]	1,717	1,670	6,068,490

[1] Projected.
Source: The District.

The District's statutory base revenue limit per ADA under the State revenue limit formula was $3,165.04 for fiscal year 2005-06, and is projected to be $3,633.83 per ADA for fiscal year 2006-07. See "GENERAL SCHOOL DISTRICT FINANCIAL INFORMATION – State Funding of School Districts" herein.

Financial Statements of the District

The General Fund of the District, as shown herein, is a combined fund comprised of moneys which are unrestricted and available to finance the legally authorized activities of the District not financed by restricted funds and moneys which are restricted to specific types of programs or purposes. General Fund revenues shown thereon are derived from such sources as taxes, aid from other government agencies, charges for current services and other revenue.

The District's financial statements are prepared on a modified accrual basis of accounting in accordance with generally accepted accounting principles as set forth by the Governmental Accounting Standards Board. The financial statements included herein were prepared by the District and audited by Goodell, Porter & Fredericks, LLP, Certified Public Accountants, Sacramento, California.

The District has not requested its auditor to provide any review or update of such financial statements in connection with their inclusion in this Official Statement. Certain information from the District's financial statements follows. The District's audited financial statements for the 2005-06 fiscal year are attached hereto as APPENDIX B.

General Fund

The following table describes the District's audited financial results for the fiscal years 2003-04, 2004-05 and 2005-06.

Table 4
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)
GENERAL OBLIGATION BONDS

GENERAL FUND REVENUE, EXPENDITURES AND FUND BALANCES

	Audited 2003-04	Audited 2004-05	Audited 2005-06
REVENUES			
Revenue Limit Sources:			
State Apportionments	$4,445,203	$5,289,182	$5,442,679
Local Sources	4,017,474	3,682,211	4,044,443
Total Revenue Limit	8,462,677	8,971,393	9,487,122
Federal Revenues	555,895	572,986	735,264
Other State Revenues	1,244,408	1,594,781	1,499,474
Other Local Revenues	866,674	827,540	933,936
Total Revenues	$11,129,654	$11,966,700	$12,655,796
EXPENDITURES			
Certificated Salaries	5,571,027	5,909,383	6,121,703
Classified Salaries	1,810,706	1,880,173	1,946,881
Employee Benefits	2,284,267	2,452,650	2,672,524
Books and Supplies	693,623	642,770	731,468
Services & Other Operating Expenditures	814,168	897,880	897,636
Other Outgo	8,609	--	39,189
Debt Service:			
Principal Retirement	25,687	4,063	--
Interest and Fiscal Charges	30,553	--	--
Capital Outlay	94,075	65,551	151,186
Total Expenditures	11,332,715	11,852,470	12,560,587
Excess (Deficiency) of Revenues Over (under) Expenditures	(203,061)	114,230	95,209
OTHER FINANCING SOURCES (USES):			
Other Sources	25,326	24,552	
Operating Transfers In	52,158	168,507	149,470
Operating Transfers Out	(107,434)	(87,314)	(175,621)
Total Other Financing Sources (Uses)	(29,950)	105,745	(26,151)
Excess of Revenues and Other Financing Sources Over (Under) Expenditures and Other Uses	(233,011)	219,975	69,058
Fund Balances at Beginning of Year	**$980,132**	**$747,121**	**$967,096**
Fund Balances at End of Year	**$747,121**	**$967,096**	**$1,036,154**

Source: The District.

Budget Process

The District is required by provisions of the State Education Code to maintain a balanced budget each year, in which the sum of expenditures and the ending fund balance cannot exceed the sum of revenues and the carry-over fund balance from the previous year. The State Department of Education imposes a uniform budgeting and accounting format for school districts. The budget process for school districts was substantially amended by Assembly Bill 1200 ("AB 1200"), which became State law on October 14, 1991. Portions of AB 1200 are summarized below.

School districts must adopt a budget on or before July 1 of each year. The budget must be submitted to the county superintendent within five days of adoption or by July 1, whichever occurs first. A district may be on either a dual or single budget cycle. The dual budget option requires a revised and readopted budget by September 1 that is subject to State-mandated standards and criteria. The revised budget must reflect changes in projected income and expenses subsequent to July 1. The single budget is only readopted if it is disapproved by the county office of education, or as needed. The District is on a single budget cycle and adopts its budget on or before July 1.

For both dual and single budgets submitted on July 1, the county superintendent will examine the adopted budget for compliance with the standards and criteria adopted by the State Board of Education and identify technical corrections necessary to bring the budget into compliance, will determine if the budget allows the district to meet its current obligations and will determine if the budget is consistent with a financial plan that will enable the district to meet its multi-year financial commitments. On or before August 15, the county superintendent will approve or disapprove the adopted budget for each school district. Budgets will be disapproved if they fail the above standards. The district board must be notified by August 15 of the county superintendent's recommendations for revision and reasons for the recommendations. The county superintendent may assign a fiscal advisor or appoint a committee to examine and comment on the superintendent's recommendations. The committee must report its findings no later than August 20. Any recommendations made by the county superintendent must be made available by the district for public inspection. The law does not provide for conditional approvals; budgets must be either approved or disapproved. No later than August 20, the county superintendent must notify the Superintendent of Public Instruction of all school districts whose budget has been disapproved. For all dual budget options and for single and dual budget option districts whose budgets have been disapproved, the district must revise and readopt its budget by September 8, reflecting changes in projected income and expense since July 1, including responding to the county superintendent's recommendations. The county superintendent must determine if the budget conforms with the standards and criteria applicable to final district budgets and not later than October 8, will approve or disapprove the revised budgets. If the budget is disapproved, the county superintendent will call for the formation of a budget review committee pursuant to Education Code Section 42127.1. Until a district's budget is approved, the district will operate on the lesser of its proposed budget for the current fiscal year or the last budget adopted and reviewed for the prior fiscal year.

The District has never had an adopted budget disapproved by the county superintendent of schools, and has never received a "negative" certification of an Interim Financial Report pursuant to AB 1200.

The following table shows figures taken from the 2006/07 First Interim Report figures for fiscal years 2006-07 and 2007-08.

Table 5
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)
GENERAL OBLIGATION BONDS

GENERAL FUND REVENUE, EXPENDITURES AND FUND BALANCES
(Budgeted For Fiscal Years 2006-07 and 2007-08)

	Budget 2006-07	Budget 2007-08
REVENUES		
Revenue Limit Sources	$9,488,952	$10,019,989
Federal Revenues	12,158	12,729
Other State Revenues	817,491	855,913
Other Local Revenues	182,495	191,072
Other Financing Sources	(952,651)	(981,231)
Total Revenues	$9,548,445	$10,098,472
EXPENDITURES		
Certificated Salaries	5,195,027	5,350,878
Classified Salaries	1,218,010	1,254,549
Employee Benefits	2,192,400	2,258,172
Books and Supplies	202,471	208,545
Services & Other Operating Expenditures	727,931	764,328
Capital Outlay	35,151	36,909
Other Outgo	177,661	181,214
Direct Support/Indirect Costs	(235,940)	(232,967)
Other Financing Uses	98,295	99,524
Total Expenditures	9,611,006	9,921,152
NET CHANGE IN FUND BALANCE	**(62,561)**	**177,320**
Fund Balance, July 1 (as adjusted)	**$754,736**	**$692,176**
Fund Balance, June 30	**$692,175**	**$869,496**

Source: The District.

Retirement System

The District participates in the State of California Teachers Retirement System ("STRS") which provides retirement benefits to certificated personnel. The District contributed $470,550 to STRS in fiscal year 2004-05, $494,263 for fiscal year 2005-06 and estimates a contribution of $518,901 for fiscal year 2006-07. The District also participates in the State of California Public Employees' Retirement System ("PERS") which provides retirement benefits to classified personnel. The District contributed $189,696 to PERS in fiscal year 2004-05, $171,948 for fiscal year 2005-06 and estimates a contribution of $190,700 for fiscal year 2006-07.

Both CalPERS and STRS are operated on a statewide basis and, based on available information, STRS and CalPERS both have unfunded liabilities. CalPERS may issue certain pension obligation bonds to reach funded status. (Additional funding of STRS by the State and the inclusion of adjustments to such State contributions based on consumer price changes were provided for in 1979 Statutes, Chapter 282.) The amounts of the pension/award benefit obligation (CalPERS) or actuarially accrued liability (STRS) will vary from time to time depending upon actuarial assumptions, rates of return on investments, salary scales, and levels of contribution. The District is unable to predict what the amount of unfunded liabilities will be in the future or the amount of the contributions which the District may be required to make.

Insurance

The District is a member of Self-Insured Schools of California ("SISC"), a joint powers authority, that provides property and liability insurance to its members. In addition to SISC, the District maintains insurance or self-insurance in such amounts and with such retentions and other terms providing coverages for property damage, fire and theft, general public liability and worker's compensation as are adequate, customary and comparable with such insurance maintained by similarly situated elementary school districts. In addition, based upon prior claims experience, the District believes that the recorded liabilities for self-insured claims are adequate.

Capital Leases

The District leases relocatable buildings, a computer-based learning lab and various computers under various agreements. Future minimum lease payments are as follows under capital leases:

Year Ended June 30	Lease Payments
2007	$173,660
2008	92,953
2009	107,864
Total	374,477
Lease Amount Representing Interest	31,869
Present Value of Net Minimum Lease Payments	$342,608

Certain Existing Obligations

In addition to the District's Capital Leases, as discussed above, on October 4, 2001, the District obtained a loan of $131,559 from the State of California, California Energy Commission, evidenced by a promissory note, the balance which is $81,447 as of July 1, 2006.

A schedule of the District's changes in long-term debt for the year ended June 30, 2006 is shown below:

SCHEDULE OF CHANGES IN GENERAL LONG-TERM DEBT

	Balance July 1, 2005	Additions	Deductions	Balance June 30, 2006	Due Within One Year
Early Retirement Incentives	$ 445,774	$ --	$ 63,682	$ 382,092	$ 63,682
Capital Lease Obligations	497,409	--	154,801	342,608	155,872
Other Long-Term Debt	91,759	--	10,312	81,447	10,623
Compensated Absences	37,937	20,004	--	57,941	57,941
Totals	$1,072,879	$20,004	$228,795	$864,088	$288,118

District Investments

The Lake County Treasurer-Tax Collector (the "Treasurer") manages, in accordance with California Government Code Section 53600 *et seq.*, funds deposited with the Treasurer by school and community college districts located in the County, various special districts, and some cities within the State of California. State law generally requires that all moneys of the County, school and community college districts and certain special districts located in the County be held in the County's Treasury Pool. All money held in any of the funds or accounts established pursuant to the Resolution shall be held in the Treasury Pool and disbursed in accordance with the Resolution.

The composition and value of investments under management in the Treasury Pool vary from time to time depending on cash flow needs of the County and public agencies invested in the pool, maturity or sale of investments, purchase of new securities, and due to fluctuations in interest rates generally. For a further discussion of the Pooled Investment Fund, see the caption "THE LAKE COUNTY TREASURY POOL" herein.

DISTRICT TAX BASE INFORMATION

This section presents certain information concerning the property tax base in the District. For general information on how ad valorem property is assessed, and how taxes are levied and collected, see "AD VALOREM PROPERTY TAXATION" herein.

Assessed Valuations

The assessed valuation of property in the District is established by the County Assessor, except for public utility property which is assessed by the State Board of Equalization. Assessed valuations are reported at 100% of the full value of the property, as defined in Article XIII A of the California Constitution. See "CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS" herein.

The State-reimbursed exemption currently provides a credit of $7,000 of the full value of an owner-occupied dwelling for which application has been made to the County Assessor. The revenue estimated to be lost to local taxing agencies due to the exemption is reimbursed from State sources. Reimbursement is based upon total taxes due upon such exempt value and is not reduced by any amount for estimated or actual delinquencies.

In addition, certain classes of property such as churches, colleges, not-for-profit hospitals and charitable institutions are exempt from property taxation and do not appear on the tax rolls. No reimbursement is made by the State for such exemptions.

Table 6
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)
GENERAL OBLIGATION BONDS

ASSESSED VALUATIONS

Fiscal Year	Local Secured and Utility	Utility	Unsecured	Total
2002-03	$831,190,538	$774,016	$24,466,455	$856,431,009
2003-04	915,248,403	774,016	25,389,342	941,411,761
2004-05	1,007,873,850	774,016	25,529,836	1,034,177,702
2005-06	1,148,036,715	774,016	29,779,955	1,178,590,686
2006-07	1,331,827,691	774,016	28,561,623	1,361,163,330

Source: California Municipal Statistics, Inc.

Table 7
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)
GENERAL OBLIGATION BONDS

ASSESSED VALUATION AND PARCELS BY LAND USE

	2006-07 Assessed Valuation [(1)]	% of Total	No. of Parcels	% of Total
Non-Residential:				
Agricultural	54,986,611	4.13%	372	4.98%
Commercial	40,902,366	3.07	135	1.81
Vacant Commercial	4,193,799	0.30	35	0.47
Industrial	1,124,679	0.08	4	0.05
Power Generation	182,494,550	13.70	90	1.20
Government/Social/Institutional	10,045,545	0.75	46	0.62
Subtotal Non-Residential	$293,747,550	22.06%	682	9.12%
Residential:				
Single Family Residence	897,815,037	67.41%	3,993	53.42%
Mobile Home	36,541,545	2.74	263	3.52
Mobile Home Park	462,209	0.03	1	0.01
2+ Residential Units/Apartments	37,354,199	2.80	141	1.89
Residential Improvements	5,242,488	0.39	59	0.79
Vacant Residential	60,562,774	4.55	2,247	30.06
Subtotal Residential	$1,037,978,252	77.94%	6,704	89.69%
Unknown Use	$101,889	0.01%	89	1.19%
Total	$1,331,827,691	100.00%	7,475	100.00%

(1) Local Secured Assessed Valuation; excluding tax-exempt property.
Source: California Municipal Statistics, Inc.

Table 8
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)
GENERAL OBLIGATION BONDS

2006-07 LARGEST LOCAL SECURED TAXPAYERS

	Property Owner	Land Use	2006-07 Assessed Valuation	% of Total[1]
1.	Calpine Corporation/Geysers Power	Power Generation	$182,494,550	13.70%
2.	Guenoc Winery Inc.	Agriculture	10,338,939	0.78
3.	Michael J. Browning, Trustee	Agriculture	7,373,567	0.55
4.	GR Hardester LLC	Commercial	5,311,472	0.40
5.	Farrar Investments Inc.	Apartments	5,100,000	0.38
6.	James Kurt Steil	Agriculture	3,350,000	0.25
7.	David R. Johnson, Trustee	Agriculture	3,340,725	0.25
8.	Lily's Reach LLC	Agriculture	2,903,517	0.22
9.	Great Spring Waters of America Inc.	Commercial	2,447,393	0.18
10.	Middletown Waters LLC	Residential	2,346,000	0.18
11.	Glen and Amy J. Marks	Commercial	2,289,607	0.17
12.	Sutter Home Winery	Agricultural	2,261,977	0.17
13.	Norman Alumbaugh Co. Inc.	Commercial	2,261,688	0.17
14.	Langtry Estate and Vineyards LLC	Agricultural	2,116,000	0.16
15.	Pat and Christine Taylor	Agricultural	1,792,157	0.13
16.	Jack and Karen Lair	Commercial	1,779,900	0.13
17.	Middletown Investment Group	Apartments	1,735,000	0.13
18.	Daniel B. and Malinda Beck, Trustee	Apartments	1,687,776	0.13
19.	Arthur B. Fichtenberg, Trustee	Commercial	1,681,524	0.13
20.	William F. and Mary A. Bottoms, Trustee	Agricultural	1,594,676	0.12
	Totals		$244,206,468	18.34%

(1) 2006-07 Local Secured Assessed Valuation: $1,331,827,691.
Source: California Municipal Statistics, Inc.

Direct and Overlapping Debt

Numerous local agencies which provide public services overlap the District's service area. These local agencies have outstanding debt in the form of general obligation, lease revenue and special assessment bonds. The following table shows the District's estimated direct and overlapping bonded debt. The statement excludes self-supporting revenue bonds, tax allocation bonds and non-bonded capital lease obligations. The District has not reviewed this table and there can be no assurance as to the accuracy of the information contained in the table; inquiries concerning the scope and methodology of procedures carried out to compile the information presented should be directed to California Municipal Statistics, Inc. The following table is a statement of the District's direct and estimated overlapping bonded debt as of December 31, 2006:

Table 9
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)
GENERAL OBLIGATION BONDS

DIRECT AND OVERLAPPING BONDED INDEBTEDNESS

2006-07 Assessed Valuation: $1,361,163,330

DIRECT AND OVERLAPPING TAX AND ASSESSMENT DEBT:	% Applicable (1)	Debt 12/31/06	
Middletown Unified School District	**100. %**	**$ -**	(2)
Callayomi Water District	100.	60,000	
County and Special District 1915 Act Bonds	100.	2,080,000	
TOTAL DIRECT AND OVERLAPPING TAX AND ASSESSMENT DEBT		$2,140,000	
OVERLAPPING GENERAL FUND DEBT:			
Yuba Joint Community College District Certificates of Participation	5.911	$171,419	
TOTAL OVERLAPPING GENERAL FUND EBT		$171,419	
COMBINED TOTAL DEBT		$2,311,419	(3)

(1) Based on 2005-06 ratios.
(2) Excludes general obligation bonds to be sold.
(3) Excludes tax and revenue anticipation notes, enterprise revenue, mortgage revenue and tax allocation bonds and non-bonded capital lease obligations.

Ratios to 2006-07 Assessed Valuation:
Direct Debt .... **- %**
Total Direct and Overlapping Tax and Assessment Debt............ 0.16%
Combined Total Debt 0.17%

STATE SCHOOL BUILDING AID REPAYABLE AS OF 6/30/06: $0

Source: California Municipal Statistics, Inc.

ECONOMIC PROFILE OF THE DISTRICT

While the economics of the County and surrounding region influence the economics within the District, only property within the District is subject to an unlimited ad valorem tax levy to pay debt service on the Bonds.

Introduction

The District is located in the unincorporated town of Middletown in Lake County, California.

Lake County was formed in 1861 from parts of Napa and Mendocino counties. Lake County has long been known as a farming community. Vineyards were planted in the 1870s; by the early 1900's the area was earning a reputation for producing some of the world's greatest wines. However, in 1920 Prohibition forced an end to Lake County wine production. Most of the crops were ripped out and replanted with other crops such as walnut and pear farms. Re-emergence of the wine industry began in the 1960's when a few growers rediscovered the area's grape growing potential and began planting vineyards. The area went from less than 100 acres in 1965 to over 8,800 acres of vineyards and the establishment of several American Viticultural Appellations such as High Valley. Many of the vineyards in Lake County today support sustainable farming practices.

Lake County's economy is based largely on tourism and recreation, due to the accessibility and popularity of its many recreational areas, including Clear Lake, the largest natural freshwater lake in California. Lake County is home to numerous other lakes, such as Blue Lake, Lake Pillsbury, and the Indian Valley Reservoir. In 2006, California's Department of Finance estimated Lake's population at more than 64,000 persons. By the year 2020, the county is projected to be home to almost 80,000 residents. Surrounding counties include Mendocino County to the west; Sonoma and Napa counties to the south; and Yolo, Colusa, and Glenn counties to the east.

POPULATION

The following table summarizes actual and projected population figures for the County.

Table 10
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)

COUNTYWIDE RATE AND HISTORICAL RATE COMBINATION

	Growth Rate	Actual 2000	Projection 2005	Projection 2010	Projection 2015	Projection 2020
Total County	*1.50%*	*58,309*	*62,815*	*67,670*	*72,900*	*78,534*
Clearlake	1.08%	13,142	13,867	14,632	15,440	16,292
Clearlake Oaks	0.50%	2,402	2,463	2,525	2,589	2,654
Cobb	1.04%	1,638	1,725	1,817	1,913	2,015
Coyote Valley	multiple	3,777	7,677	11,228	12,096	13,031
Kelseyville	1.24%	2,928	3,114	3,312	3,523	3,746
Lakeport	0.94%	4,820	5,051	5,293	5,546	5,812
Lower Lake	1.50%	1,755	1,891	2,037	2,194	2,364
Lucerne	1.50%	2,870	3,092	3,331	3,588	3,865
Middletown	multiple	1,020	1,541	1,700	1,831	1,973
Nice	1.67%	2,509	2,726	2,961	3,217	3,494
Upper Lake	1.45%	989	1,063	1,142	1,227	1,319
Rural Unincorporated		20,459	18,605	17,692	19,736	21,969

Source: The County.

Employment

The following table summarizes Labor Force Data (employment and unemployment) for Sub-County Areas in the County of Lake.

Table 11
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)

LABOR FORCE DATA FOR SUB-COUNTY AREAS

Area Name	Labor Force	Employed	Unemployment Number	Unemployment Rate	Census Ratios Employed	Census Ratios Unemployed
Lake County	26,100	24,300	1,800	6.8%	1.000000	1.000000
Clearlake City	4,400	4,000	400	9.8%	0.165781	0.246233
Clearlake Oaks	700	600	100	10.6%	0.025313	0.040841
Cobb	1,000	900	100	5.5%	0.037897	0.030135
Hidden Valley Lake	1,700	1,600	100	5.4%	0.067844	0.052736
Kelseyville	1,500	1,400	100	6.7%	0.057455	0.055908
Lakeport City	2,300	2,200	100	6.1%	0.091840	0.081285
Lower Lake	700	700	0	5.3%	0.030678	0.023394
Lucerne	1,100	1,000	100	7.2%	0.042969	0.045202
Middletown	*500*	*500*	*0*	*8.6%*	*0.021753*	*0.027756*
Nice	1,000	900	100	10.0%	0.036385	0.055115
North Lakeport	1,400	1,300	100	5.9%	0.055602	0.047581
Upper Lake	400	400	0	2.6%	0.017656	0.006344

Source: California Employment Development Department, Labor Market Information Division.

INDUSTRY EMPLOYMENT

According to the California Employment Development Department, during the period from 2001–2005, Lake County industry employment saw an overall increase of 210 jobs, or 1.5 percent. Job gains concentrated in three industries: educational and health services; trade, transportation, and utilities; and government. Educational and health services recorded a growth rate of close to 16 percent during this period, gaining 290 jobs. In trade, transportation, and utilities, growth concentrated in the transportation, warehousing, and utilities component with 170 of the industry's 240 added jobs. Within government, local government gained 250 jobs. Over these years, gains in the profiled industries combined with growth in leisure and hospitality; information; natural resources, mining, and construction; and financial activities helped to offset losses in professional and business services; manufacturing; other services; and agriculture.

The County is home to nine basic types of businesses and industries generating over 14,000 jobs. Government is the largest industry, and employs around 3,700 workers. Service is the second largest sector, with 3,680 jobs, followed closely by retail with 2,870 jobs, and agriculture is the fourth largest employer with around 930 jobs. Construction and mining businesses employ about 700 workers; manufacturing employs about 540 workers; transportation and public utilities employs about 550 workers, wholesale trade provides about 330 jobs and finance, insurance, and real estate provides about 510 jobs.

The following table illustrates business/job growth in Lake County.

Table 12
MIDDLETOWN UNIFIED SCHOOL DISTRICT
(County of Lake, California)

JOBS CREATED: 1997 THROUGH 2004

INDUSTRY	1997	2004	NEW JOBS	PERCENT CHANGE
TOTAL NONFARM	11,890	15,320	3,430	29%
CONSTRUCTION & MINING	540	650	110	20%
MANUFACTURING	450	680	230	51%
TRANSP & PUB UTIL	490	910	420	86%
WHOLESALE TRADE	340	380	40	12%
RETAIL TRADE	2,700	3,140	440	16%
FOOD STORES	670	700	30	5%
EATING & DRINKING PLACES	870	940	70	8%
OTHER RETAIL TRADE	1,160	1,500	340	29%
FIN., INS. & RL EST.	560	570	10	2%
SERVICES	3,300	5,270	1,970	60%
HOTELS/MOTELS	570	720	150	26%
HEALTH SERVICES	1,120	1,940	820	73%
OTHER SERVICES	1,620	2,610	990	61%
GOVERNMENT	3,520	3,730	210	6%

Source: California Employment Development Department.

Construction Activity

The following table summarizes building permits issued and building valuation in the County for the past six years.

Table 13
MIDDLETOWN UNIFIED SCHOOL DISTRICT

BUILDING PERMITS AND VALUATIONS

Year	Single-Family	Multi-Family	Total Units	Residential Valuation	Non-Residential Valuation	Total Valuation
2001	118	0	118	$21,782,000	$3,531,000	$25,313,000
2002	301	12	313	$60,881,000	$4,694,000	$65,575,000
2003	416	124	540	$91,895,000	$7,549,000	$99,444,000
2004	521	111	632	$110,565,000	$13,915,000	$124,480,000
2005	503	6	509	$116,102,000	$10,754,000	$126,856,000
2006	524	117	641	$107,497,000	$12,871,000	$120,368,000

Source: Construction Industry Research Board.

GENERAL SCHOOL DISTRICT FINANCIAL INFORMATION

State Funding of Education

The State Constitution requires that from all State revenues there will first be set apart the moneys to be applied by the State for support of the public school system and public institutions of higher education. As discussed below, school districts in the State receive a significant portion of their funding from State appropriations.

Annual State apportionments of basic and equalization aid to school districts for general purposes are computed up to a revenue limit (as described below) per unit of average daily attendance ("ADA"). Generally, such apportionments will amount to the difference between the District's revenue limit and the District's local property tax allocation. Revenue limit calculations are adjusted annually in accordance with a number of factors designed primarily to provide cost of living increases and to equalize revenues among all of the same type of California school districts (*i.e.*, unified, high school or elementary). State law also provides for State support of specific school-related programs, including summer school, adult education, deferred maintenance of facilities, pupil transportation, portable classrooms and other capital outlays and various categorical aids.

The State revenue limit is calculated three times a year for each school district. The first calculation is performed for the February 20th First Principal Apportionment, the second calculation for the June 25th Second Principal Apportionment, and the final calculation for the end of the year Annual Principal Apportionment. Calculations are reviewed by the County Office of Education and submitted to the State Department of Education to review the calculations for accuracy, calculate the amount of State aid owed to such school district and notify the State Controller of the amount, who then distributes the State aid.

The calculation of the amount of State aid a school district is entitled to receive each year is a five step process. First, the prior year State revenue limit per ADA is established, with recalculations as are necessary for adjustments for equalization or other factors. Second, the adjusted prior year State revenue limit per ADA is inflated according to formulas based on the implicit price deflator for government goods and services and the statewide average State revenue limit per ADA for the school districts. Third, the current year's State revenue limit per ADA for each school district is multiplied by such school district's ADA for either the current or prior year. Fourth, revenue limit add-ons are calculated for each school district if such school district qualifies for the add-ons. Add-ons include the necessary small school district adjustments, meals for needy pupils and small school district transportation, and are added to the State revenue limit for each qualifying school district. Finally, local property tax revenues are deducted from the State revenue limit to arrive at the amount of state aid based on the State revenue limit each school district is entitled to for the current year. See "District Growth" for the District's ADA record.

State Assistance

The District's principal funding formulas and revenue sources are derived from the budget of the State of California. The following information concerning the State of California's budgets has been obtained from publicly available information which the District believes to be reliable; however, the District takes no responsibility as to the accuracy or completeness thereof and has not independently verified such information.

2005-06 State Budget. Governor Schwarzenegger signed a $117.3 billion 2005-06 State Budget (the "2005-06 Budget") into law on July 11, 2005, addressing a State budget shortfall through spending cuts, without increasing taxes or additional borrowing. California's economy continued to improve with industry employment reaching a record high in May 2005, the unemployment rate falling to 5.3 percent in the same month, and inflation-adjusted Gross State Product up by 5.1 percent in 2004. California personal income was 7.1 percent higher in the first quarter of 2005 than a year earlier and statewide taxable sales were 7 percent higher in the fourth quarter of 2004 than the same period in 2003. While the 2005-06 Budget marked substantial and continuing progress toward structural balance, budget analysts warned that State expenses were projected to continue growing much faster than revenues, leaving the State with an estimated shortfall of $7.5 billion in fiscal year 2006-07.

The 2005-06 Budget assumed 2005-06 total General Fund revenues and transfers of $91.97 billion, total expenditures of $90.03 billion and a year-end reserve of $1.94 billion. Approximately $641 million of the reserve was designated as a reserve for the liquidation of encumbrances and the remaining $1.3 billion was designated as a special fund for economic uncertainties (which includes $900 million set aside for refunds and accelerations of amnesty related revenue in 2006-07).

The 2005-06 Budget improved roads and bridges throughout California by fully funding Proposition 42 and provides a year-over-year increase of more than $3 billion for K-14 education for a total of nearly $50 billion. Per-pupil spending from all sources exceeded $10,000 for the first time, and as a result of the Governor's agreement with Legislators, the 2005-06 Budget fully repaid local governments $1.2 billion owed to them one year earlier than required under State law.

With regard to K-12 school districts, total per–pupil spending in 2005-06 exceeded $10,000 for the first time, at $10,325. The 2005-06 Budget fully funded cost-of-living adjustments ("COLA") and student growth for K-14 education, restores approximately half of the general purpose revenue limit funding reductions reflected in prior budgets and provides over $70 million for the repayment of prior year mandated costs for school districts and community colleges. According to the 2005-06 Budget, the Proposition 98 settle-up obligation should be measured at $584 million for 2003-04, and $3.8 billion in 2004-05 which will be restored to the Proposition 98 budget in future years as General Fund revenue growth exceeds personal income growth. The 2005-06 Budget also included $16.8 million in payments towards prior year Proposition 98 obligations dating back to 1995-96, which was to be supplemented beginning in 2006-07 by annual payments of $150 million per year until the estimated $1.3 billion in such obligations are fully repaid.

Proposition 98
(Dollars in thousands)

	2003-04	2004-05	2005-06
General Fund	$30,529,463	$34,009,289	$36,590,833
Local Revenue	15,762,333	12,932,043	13,376,787
Total Funded Guarantee	$46,291,796	$46,941,332	$49,967,620
Base Guarantee Level	46,875,655	50,768,633	49,226,734
Savings	583,859	3,827,301	(740,886)

The General Fund contribution to the Proposition 98 guarantee increased by $2.6 billion from 2004-05 to 2005-06, while the local property tax revenue contribution increased by $445 million. This large General Fund share of the guarantee's increase reflected the second year of the agreement with California's local governments to reduce Vehicle License Fee revenues, replace those revenues with additional property tax allocations and hold schools harmless by providing additional General Fund moneys and reallocating local property taxes.

- **K-12 Proposition 98 Per Pupil Funding** – Estimated Proposition 98 funding per pupil rose to $7,402 in fiscal year 2005-06, representing an increase of $379 per pupil from the revised 2004-05 level. Compared to the 2004-05 Budget Act level of $7,007 per pupil, 2005-06 per pupil expenditures increased $395. Total General Fund allocations of $33.1 billion for K-12 education represented 40.2 percent of the General Fund budget subject to the State appropriations limit.

- **Total K-12 Funding –** An increase of $2.7 billion over 2004-05 brought total funding from all sources to $62.3 billion. Total funding per pupil increased by $380, from $9,945 in 2004-05 to $10,325 in 2005-06. This represented a 3.8 percent increase over the adjusted estimate for 2004-05.

From 2004-05 to 2005-06, General Fund increased $2.3 billion, while local property taxes increased by $380 million and federal funds grow by $48.6 million. Major General Fund changes included the following: an increase of $2.2 billion to Proposition 98 General Fund, an increase of $190.2 million in bond debt service and a net decrease of $49.2 million in contributions to the State Teachers' Retirement System.

- **Enrollment Growth** – The 2005-06 Budget provided $193.6 million to fund enrollment growth increases for school apportionments ($53.3 million), Special Education ($20.3 million) and other categorical programs ($120 million). This amount included $4.4 million deferred to 2006-07.

- **Cost-of-Living Adjustments** – The 2005-06 Budget included over $1.7 billion to provide a 4.23 percent COLA increase to K-12 programs. Included in this amount was funding for school apportionments ($1.3 billion), Special Education ($125 million) and other categorical programs ($295 million). Of this amount, $15.7 million was deferred to 2006-07. The 4.23 percent calculation substantially exceeded the expected growth of the consumer price index (CPI) in California.

- **Revenue Limits** – Revenue limit funding constituted the basic funding source for classroom instruction. The 2005-06 Budget provided a net increase of $1.6 billion to school district and county office of education revenue limits, which included funding for enrollment growth, a cost-of-living adjustment and the repayment of $328 million or approximately half of the outstanding deficit factor owed as a result of reductions made by the prior Administration.

- **K-12 Education Mandates** – The 2005-06 Budget provided $60.6 million ($53.8 million from the Proposition 98 Reversion Account and $6.8 million in Proposition 98 settle-up funds) to pay prior year K-12 education mandate claims. These one-time funds were intended to pay for claims on the basis of oldest first.

Accountability – The 2004-05 Budget provided $348.4 million for programs to assist and promote academic performance including $228.7 million Proposition 98 General Fund to assist low-performing schools through the High Priority Schools Grant Program, $53 million to assist schools subject to sanctions pursuant to State and federal accountability programs, $30 million for federal Comprehensive School Reform Program grants, $29.2 million in federal Title I School improvement funds to fund district accountability activities and $7.5 million Proposition 98 General Fund in deferred funding from 2004-05 for the final year of implementation for schools participating in the Immediate Intervention/Underperforming Schools Program.

***Williams* Litigation** – The 2005-06 Budget provided $183.5 million from the Proposition 98 Reversion Account for school facility emergency repairs, consistent with the *Williams* settlement agreement.

Pupil Testing – The 2005-06 Budget provided $118.9 million, including federal funds, for various statewide exams. The budget also provided $650,000 for the development of an alternative assessment for moderately disabled students who presently do not test at grade level, pursuant to federal guidelines.

Commission on Teacher Credentialing – The 2005-06 Budget contained $51 million ($34.5 million General Fund and $16.1 million other funds) and 161.5 positions for the Commission on Teacher Credentialing in 2005-06. This represented a reduction of $9.6 million and 4.9 positions from the revised 2004-05 Budget.

Low Performing School Enrichment Block Grant – The 2005-06 Budget included $49.5 million for the Low-Performing School Enrichment Block Grant, a one-time block grant for low-performing schools. These funds were to be available to schools in the bottom three deciles of the Academic Performance Index.

Supplemental Instruction High School Exit Exam Program – The 2005-06 Budget provided on a one-time basis $47.9 million Special Education Program funding and $20 million under the Pupil Retention Block Grant to provide additional supplemental instruction to pupils who have failed one or both parts of the High School Exit Exam.

2006-07 State Budget. Governor Schwarzenegger signed a $131.4 billion 2006-07 State Budget (the "2006-07 Budget") into law on June 30, 2006, which aims to improve the State's fiscal health by paying down debt and building a reserve and fully funding education while also providing funding for law enforcement, disaster readiness and services for abused and neglected children. The 2006-07 Budget sets aside a combined total of more than $4.9 billion, or 4.7 percent of total General Fund resources available, to address the State's debt by establishing a budget reserve of $2.1 billion and early debt repayments of $2.8 billion.

The 2006-07 Budget provides a record level of funding for the State's K-12 schools and community colleges. The 2006-07 Budget provides $55.1 billion in education spending under Proposition 98, an increase of $8.1 billion, or 17 percent compared to the 2004 Budget Act. This funding increases total per-pupil spending from $9,977 in 2004-05 to $11,264 in the 2006-07 Budget, an increase of $1,287 or 13 percent. The 2006-07 Budget includes the restoration of funding for arts and music, physical education, student counselors in grades 7-12 and a new, targeted preschool initiative.

The 2006-07 Budget also provides new resources to protect the public, including $256 million ($163 million General Fund) to improve services to abused and neglected children; $214 million ($180 million General Fund) to improve the capacity of hospitals to handle disaster- and epidemic-related surges in healthcare demand; $196 million for law enforcement initiatives, enhancements to law enforcement subventions, funding for methamphetamine eradication, funding for sexual assault felony enforcement grants to local governments, and grants to help county sheriffs and probation officers manage mentally ill offenders.

In addition, the 2006-07 Budget provides $1.4 billion to fully fund Proposition 42 for the second consecutive year and provides an additional $1.4 billion for the early repayment of past loans from Proposition 42, for a total of $2.8 billion. Of the $1.4 billion repayment, $446 million is designated for cities and counties for local road and street maintenance. The 2006-07 Budget also provides $250 million for deferred maintenance in the State park system.

With regard to K-12 school districts, total funding from all sources increases by $2.9 billion over the revised 2005-06 Budget, bringing total funding to $67.1 billion for the 2006-07 fiscal year. The 2005-06 revised per-pupil funding of $10,748 represents an increase of $423 from the 2005-06 Budget Act level of $10,325. Funding per pupil from all sources for fiscal year 2006-07 is $11,264, an increase of $516 from the revised 2005-06 Budget level.

Total Proposition 98 funding in fiscal year 2006-07 for K-12 and community colleges is budgeted at $55.1 billion, which reflects a 3.3 percent increase over the revised estimate for fiscal year 2005-06. The General Fund comprises approximately 75 percent of the total, or $41.3 billion. The $55.1 billion Proposition 98 funding level for fiscal year 2006-07 also includes an increase of $426 million associated with the full implementation of Proposition 49. Beginning in fiscal year 2006-07, Proposition 49 will increase State funding for the After-School Education and Safety Program to $550 million per year.

The following chart compares Proposition 98 funding over the past three fiscal years.

Proposition 98
(Dollars in Thousands)

	2004-05	***2005-06***	***2006-07***
General Fund	$34,034,274	$38,420,035	$41,294,823
Local Revenue	13,020,472	13,626,441	13,826,507
Total Funded Guarantee	$47,054,746	$52,046,476	$55,121,330
Settlement Agreement	1,620,928	1,298,944	-0-
Total Guarantee	**$48,675,674**	**$53,345,420**	**$55,121,330**

The estimated Proposition 98 per-pupil funding rises to $8,288 in fiscal year 2006-07, representing an increase of $510 from the revised fiscal year 2005-06 level. Total Proposition 98 General Fund allocations of $37.1 billion for K-12 education comprise 40 percent of the General Fund budget which is subject to the State appropriations limit.

Further, to resolve the pending lawsuit regarding Proposition 98 funding, the Administration has agreed to calculate the Proposition 98 guarantee consistent with the legislative intent language contained in Chapter 213, Statutes of 2004. As a result, the State will pay $2.9 billion in settle-up funding, comprised of approximately $1.6 billion to count toward the Proposition 98 guarantees for fiscal years 2004-05 and 2005-06. In order to provide resources to offset the cost for the initial years of the settlement schedule, the Administration is proposing legislation to authorize the refinancing of the Golden State Tobacco Securitization Corporation's 2003A bonds. This refinancing involves a new structure for using tobacco settlement payments in a way that will generate additional proceeds of $900 million for the State.

The 2006-07 Budget includes the following significant changes to major education programs:

- **Enrollment Growth** – The 2006-07 Budget provides $112.4 million for K-12 enrollment growth increases. Because Statewide K-12 enrollment growth is projected to be negative for fiscal year 2006-07, growth costs were limited to certain programs with targeted populations, such as Economic Impact Aid ($29.3 million) and Adult Education ($15.1 million).

- **Cost-of-Living Adjustments –** The 2006-07 Budget includes over $2.6 billion to provide a 5.92 percent cost-of-living adjustment to K-12 programs. Included in this amount are funding for school apportionments ($1.9 billion), special education ($184.3 million) and K-3 class size reduction ($182.5 million).

- **Revenue Limits** – The 2006-07 Budget provides a net increase of $2.3 billion to school district and county office of education revenue limits, which includes the decrease due to anticipated declines in ADA, the increase due to the COLA factor and an adjustment to account for revised local revenues. This figure also incorporates the cost of eliminating the deficit factor and the proposed increase in equalization funding discussed below.

- **Deficit Reduction** – The 2006-07 Budget includes $308.6 million to completely eliminate the deficit factor for school district and county offices of education revenue limits. This funding compensates local education agencies for reduced COLAs provided in prior years and provides an ongoing source of general purpose funding.

- **Equalization** –The 2006-07 Budget includes $350 million for school district revenue limit equalization to address the disparity in base general-purpose funding levels across school districts. These funding disparities are rooted in historical changes to property tax law and result in less funding being provided to some districts than is provided to other, equally situated school districts. The $350 million proposed for fiscal year 2006-07 will eliminate close to three-quarters of the remaining disparity.

- **K-12 Education Mandates** – The 2006-07 Budget provides approximately $957 million in Proposition 98 General Fund to fund K-12 mandate costs. Of that amount, $927 million is for the purpose of paying off prior year claims. This largely eliminates the accumulated debt the State has incurred from deferring mandate payments.

- **Economic Impact Aid** – The 2006-07 Budget includes a $350 million Proposition 98 General Fund augmentation to the Economic Impact Aid Program to help close the achievement gap of English-learner and economically disadvantaged students.

- **After-School Programs** – In 2002, California voters approved Proposition 49, significantly expanding access to before and after-school programs. Proposition 49 also established funding priorities and expanded program activities to include computer training, fine arts and physical fitness. In fiscal year 2005-06, the State After-School Education and Safety Program was funded at $121.6 million, serving more than 100,000 children annually. Beginning in fiscal year 2006-07, Proposition 49 will provide an increase of $428 million over that funding level.

- **One-Time Discretionary Block Grant** – The 2006-07 Budget includes $533.5 million one-time Proposition 98 General Fund for a discretionary block grant, of which 75 percent is for school site programs and the remaining 25 percent may be used to address district wide issues.

The 2006-07 Budget includes significant new one-time and ongoing education initiatives:

Arts and Music Block Grant – The 2006-07 Budget includes $105 million Proposition 98 General Fund for an annual Arts and Music Block Grant program. These funds will be distributed to school districts, charter schools and county offices of education to support standards-aligned instruction in kindergarten through grade twelve. The funds will be available for hiring additional staff, staff development, purchasing materials, books, supplies and equipment.

Arts, Music and Physical Education One-Time Equipment Grants – The 2006-07 Budget also includes $500 million Proposition 98 General Fund on a one-time basis for the purchase of arts, music and/or physical education supplies and equipment.

Supplemental School Counseling Program – The 2006-07 Budget includes $200 million ongoing Proposition 98 General Fund to increase the number of school counselors that serve seventh through twelfth grade students.

K-12/Community College Career Technical Education – The 2006-07 Budget includes $100 million for public schools and community colleges, including $20 million in ongoing funding to support the second year of the Governor's Career Technical Education Initiative, which is aimed at improving collaboration between the community colleges and K-12 career technical programs.

Instructional Materials, School Libraries and Education Technology Grants – The 2006-07 Budget includes $100 million in one-time Proposition 98 funds for the purchase of instructional materials, school and classroom library materials and one-time technology costs.

2007-08 State Budget. On January 10, 2007, the Governor released his proposed budget for 2007-08 (the "Proposed 2007-08 Budget"). The Proposed 2007-08 Budget includes a number of budget-balancing actions, including a major redirection of transportation funds and significant reductions in social services, to eliminate a significant shortfall in 2007-08.

The Proposed 2007-08 Budget proposes to use the Public Transportation Account ("PTA") in lieu of Proposition 98 to fund the $627 million Home-to-School Transportation program. If the proposed shift occurs, the Proposed 2007-08 Budget assumes a $1.4 billion increase in K-12 Proposition 98 funding. This represents a 2.9% increase from 2006-07. With the shift, the 2007-08 Proposition 98 per pupil funding rate would be $8,525 (a 3.3% increase from the revised 2006-07 estimate). If the $627 million shift were not to occur, total K-12 Proposition 98 funding would increase by $2.1 billion, or 4.2%, from 2006-07, and the 2007-08 per pupil funding rate would be $8,631(a 4.6% increase over 2006-07).

Additional provisions, as summarized by the Legislative Analyst's Office, include: (i) implementation 2006-07 Proposition 98 expansions, but does not propose new expansions for budget year; (ii) full funding of both statutory and discretionary COLAs at 4.04% ($1.9 Billion); (iii) increase of Proposition 98 Spending for Child Care ($269 Million); and (iv) recognition of Savings from Declining Attendance (About $90 Million). The Proposed 2007-08 Budget assumes that student attendance will decline by 0.39% from 2006-07 to 2007-08.

While the Proposed 2007-08 Budget, if adopted, would produce a balanced budget and healthy reserve, the Legislative Analyst's Office notes that implementation could be problematic and that several of the assumptions may be overly optimistic. The Proposed 2007-08 Budget is subject to extensive review and change by various Senate and Assembly review committees, as well as final passage by the Senate and Assembly. See "The Budget Process" above.

Information about the State budget is regularly available at various State-maintained websites. The Fiscal Years 2005-06 and 2006-07 State Budgets may be found at the website of the Department of Finance, www.dof.ca.gov, under the heading "California Budget". Additionally, an impartial analysis of the budget is posted by the Office of the Legislative Analyst at www.lao.ca.gov. The information referred to is prepared by the respective State agency maintaining each website and not by the District, and the District takes no responsibility for the continued accuracy of the internet addresses or for the accuracy, completeness or timeliness of information posted there, and such information is not incorporated herein by these references.

Future State Budgets. Under State law, the State Legislature is required to adopt its budget by June 15 of each year for the upcoming fiscal year, with approval by the Governor to occur on June 30. The State Legislature failed to pass a State budget for fiscal year 2004-05 and 2005-06 in a timely fashion. Accordingly, many State payments were held until the 2004-05 State Budget was adopted, including some scheduled to be made to school and community college districts under Proposition 98 and receipt of State categorical funds by districts were in some cases delayed until the State budget was adopted for the 2004-05 fiscal year. The State Legislature again failed to approve a final State Budget by the June 30 deadline for the 2005-06 fiscal year, with a concomitant possibility of delayed payments to districts. The events leading to the inability of the State Legislature to pass a budget in a timely fashion in past fiscal years are not unique, and the District cannot predict what circumstances may cause a similar failure in future years. In each year where the State budget lags adoption of the District's budget, it will be necessary for the District's staff to review the consequences of the changes, if any, at the State level from the proposals in the Governor's May Revision for that year, and determine whether the District's budget will have to be revised. The State has in past years experienced budgetary difficulties and has balanced its budget by requiring local political subdivisions to fund certain costs theretofore borne by the State. State actions taken to address its budgetary difficulties could have the effect of reducing K-12 support indirectly, and the District is unable to predict the nature, extent or effect of such reductions.

On March 2, 2004, the voters of the State adopted Propositions 57 and 58, which provided for a one-time borrowing by the State of up to $15.0 billion to refund past deficit borrowings and which required a balanced budget to be passed by the State Legislature at the beginning of each fiscal year. The District is unable to predict whether the methodology for budgets inherent in Proposition 58 will result in more timely adoption of State budgets and less adverse impacts upon the District's own budget process.

In addition, the District cannot predict the effect that the general economic conditions within the State and the State's budgetary problems may have in the future on the District budget or operations or on its ability to make payments of principal of and interest on the Bonds.

Significant Accounting Policies and Audited Financial Statements

The California State Department of Education imposes by law uniform financial reporting and budgeting requirements for K-12 school districts. Financial transactions are accounted for in accordance with the California School Accounting Manual. Goodell, Porter & Fredericks, LLP, Certified Public Accountants, Sacramento, California, serve as independent auditors to the District and excerpts of their report for the Fiscal Year Ended June 30, 2006, are attached hereto as APPENDIX B. The District's auditors have not specifically approved the inclusion of such excerpts herewith.

California Assembly Bill 1200 ("A.B. 1200"), effective January 1, 1992, tightened the budget development process and interim financial reporting for school districts, enhancing the authority of the county schools superintendents' offices and establishing guidelines for emergency State aid apportionments. Many provisions affect District operations directly, while others create a foundation from which outside authorities (primarily state and county school officials) may impose actions on the District. Under the provisions of A.B. 1200, each school district is required to file interim certifications with the county office of education as to its ability to meet its financial obligations for the remainder of the then-current fiscal year and, based on current forecasts, for the subsequent fiscal year. The county office of education reviews the certification and issues either a positive, negative or qualified certification. A positive certification is assigned to any school district that will meet its financial obligations for the current fiscal year and subsequent two fiscal years. A negative certification is assigned to any school district that will be unable to meet its financial obligations for the remainder of the fiscal year or subsequent fiscal year. A qualified certification is assigned to any school district that may not meet its financial obligations for the current fiscal year or two subsequent fiscal years. Each certification is based on then-current projections. The District currently holds a positive certification from the Lake County Office of Education for its budget submissions.

Independently audited financial reports are prepared annually in conformity with generally accepted accounting principles for educational institutions. The annual audit report is generally available about six months after the June 30 close of each fiscal year. For the District's most recent available audited financial statements, see "APPENDIX B."

Proposition 98

General. In 1988, California voters approved Proposition 98, an initiative that amended Article XVI of the State Constitution and provided specific procedures to determine a minimum guarantee for annual grade kindergarten to 14 ("K-14") funding. The constitutional provision links the K-14 funding formulas to growth factors that are also used to compute the State appropriations limit. Proposition 111 (Senate Constitutional Amendment 1), adopted in June 1990, among other things, revised certain funding provisions of Proposition 98 relating to the treatment of revenues in excess of the State spending limit and added a third funding "test" to calculate the annual funding guarantee. This third calculation is operative in years in which general fund tax revenue growth is weak. The amendment also specified that under Test 2 (see below), the annual cost of living adjustment ("COLA") for the minimum guarantee would be the change in California's per-capita personal income, which is the same COLA used to make annual adjustments to the State appropriations limit (Article XIII B).

Calculating Minimum Funding Guarantee. There are currently three tests which determine the minimum level of K-14 funding. Test 1 guarantees that K-14 education will receive at least the same funding share of the State general fund budget it received in 1986-87. Initially, that share was just over 40 percent. Because of the major shifts of property tax from local government to community colleges and K-12 which began in 1992-93 and increased in 1993-94, the percentage dropped to 33.0%.

Under implementing legislation (AB 198 and SB 98 of 1989), each segment of public education (K-12 districts, community college districts, and direct elementary and secondary level instructional services provided by the State of California) has separately calculated amounts under the Proposition 98 tests. The base year for the separate calculations is 1989-90. Each year, each segment is entitled to the greater of the amounts separately computed for each under Test 1 or 2. Should the calculated amount Proposition 98 guarantee (K-14 aggregated) be less than the sum of the separate calculations, then the Proposition 98 guarantee amount shall be prorated to the three segments in proportion to the amount calculated for each. This statutory split has been suspended in every year beginning with 1992-93. In those years, community colleges received less than was required from the statutory split.

Test 2 provides that K-14 education will receive as a minimum, its prior-year total funding (including State general fund and local revenues) adjusted for enrollment growth ("ADA") and per-capita personal income COLA.

A third formula, established pursuant to Proposition 111 as "Test 3," provides an alternative calculation of the funding base in years in which State per-capita General Fund revenues grow more slowly than per-capita personal income. When this condition exists, K-14 minimum funding is determined based on the prior-year funding level, adjusted for changes in enrollment and COLA where the COLA is measured by the annual increase in per-capita general fund revenues, instead of the higher per-capita personal income factor. The total allocation, however, is increased by an amount equal to one-half of one percent of the prior-year funding level as a funding supplement.

In order to make up for the lower funding level under Test 3, in subsequent years K-14 education receives a maintenance allowance equal to the difference between what should have been provided if the revenue conditions had not been weak and what was actually received under the Test 3 formula. This maintenance allowance is paid in subsequent years when the growth in per-capita State tax revenue outpaces the growth in per-capita personal income.

The enabling legislation to Proposition 111, Chapter 60, Statutes of 1990 (SB 88, Garamendi), further provides that K-14 education shall receive a supplemental appropriation in a Test 3 year if the annual growth rate in non-Proposition 98 per-capita appropriations exceeds the annual growth rate in per-pupil total spending.

Supplemental Information Concerning Litigation Against the State of California

In June 1998, a complaint was filed in Los Angeles County Superior Court challenging the authority of the State Controller to make payments in the absence of a final, approved State Budget. The Superior Court judge issued a preliminary injunction preventing the State Controller from making payments including those made pursuant to continuing appropriations prior to the enactment of the State's annual budget. As permitted by the State Constitution, the Legislature immediately enacted and the Governor signed an emergency appropriations bill that allowed continued payment of various State obligations, including debt service, and the injunction was stayed by the California Court of Appeal, pending its decision.

On May 29, 2003, the California Court of Appeal for the Second District decided the case of *Steven White, et al. v. Gray Davis (as Governor of the State of California), et al*. The Court of Appeal concluded that, absent an emergency appropriation, the State Controller may authorize the payment of state funds during a budget impasse only when payment is either (i) authorized by a "continuing appropriation" enacted by the Legislature, (ii) authorized by a self-executing provision of the California Constitution, or (iii) mandated by federal law. The Court of Appeal specifically concluded that the provisions of Article XVI, Section 8 of the California Constitution – the provision establishing minimum funding of K-14 education enacted as part of

Proposition 98 – did not constitute a self-executing authorization to disburse funds, stating that such provisions merely provide formulas for determining the minimum funding to be appropriated every budget year but do not appropriate funds. The State Controller has concluded that the provisions of the Education Code establishing K-12 and county office revenue limit funding do constitute continuing appropriations enacted by the Legislature and, therefore, the State Controller has indicated that State payments of such amounts would continue during a budget impasse. However, no similar continuing appropriation has been cited with respect to K-12 categorical programs and revenue limit funding for community college districts, such as the District, and the State Controller has concluded that such payments are not authorized pursuant to a continuing appropriation enacted by the Legislature and, therefore, cannot be paid during a budget impasse. The California Supreme Court granted the State Controller's Petition for Review on a procedural issue unrelated to continuous appropriations and on the substantive question as to whether the State Controller is authorized to pay State employees their full and regular salaries during a budget impasse. No other aspect of the Court of Appeal's decision was addressed by the State Supreme Court.

On May 1, 2003, with respect to the substantive question, the California Supreme Court concluded that the State Controller is required, notwithstanding a budget impasse and the limitations imposed by State law, to timely pay those state employees who are subject to the minimum wage and overtime compensation provisions of the federal Fair Labor Standards Act. The Supreme Court also remanded the preliminary injunction issue to the Court of Appeal with instructions to set aside the preliminary injunction in its entirety.

The Class Size Reduction Kindergarten-University Public Education Facilities Bond Acts of 2002 and 2004

Proposition 47. The Class Size Reduction Kindergarten - University Public Education Facilities Bond Act of 2002 ("Proposition 47") appeared on the November 5, 2002 ballot as Proposition 47 and was approved by the California voters. This measure authorized the sale and issuance of $13.05 billion in general obligation bonds for construction and renovation of K-12 school facilities ($11.4 billion) and higher education facilities ($1.65 billion). Proposition 47 included $6.35 billion for acquisition of land and new construction of K-12 school facilities. Of this amount, $2.9 billion was set aside to fund backlog projects for which school districts submitted applications to the State on or prior to February 1, 2002. The balance of $3.45 billion would be used to fund projects for which school districts submitted applications to the State after February 1, 2002. K-12 school districts will be required to pay 50 percent of the costs for acquisition of land and new construction with local revenues. In addition, $100 million of the $3.45 billion would be available for charter school facilities. Proposition 47 makes available $3.3 billion for reconstruction or modernization of existing K-12 school facilities. Of this amount, $1.9 billion will be set aside to fund backlog projects for which school districts submitted applications to the State on or prior to February 1, 2002 and the balance of $1.4 billion would be use to fund projects for which school districts submitted applications to the State after February 1, 2002. K-12 school districts will be required to pay 40 percent of the costs for reconstruction or modernization with local revenues. Proposition 47 provides a total of $1.7 billion to K-12 school districts which are considered critically overcrowded, specifically to schools that have a large number of pupils relative to the size of the school site. In addition, $50 million will be available to fund joint-use projects. Proposition 47 also includes $1.65 billion to construct new buildings and related infrastructure, alter existing buildings and purchase equipment for use in the State's public higher education systems.

Proposition 47 represents the second largest general obligation bond measure for school construction and modernization approved by California voters in the last several years. Proposition 1A was previously approved in November 1998 and provided $6.7 billion of capital funding for schools.

The new buildings and infrastructure constructed by community colleges with the proceeds of Proposition 47 general obligation bonds were selected by the Governor and the Legislature, based upon applications from the college districts.

Proposition 55. The Kindergarten-University Public Education Facilities Bond Act of 2004 ("Proposition 55") appeared on the March 2, 2004 ballot as Proposition 55 and was approved by the California voters. This measure authorizes the sale and issuance of $12.3 billion in general obligation bonds for the construction and renovation of K-12 school facilities ($10 billion) and higher education facilities ($2.3 billion). Proposition 55 includes $5.26 billion for the acquisition of land and construction of new school buildings. A district would be required to pay for 50 percent of costs with local resources unless it qualifies for state hardship funding.

Proposition 55 makes $2.25 billion available for the reconstruction or modernization of existing school facilities. Districts would be required to pay 40 percent of project costs from local resources. Proposition 55 directs a total of $2.44 billion to districts with schools which are considered critically overcrowded. These funds would go to schools that have a large number of pupils relative to the size of the school site. Proposition 55 also makes a total of $50 million available to fund joint-use projects. Proposition 55 includes $2.3 billion to construct new buildings and related infrastructure, alter existing buildings and purchase equipment for use in these buildings for California's public higher education systems. The measure allocates $690 million to each University of California and California State University campus and $920 million to California community colleges. The Governor and the Legislature will select specific projects to be funded by the bond proceeds.

Proposition 1A

Proposition 1A (SCA 4), proposed by the Legislature in connection with the 2004-05 Budget Act and approved by the voters in November 2004, provides that the State may not reduce any local sales tax rate, limit existing local government authority to levy a sales tax rate or change the allocation of local sales tax revenues, subject to certain exceptions. Proposition 1A generally prohibits the State from shifting to schools or community colleges any share of property tax revenues allocated to local governments for any fiscal year, as set forth under the laws in effect as of November 3, 2004. Any change in the allocation of property tax revenues among local governments within a county must be approved by two-thirds of both houses of the State Legislature. Proposition 1A provides, however, that beginning in fiscal year 2008-09, the State may shift to schools and community colleges up to 8% of local government property tax revenues, which amount must be repaid, with interest, within three years, if the Governor proclaims that the shift is needed due to a severe state financial hardship, the shift is approved by two-thirds of both houses of the State Legislature and certain other conditions are met. The State may also approve voluntary exchanges of local sales tax and property tax revenues among local governments within a county. Proposition 1A also provides that if the State reduces the Vehicle License Fee rate currently in effect, which is 0.65 percent of vehicle value, the State must provide local governments with equal replacement revenues. Further, Proposition 1A requires the State, beginning July 1, 2005, to suspend State mandates affecting cities, counties and special districts, schools or community colleges, excepting mandates relating to employee rights, in any year that the State does not fully reimburse local governments for their costs of compliance with such mandates.

CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS

Article XIIIA of the California Constitution

Article XIIIA of the California Constitution limits the amount of any *ad valorem* tax on real property, to one percent of the full cash value thereof, except that additional *ad valorem* taxes may be levied to pay debt service on indebtedness approved by the voters prior to July 1, 1978 and on bonded indebtedness for the acquisition or improvement of real property which has been approved on or after July 1, 1978 by two-thirds of the voters on such indebtedness. Article XIIIA defines full cash value to mean "the county assessor's valuation of real property as shown on the 1975-76 tax bill under "full cash value," or thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership have occurred after the 1975 assessment." The full cash value may be increased at a rate not to exceed two percent per year to account for inflation.

Article XIIIA has subsequently been amended to permit reduction of the "full cash value" base in the event of declining property values caused by damage, destruction or other factors, to provide that there would be no increase in the "full cash value" base in the event of reconstruction of property damaged or destroyed in a disaster and in other minor or technical ways.

Legislation Implementing Article XIIIA

Legislation has been enacted and amended a number of times since 1978 to implement Article XIIIA. Under current law, local agencies are no longer permitted to levy directly any property tax (except to pay voter-approved indebtedness). The one percent property tax is automatically levied by the county and distributed according to a formula among taxing agencies. The formula apportions the tax roughly in proportion to the relative shares of taxes levied prior to 1989.

Increases of assessed valuation resulting from reappraisals of property due to new construction, change in ownership or from the two percent annual adjustment are allocated among the various jurisdictions in the "taxing area" based upon their respective "situs." Any such allocation made to a local agency continues as part of its allocation in future years.

All taxable property is shown at full market value on the tax rolls, with tax rates expressed as $1 per $100 of taxable value. All taxable property value included in this Official Statement is shown at 100% of market value (unless noted differently) and all tax rates reflect the $1 per $100 of taxable value.

Article XIIIB of the California Constitution

Under Article XIIIB of the California State Constitution state and local government entities have an annual "appropriations limit" and are not permitted to spend certain moneys which are called "appropriations subject to limitation" (consisting of tax revenues, state subventions and certain other funds) in an amount higher than the "appropriations limit." Article XIIIB does not affect the appropriations of moneys which are excluded from the definition of "appropriations subject to limitation," including debt service on indebtedness existing or authorized as of January 1, 1979, or bonded indebtedness subsequently approved by the voters. In general terms, the "appropriations limit" is to be based on certain 1978-79 expenditures, and is to be adjusted annually to reflect changes in consumer prices, populations, and services provided by these entities. Among other provisions of Article XIIIB, if these entities' revenues in any year exceed the amounts permitted to be spent, the excess would have to be returned by revising tax rates or fee schedules over the subsequent two years.

Unitary Property

AB 454 (Chapter 921, Statutes of 1986) provides that revenues derived from most utility property assessed by the State Board of Equalization ("Unitary Property"), commencing with the 1988-89 fiscal year, will be allocated as follows: (1) each jurisdiction will receive up to 102% of its prior year State-assessed revenue; and (2) if county-wide revenues generated from Unitary Property are less than the previous year's revenues or greater than 102% of the previous year's revenues, each jurisdiction will share the burden of the shortfall or excess revenues by a specified formula. This provision applies to all Unitary Property except railroads, whose valuation will continue to be allocated to individual tax rate areas.

The provisions of AB 454 do not constitute an elimination of the assessment of any State-assessed properties nor a revision of the methods of assessing utilities by the State Board of Equalization. Generally, AB 454 allows valuation growth or decline of Unitary Property to be shared by all jurisdictions in a county.

California Lottery

In the November 1984 general election, the voters of the State approved a Constitutional Amendment establishing a California State Lottery (the "State Lottery"), the net revenues (revenues less expenses and prizes) of which shall be used to supplement other moneys allocated to public education. The legislation further requires that the funds shall be used for the education of pupils and students and cannot be used for the acquisition of real property, the construction of facilities or the financing of research.

Allocation of State Lottery net revenues is based upon the average daily attendance of each school and community college district; however, the exact allocation formula may vary from year to year. In 2005-06, the District received $266,829 (restricted and unrestricted) in State Lottery aid and has budgeted $242,720 (restricted and unrestricted) for such aid in 2006-07. At this time, the amount of additional revenues that may be generated by the State Lottery in any given year cannot be predicted.

Proposition 46

On June 3, 1986, California voters approved Proposition 46, which added an additional exemption to the 1% tax limitation imposed by Article XIIIA. Under this amendment to Article XIIIA, local governments and school and community college districts may increase the property tax rate above 1% for the period necessary to retire new, general obligation bonds, if two-thirds of those voting in a local election approve the issuance of such bonds and the money raised through the sale of the bonds is used exclusively to purchase or improve real property.

Proposition 39

On November 7, 2000, California voters approved Proposition 39, called the "Smaller Classes, Safer Schools and Financial Accountability Act" (the "Smaller Classes Act") which amends Section 1 of Article XIIIA, Section 18 of Article XVI of the California Constitution and Section 47614 of the California Education Code and allows an alternative means of seeking voter approval for bonded indebtedness by 55 percent of the vote, rather than the two-thirds majority required under Section 18 of Article XVI of the

Constitution. The 55 percent voter requirement applies only if the bond measure submitted to the voters includes, among other items: (1) a restriction that the proceeds of the bonds may be used for "the construction, reconstruction, rehabilitation, or replacement of school facilities, including the furnishing and equipping of school facilities, or the acquisition or lease of real property for school facilities," (2) a list of projects to be funded and a certification that the school district board has evaluated "safety, class size reduction, and information technology needs in developing that list" and (3) that annual, independent performance and financial audits will be conducted regarding the expenditure and use of the bond proceeds.

Section 1(b)(3) of Article XIIIA has been added to exempt the one percent *ad valorem* tax limitation that Section 1(a) of Article XIIIA of the Constitution levies, to pay bonds approved by 55 percent of the voters, subject to the restrictions explained above.

The Legislature enacted AB 1908, Chapter 44, which became effective upon passage of Proposition 39 and amends various sections of the Education Code. Under amendments to Section 15268 and 15270 of the Education Code, the following limits on *ad valorem* taxes apply in any single election: (1) for an elementary and high school district, indebtedness shall not exceed $30 per $100,000 of taxable property, (2) for a unified school district, indebtedness shall not exceed $60 per $100,000 of taxable property, and (3) for a community college district, indebtedness shall not exceed $25 per $100,000 of taxable property. Finally, AB 1908 requires that a citizens' oversight committee must be appointed who will review the use of the bond funds and inform the public about their proper usage.

Article XIIIC and XIIID of the California Constitution

On November 5, 1996, an initiative to amend the California Constitution known as the "Right to Vote on Taxes Act" ("Proposition 218") was approved by a majority of California voters. Proposition 218 added Articles XIIIC and XIIID to the State Constitution and requires majority voter approval for the imposition, extension or increase of general taxes and 2/3 voter approval for the imposition, extension or increase of special taxes by a local government, which is defined in Proposition 218 to include counties. Proposition 218 also provides that any general tax imposed, extended or increased without voter approval by any local government on or after January 1, 1995, and prior to November 6, 1996 shall continue to be imposed only if approved by a majority vote in an election held within two years following November 6, 1996. All local taxes and benefit assessments which may be imposed by public agencies will be defined as "general taxes" (defined as those used for general governmental purposes) or "special taxes" (defined as taxes for a specific purpose even if the revenues flow through the local government's general fund) both of which would require a popular vote. New general taxes require a majority vote and new special taxes require a two-thirds vote. Proposition 218 also extends the initiative power to reducing or repealing local taxes, assessments, fees and charges, regardless of the date such taxes, assessments or fees or charges were imposed, and lowers the number of signatures necessary for the process. In addition, Proposition 218 limits the application of assessments, fees and charges and requires them to be submitted to property owners for approval or rejection, after notice and public hearing.

The District has no power to impose taxes except property taxes associated with a general obligation bond election, following approval by 55% or 2/3 of the District's voters, depending upon the Article of the Constitution under which it is passed. Under previous law, the District could apply provisions of the Landscape and Lighting Act of 1972 to create an assessment district for specified purposes, based on the absence of a majority protest. Proposition 218 significantly reduces the ability of the District to create such special assessment districts. Any assessments, fees or charges levied or imposed by any assessment district created by the District will become subject to the election requirements of Proposition 218 as described above, a more elaborate notice and balloting process and other requirements.

Proposition 218 also expressly extends the initiative power to give voters the power to reduce or repeal local taxes, assessments, fees and charges, regardless of the date such taxes, assessments, fees or charges were imposed, and reduces the number of signatures required for the initiative process. This extension of the initiative power to some extent constitutionalizes the March 6, 1995 State Supreme Court decision in *Rossi v. Brown*, which upheld an initiative that repealed a local tax and held that the State constitution does not preclude the repeal, including the prospective repeal, of a tax ordinance by an initiative, as contrasted with the State constitutional prohibition on referendum powers regarding statutes and. ordinances which impose a tax. Generally, the initiative process enables California voters to enact legislation upon obtaining requisite voter approval at a general election. Proposition 218 extends the authority stated in Rossi v. Brown by expanding the initiative power to include reducing or repealing assessments, fees and charges, which had previously been considered administrative rather than legislative matters and therefore beyond the initiative power. This extension of the initiative power is not limited by the terms of Proposition 218 to fees imposed after November 6,1996 and absent other legal authority could result in retroactive reduction in any existing taxes, assessments or fees and charges. Such legal authority could include the limitations imposed on the impairment of contracts under the contract clause of the United States Constitution.

Proposition 218 has no effect upon the District's ability to pursue approval of a general obligation bond issue or a Mello-Roos Community Facilities District bond issue in the future, both of which are already subject to a 2/3 vote, although certain procedures and burdens of proof may be altered slightly. The District is unable to predict the nature of any future challenges to Proposition 218 or the extent to which, if any, Proposition 218 may be held to be unconstitutional.

Future Initiatives

Article XIIIA, Article XIIIB, Article XIIIC, Article XIIID and Propositions 98, 46 and 39 were each adopted as measures that qualified for the ballot pursuant to the State's initiative process. From time to time, other initiative measures could be adopted, further affecting the District's revenues or their ability to expend revenues.

THE LAKE COUNTY TREASURY POOL

The following information concerning the Lake County Treasury Pool (the "Investment Pool" or "Pool") has been provided by the Treasurer and has not been confirmed or verified by the District or the Underwriter. No representation is made herein as to the accuracy or adequacy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof or that the information contained or incorporated hereby by reference is correct as of any time subsequent to its date.

Under the California Education Code, the District is required to pay all monies received from any source into the County of Lake Treasury to be held on behalf of the District. The Pool consists of monies deposited with the Treasurer by County departments and agencies, school districts, certain non-County governmental agencies and special assessment districts. Most of the Pool's depositors are required by State law to invest their excess moneys in the Pool. Less than 5% of the Pool's market value is allocable to voluntary depositors.

Each depositor is assigned a distinct fund number within the Investment Pool. Cash represented by the fund balances is commingled in a Pooled Cash Portfolio for investment purposes; no funds are segregated for separate investment. Investments are selected from those authorized by California Government Code Section 53635 ("Code"). Authorized investments include obligations of the United States Treasury, agencies of the United States government, federally sponsored enterprises, local and State bond issues, bankers acceptances, commercial paper of prime quality, collateralized and negotiable certificates of deposit, repurchase and reverse repurchase agreements, medium term corporate notes, shares of beneficial interest in diversified management companies (mutual funds), and asset backed (including mortgage related) and pass-through securities.

Each calendar year the Treasurer prepares an Annual Statement of Investment Policy (the "Investment Policy") that sets the framework for the investment practices relating to the County treasury. Legislation enacted in 1996 and effective January 1, 1997 requires that the Investment Policy be filed and approved by the Board in open session. Additionally, the Board must determine whether to delegate investment authority to the Treasurer each year. Failure to so delegate transfers investment responsibility to the Board itself. The Board of Supervisors approved the current Investment Policy as presented by the Treasurer and delegated investment responsibility to the Treasurer, and having been so approved, the Investment Policy may not be changed without Board approval.

The approved Investment Policy provides that the County's investment objectives are "capital preservation and liquidity, while seeking high current income consistent with capital preservation and liquidity." The Investment Policy provides that no more than 6% of the assets in the Pool can be invested in the securities of any single issuer other than the United States Treasury and agencies of the United States government. Investments in reverse repurchase agreements are limited to 10% of the total Pool and must always be matched in maturity to the reinvestment. Additionally, no investment will be made in any security whose coupon rate varies inversely with general credit market rates.

In accordance with California law, the Lake County Board of Supervisors created an eleven-member Treasury Oversight Committee (the "TOC"). The statutory role of the TOC is to review the Investment Policy as prepared by the Treasurer and make recommendations to the Board, to monitor policy compliance as well as investment performance and to cause an annual independent audit to be performed. The TOC meets semi-annually to accomplish its tasks.

As described above, a wide range of investments is authorized under State law and the Investment Policy. Therefore, there can be no assurance that the investments in the Pool will not vary significantly from the investments described below. In addition, the value of various investments in the Pool will fluctuate on a daily basis as a result of several factors, including generally prevailing interest rates and other economic conditions.

LEGAL MATTERS

The legal opinion of Quint & Thimmig LLP, San Francisco, California, Bond Counsel to the District ("Bond Counsel"), attesting to the validity of the Bonds, will be supplied to the original purchasers of the Bonds without charge. A copy of the legal opinion will be attached to the Bonds. Bond Counsel will receive compensation contingent upon the sale and delivery of the Bonds. Certain legal matters will be passed upon for the District by its Disclosure Counsel, the Law Offices of Cameron A. Weist, Scotts Valley, California.

TAX MATTERS

Federal tax law contains a number of requirements and restrictions which apply to the Bonds, including investment restrictions, periodic payments of arbitrage profits to the United States, requirements regarding the proper use of bond proceeds and the facilities financed therewith, and certain other matters. The District has covenanted to comply with all requirements that must be satisfied in order for the interest on the Bonds to be excludable from gross income for federal income tax purposes. Failure to comply with certain of such covenants could cause interest on the Bonds to not be excludable from gross income under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code") for federal income tax purposes retroactively to the date of issuance of the Bonds.

Subject to the District's compliance with the above-referenced covenants, under present law, in the opinion of Quint & Thimmig LLP, San Francisco, California, Bond Counsel, interest on the Bonds is excludable from the gross income of the owners thereof for federal income tax purposes under Section 103 of the Code and under Section 55 of the Code is not included as an item of tax preference in computing the federal alternative minimum tax for individuals and corporations. Interest on the Bonds is taken into account, however, in computing an adjustment used in determining the federal alternative minimum tax for certain corporations and in computing the branch profits tax on certain corporations. Subject to the District's compliance with certain covenants, in the opinion of Bond Counsel, the Bonds are "qualified tax-exempt obligations" under the small issuer exception provided under section 265(b)(3) of the Code, which affords banks and certain other financial institutions more favorable treatment of their deduction for interest expense than would otherwise be allowed under section 265(b)(2) of the Code.

In rendering its opinion, Bond Counsel will rely upon certifications of the District with respect to certain material facts solely within the District's knowledge. Bond Counsel's opinion represents its legal judgment based upon its review of the law and the facts that it deems relevant to render such opinion and is not a guarantee of a result.

The Code includes provisions for an alternative minimum tax ("AMT") for corporations in addition to the corporate regular tax in certain cases. The AMT, if any, depends upon the corporation's alternative minimum taxable income ("AMTI"), which is the corporation's taxable income with certain adjustments. One of the adjustment items used in computing the AMTI of a corporation (excluding S Corporations, Regulated Investment Companies, Real Estate Investment Trusts, REMICs and FASITs) is an amount equal to 75% of the excess of such corporation's "adjusted current earnings" over an amount equal to its AMTI (before such adjustment item and the alternative tax net operating loss deduction). "Adjusted current earnings" would include all tax exempt interest, including interest on the Bonds.

Under the provisions of Section 884 of the Code, a branch profits tax is levied on the "effectively connected earnings and profits" of certain foreign corporations, which earnings and profits may include tax-exempt interest such as interest on the Bonds.

Ownership of the Bonds may result in collateral federal income tax consequences to certain taxpayers, including, without limitation, corporations subject to the branch profits tax, financial institutions, certain insurance companies, certain S corporations, individual recipients of Social Security or Railroad Retirement benefits and taxpayers who may be deemed to have incurred (or continued) indebtedness to purchase or carry tax-exempt obligations. Prospective purchasers of the Bonds should consult their tax advisors as to applicability of any such collateral consequences.

If a Bond is purchased at any time for a price that is less than the Bond's stated redemption price at maturity the purchaser will be treated as having purchased a Bond with market discount subject to the market discount rules of the Code (unless a statutory de minimis rule applies). Accrued market discount is treated as taxable ordinary income and is recognized when a Bond is disposed of (to the extent such accrued discount does not exceed gain realized) or, at the purchaser's election, as it accrues. The applicability of the market discount rules may adversely affect the liquidity or secondary market price of such Bond. Purchasers should consult their own tax advisors regarding the potential implications of market discount with respect to the Bonds.

There are or may be pending in the Congress of the United States legislative proposals, including some that carry retroactive effective dates, that, if enacted, could alter or amend the federal tax matters referred to above or adversely affect the market value of the Bonds. It cannot be predicted whether or in what form any such proposal might be enacted or whether, if enacted, it would apply to Bonds issued prior to enactment. Prospective purchasers of the Bonds should consult their own tax advisors regarding any pending or proposed federal tax legislation. Bond Counsel expresses no opinion regarding any pending or proposed federal tax legislation.

The Internal Revenue Service (the "Service") has an ongoing program of auditing tax-exempt obligations to determine whether, in the view of the Service, interest on such tax-exempt obligations is includable in the gross income of the owners thereof for federal income tax purposes. It cannot be predicted whether or not the Service will commence an audit of the Bonds. If an audit is commenced, under current procedures the Service will treat the District as the taxpayer and the Bondholders may have no right to participate in such procedure. The commencement of an audit could adversely affect the market value and liquidity of the Bonds until the audit is concluded, regardless of the ultimate outcome.

In the further opinion of Bond Counsel, interest on the Bonds is exempt from California personal income taxes.

Ownership of the Bonds may result in other state and local tax consequences to certain taxpayers. Bond Counsel expresses no opinion regarding any such collateral consequences arising with respect to the Bonds. Prospective purchasers of the Bonds should consult their tax advisors regarding the applicability of any such state and local taxes.

A copy of the proposed form of opinion of Bond Counsel is attached hereto as Appendix A.

CONTINUING DISCLOSURE

The District has covenanted for the benefit of holders and Beneficial Owners of the Bonds to provide certain financial information and operating data relating to the District (the "Annual Report") by not later than eight months following the end of the District's fiscal year (which shall be March 1 of each year, so long as the District's fiscal year ends on June 30), commencing with the report for the 2006-07 fiscal year (which is due not later than March 1, 2008), and to provide notices of the occurrence of certain enumerated events, if material. The Annual Report will be filed by the District with each Nationally Recognized Municipal Securities Information Repository and with the appropriate State information depository, if any.

The notices of material events will be filed by the District with each Nationally Recognized Municipal Securities Information Repository or with the Municipal Securities Rulemaking Board, and with the appropriate State information depository, if any. The specific nature of the information to be made available and to be contained in the notices of material events is summarized under the caption "Appendix E - Form of Continuing Disclosure Certificate." These covenants have been made in order to assist the Underwriter in complying with S.E.C. Rule 15c2-12(b)(5) (the "Rule"). The District has never failed to comply in all material respects with any previous undertakings with regard to said Rule to provide annual reports or notices of material events.

FINANCIAL ADVISOR

The District has entered into an agreement with Caldwell Flores Winters Inc. (the "Financial Advisor"), whereunder the Financial Advisor provides financial recommendations and guidance to the District with respect to preparation and sale of the Bonds. The Financial Advisor has read and participated in the drafting of certain portions of this Official Statement and has supervised the completion and editing thereof. The Financial Advisor has not audited, authenticated or otherwise verified the information set forth in the Official Statement, or any other related information available to the District, with respect to accuracy and completeness of disclosure of such information, and the Financial Advisor makes no guaranty, warranty or other representation respecting accuracy and completeness of the Official Statement or any other matter related to the Official Statement.

LEGALITY FOR INVESTMENT

Under provisions of the California Financial Code, the Bonds are legal investments for commercial banks in California to the extent that the Bonds, in the informed opinion of the investing bank, are prudent for the investment of funds of depositors. Under provisions of the California Government Code, the Bonds are eligible to secure deposits of public moneys in California.

RATINGS

Standard & Poor's ("S&P") has assigned their municipal bond ratings of "AAA," to the Bonds based upon the issuance of the Insurance Policy. In addition, S&P has assigned an underlying municipal bond rating of "A–" to the Bonds. Such ratings reflect only the view S&P, and an explanation of the significance of such ratings may be obtained as follows: S&P at Municipal Finance Department, 55 Water Street, New York, New York 10041, tel. (212) 208-8000. There is no assurance that such ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely if, in the judgment of the rating agencies, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Bonds.

BANK QUALIFICATION

The District has designated the Bonds as "qualified tax-exempt obligations" within the meaning of section 265(b)(3) of the Code such that, in the case of certain financial institutions (within the meaning of section 265(b)(3) of the Code), a deduction for federal income tax purposes is allowed for 80% of that portion of such financial institution's interest expense allocable to interest received on such Bonds.

UNDERWRITING

Piper Jaffray & Co., as Underwriter, has agreed to purchase the Bonds at the purchase price of $5,058,144.61 (reflecting par plus a net original issue premium in the amount of $323,047.50 less an Underwriter's discount of $73,191.72, and less $191,697.97 which is being retained by the Underwriter to pay costs of issuance), at the rates and yields shown on the inside cover hereof.

The Underwriter may offer and sell the Bonds to certain dealers and others at prices lower than the offering price stated on the inside cover page. The offering prices may be changed from time to time by the Underwriter.

NO LITIGATION

No litigation is pending concerning the validity of the Bonds, and the District's certificate to that effect will be furnished to purchasers at the time of the original delivery of the Bonds. The District is not aware of any litigation pending or threatened questioning the political existence of the District or contesting the District's ability to receive *ad valorem* taxes or to collect other revenues or contesting the District's ability to issue the Bonds.

OTHER INFORMATION

References are made herein to certain documents and reports which are brief summaries thereof which do not purport to be complete or definitive and reference is made such documents and reports for full and complete statements of the contents thereof.

Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not be construed as a contract or agreement between the District and the purchasers or Owners of any of the Bonds.

The execution and delivery of this Official Statement has been duly authorized by the District.

MIDDLETOWN UNIFIED SCHOOL DISTRICT

By: /s/ Korby Olson
Superintendent

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APPENDIX A

FORM OF BOND COUNSEL OPINION

[Letterhead of Quint & Thimmig LLP]

[Closing Date]

Board of Trustees of the
Middletown Unified School District
20932 Big Canyon Road
Middletown, California 94561

OPINION: $4,999,986.80 Middletown Unified School District (Lake County, California) General Obligation Bonds, Election of 2006, Series 2007, consisting of $3,560,000 Current Interest Bonds and $1,439,986.80 Capital Appreciation Bonds

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Members of the Board of Trustees:

We have acted as bond counsel to the Middletown Unified School District (the "District") in connection with the issuance by the Board of Supervisors of Lake County (the "Board") of $4,999,986.80 principal amount of Middletown Unified School District (Lake County, California) General Obligation Bonds, Election of 2006, Series 2007 (the "Series 2007 Bonds"), pursuant to Title 1, Division 1, Part 10, Chapter 2 (commencing with section 15100) of the California Education Code (the "Act"), and a resolution of the Board adopted on February 27, 2007 (the "Resolution"). We have examined the law and such certified proceedings and other papers as we deemed necessary to render this opinion.

As to questions of fact material to our opinion, we have relied upon representations of the Board contained in the Resolution and in the certified proceedings and certifications of public officials and others furnished to us, without undertaking to verify such facts by independent investigation.

Based upon our examination, we are of the opinion, as of the date hereof, that:

1. The District is duly created and validly existing as a school district with the power to cause the Board to issue the Series 2007 Bonds in its name and to perform its obligations under the Resolutions and the Series 2007 Bonds.

2. The District Resolution has been duly adopted by the District. The Board Resolution has been duly adopted by the Board and creates a valid first lien on the funds pledged under the Board Resolution for the security of the Series 2007 Bonds.

3. The Series 2007 Bonds have been duly authorized, executed and delivered by the Board and are valid and binding general obligations of the District. The Board is required under the Act to levy a tax upon all taxable property in the District for the interest and redemption of all outstanding bonds of the District, including the Series 2007 Bonds. The Series 2007 Bonds are payable from an *ad valorem* tax levied without limitation as to rate or amount.

4. Subject to the District's compliance with certain covenants, interest on the Series 2007 Bonds is excludable from gross income of the owners thereof for federal income tax purposes under section 103 of the Internal Revenue Code of 1986, as amended (the "Code") and, under section 55 of the Code, is not included as an item of tax preference in computing the federal alternative minimum tax for individuals and corporations under the Code but is taken into account in computing an adjustment used in determining the federal alternative minimum tax for certain corporations. Failure by the District to

comply with one or more of such covenants could cause interest on the Series 2007 Bonds to not be excludable from gross income under section 103 of the Code for federal income tax purposes retroactively to the date of issuance of the Series 2007 Bonds. In addition, the Series 2007 Bonds are "qualified tax-exempt obligations" within the meaning of section 265(b)(3) of the Code, and, in the case of certain financial institutions (within the meaning of section 265(b)(5) of the Code), a deduction is allowed for eighty percent (80%) of that portion of such financial institutions' interest expense allocable to interest payable with respect to the Series 2007 Bonds.

5. The interest on the Series 2007 Bonds is exempt from personal income taxation imposed by the State of California.

Ownership of the Series 2007 Bonds may result in other tax consequences to certain taxpayers, and we express no opinion regarding any such collateral consequences arising with respect to the Series 2007 Bonds.

The rights of the owners of the Series 2007 Bonds and the enforceability of the Series 2007 Bonds and the Resolutions may be subject to the bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore or hereafter enacted and also may be subject to the exercise of judicial discretion in accordance with general principles of equity.

In rendering this opinion, we have relied upon certifications of the District and others with respect to certain material facts. Our opinion represents our legal judgment based upon such review of the law and the facts that we deem relevant to render our opinion and is not a guarantee of a result. This opinion is given as of the date hereof and we assume no obligation to revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.

Respectfully submitted,

APPENDIX B

AUDITED FINANCIAL STATEMENTS
FOR FISCAL YEAR ENDED JUNE 30, 2006

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MIDDLETOWN UNIFIED SCHOOL DISTRICT
COUNTY OF LAKE
MIDDLETOWN, CALIFORNIA

ANNUAL FINANCIAL REPORT

JUNE 30, 2006

MIDDLETOWN UNIFIED SCHOOL DISTRICT

JUNE 30, 2006

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MIDDLETOWN UNIFIED SCHOOL DISTRICT

JUNE 30, 2006

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FINANCIAL SECTION

GOODELL, PORTER & FREDERICKS, LLP
CERTIFIED
PUBLIC
ACCOUNTANTS

RICHARD J. GOODELL, CPA
JOHN L. GOODELL, CPA
VIRGINIA K. PORTER, CPA
BEVERLY A. SANCHEZ, CPA

INDEPENDENT AUDITOR'S REPORT

Board of Education
Middletown Unified School District
Middletown, California

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Middletown Unified School District as of and for the year ended June 30, 2006, which collectively comprise the District's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion 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 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 opinion.

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 Middletown Unified School District at June 30, 2006 and the changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

1435 River Park Drive ■ Suite 400 ■ Sacramento, CA 95815 ■ (916) 929-0264 ■ FAX (916) 929-5179

The Management's Discussion and Analysis on page 3 through 12 and the budgetary comparison information on pages 41 and 42 are not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards,* we have also issued a report dated September 29, 2006 on our consideration of the Middletown Unified School District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal controls over financial reporting or on compliance, and not to provide an opinion on the internal controls over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Middletown Unified School District's basic financial statements. The accompanying statistical schedules and non-major fund financial statements are presented for additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of Middletown Unified School District. The statistical schedules, the schedule of expenditures of federal awards and the non-major fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Goodell, Porter & Fredericks, LLP

GOODELL, PORTER & FREDERICKS, LLP
Certified Public Accountants

September 29, 2006

The discussion and analysis of Middletown Unified School District's financial performance provides an overall review of the District's financial activities for the fiscal year ended June 30, 2006. The intent of this discussion and analysis is to look at the District's financial performance as a whole. To provide a complete understanding of the District's financial performance, please read it in conjunction with the Independent Auditor's Report on page 1, notes to the basic financial statements and the District's financial statements.

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

FINANCIAL HIGHLIGHTS

- General Fund revenues and other sources were greater than expenditures and other uses by $69,058, ending the year with available reserves of $727,760, higher than the State recommended reserve level of 3%.

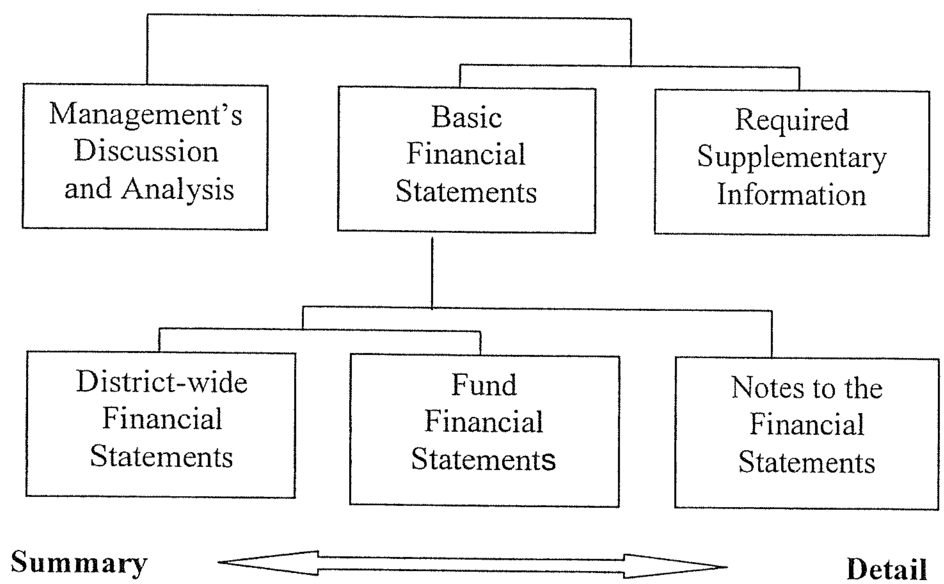
- In complying with GASB 34, fixed assets were valued at historical cost. The total of the District's fixed assets, land, site, buildings, and equipment, valued on an acquisition cost basis was $15,237,766. After depreciation, the June 30, 2006 book value for fixed assets totaled $10,212,476.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

OVERVIEW OF THE FINANCIAL STATEMENTS (CONCLUDED)

Components of the Financial Section



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

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

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

Reporting the School District as a Whole

Statement of Net Assets and the Statement of Activities

These two statements provide information about the District as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all of the District's assets and liabilities using the accrual basis of accounting. This basis of accounting takes into account all of the current year's revenues and expenses regardless of when cash is received or paid. These statements report information on the district as a whole and its activities in a way that helps answer the question, "How did we do financially during 2005-06?"

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

- Increases or decreases in the net assets of the District over time are indications of whether its financial position is improving or deteriorating, respectively.

- Additional non-financial factors such as condition of school buildings and other facilities, and changes to the property tax base of the District need to be considered in assessing the overall health of the District.

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

Reporting the School District's Most Significant Funds

Fund Financial Statements

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

- Governmental Funds

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

- Fiduciary Funds

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

FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS

The School District as a Whole

The District's net assets were $11,456,049 at June 30, 2006. Of this amount, $(390,065) was unrestricted. Investments in capital assets, net of related debt, account for $10,553,908 of the total net assets. A comparative analysis of government-wide data is presented in Table 1.

(Table 1)
Comparative Statement of Net Assets

	Governmental Activities	
	2006	(Restated) 2005
Assets		
Cash	$ 1,716,277	$ 1,086,844
Receivables	798,907	1,168,491
Stores inventory	1,998	1,999
Capital assets	10,212,476	10,623,514
Total assets	12,729,658	12,880,848
Liabilities		
Accounts payable and other current liabilities	332,307	18,690
Deferred revenue	77,214	173,080
Long-term liabilities	864,088	1,072,879
Total liabilities	$ 1,273,609	$ 1,264,649
Net Assets		
Invested in capital assets, net of related debt	10,553,908	10,034,346
Restricted	1,292,206	1,266,801
Unrestricted	(390,065)	315,052
Total net assets	$ 11,456,049	$ 11,616,199

FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS (CONTINUED)

The District's net asset position decreased $160,150 this fiscal year (See Table 2). The District's expenses for instructional and pupil services represented 75 percent of total expenses. The purely administrative activities of the District accounted for just 9 percent of total costs. The remaining 10 percent was spent in the areas of plant services and other expenses, interest on long-term debt and other outgo. (See Figure 2).

(Table 2)
Comparative Statement of Change in Net Assets

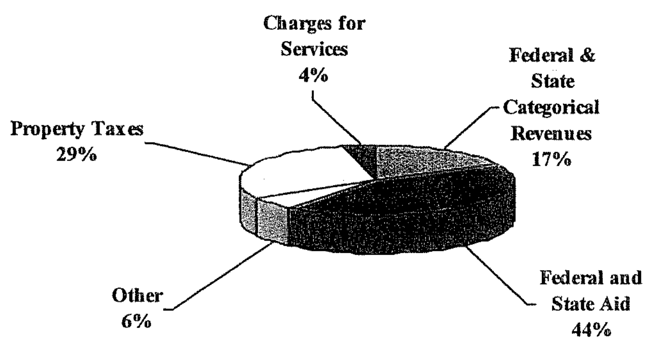
	Governmental Activities	
	2006	2005
Revenues		
Program revenues	$ 2,814,645	$ 2,145,386
General revenues		
Taxes levied for general purposes	4,044,446	3,682,211
Federal and State Aid not restricted to specific purposes	6,183,817	6,242,225
Interest and investment earnings	50,100	41,191
Miscellaneous	858,585	1,068,633
Total revenues	13,951,593	13,179,646
Expenses		
Instruction	8,019,179	7,633,142
Instruction related services	1,208,147	1,069,613
Pupil support services	1,337,043	1,345,322
General administration	1,271,292	994,315
Plant services	1,838,569	1,045,901
Other	437,513	214,738
Total expenses	14,111,743	12,303,031
Increase (Decrease) in net assets	$ (160,150)	$ 876,615

FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE STATEMENTS (CONTINUED)

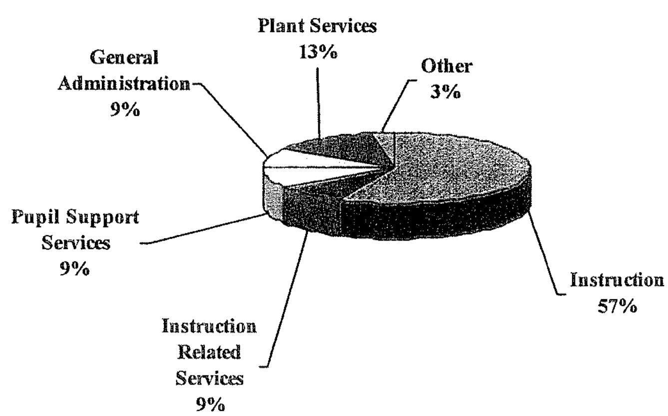
Governmental Activities

As reported in the Statement of Activities, the cost of all of the District's governmental activities this year was $14,111,743. The amount that our local taxpayers financed for these activities through property taxes was $4,044,446. State aid not restricted to specific purposes totaled $6,183,817. State and Federal Categorical revenue totaled over $2.3 million, and covered 16% of the expenses of the entire District (See Figure 1).

Sources of Revenue for the 2005-06 Fiscal Year
Figure 1



Expenses for the 2005-06 Fiscal Year
Figure 2



FINANCIAL ANALYSIS OF THE FUND STATEMENTS

The fund financial statements focus on individual parts of the District's operations in more detail than the government-wide statements. The District's individual fund statements provide information on inflows and outflows and balances of spendable resources. The District's Governmental Funds reported a combined fund balance of $2,107,661, an increase of $42,907 from the previous fiscal year's combined ending balance of $2,065,564. This increase is all reflected in the capital projects funds. The General Fund balance increased $69,058.

General Fund Budgetary Highlights

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

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

The final revised budget for the General Fund reflected a net decrease to the ending balance of $126,249.

The District ended the year with an increase of $69,058 to the General Fund ending balance. The State recommends an ending reserve for economic uncertainties of 3%. The District's ending reserve was 5.8%, which included this reserve for economic uncertainties.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

By the end of the 2005-06 fiscal year, the District had invested $15,237,766 in a broad range of capital assets, including school buildings, site improvements, vehicles, and equipment. This amount represents a decrease of $16,639 from the previous fiscal year.

CAPITAL ASSET AND DEBT ADMINISTRATION (CONTINUED)

Capital Assets (Concluded)

Table 3
Comparative Schedule of Capital Assets
(net of depreciation)
June 30, 2006 and 2005

	2006	2005	Difference
Land	$ 678,969	$ 678,969	$ 0
Site & Improvements	14,865	0	14,865
Work in Process	19,750	0	19,750
Buildings	8,876,422	9,299,462	(423,040)
Machinery & Equipment	622,470	645,083	(22,613)
Total	$10,212,476	$10,623,514	$(411,038)

Long-Term Debt

At June 30, 2006, the District had $864,088 in long-term debt outstanding.

Table 4
Comparative Schedule of Outstanding Debt
June 30, 2006 and 2005

	2006	2005
Early Retirement Incentive	$ 382,092	$ 445,774
Compensated Absences	57,941	37,937
Capital Lease Obligations	342,608	497,409
Other Long-Term Debt	81,447	91,759
TOTAL	$864,088	$1,072,879

The District continues to maintain excellent credit ratings on all of its debt issues.

The long-term debt paid by the District was approximately $228 thousand in 2006.

FACTORS BEARING ON THE DISTRICT'S FUTURE

The State's economic downturn is a major factor affecting the District's future. The financial well being of the District is tied in large measure to the state funding formula. Furthermore, the State's current year budget does not fully address its budget problem, so it is anticipated that further reductions in funding may be forthcoming.

Student enrollment and attendance are primary factors in the computation of most funding formulas for public schools in the State of California.

The State's economic condition indicates a likely decline in the District's revenue, along with related budget reductions. The future predictions require management to plan carefully and prudently to provide the resources to meet student needs over the next several years. The District has an excellent track record in meeting this challenge in what has proven to be a cycle of lean years and prosperous years for education finances.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, parents, investors, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact Teri Malvino, Middletown Unified School District, 20932 Big Canyon Road, Middletown, CA 95461, (707) 987-4100.

MIDDLETOWN UNIFIED SCHOOL DISTRICT

STATEMENT OF NET ASSETS

JUNE 30, 2006

				Governmental Activities
ASSETS				
Cash (Note 2)			$	1,716,277
Accounts Receivable (Note 3)				798,907
Stores Inventory (Note 1H)				1,998
Capital Assets (Note 5):				
Land	$	678,969		
Sites and Improvements		14,865		
Buildings and Improvements		12,659,353		
Machinery and Equipment		1,864,829		
Work in Progress		19,750		
Less Accumulated Depreciation		(5,025,290)		
Total Capital Assets, Net of Depreciation				10,212,476
Total Assets			$	12,729,658
LIABILITIES				
Accounts Payable and Other Current Liabilities			$	332,307
Deferred Income (Note 1H)				77,214
Long-term Liabilities:				
Due Within One Year:				
Capital Lease Obligations (Note 6)	$	155,872		
Compensated Absences Payable (Note 1H)		57,941		
Early Retirement Incentives (Note 12)		63,682		
Other Long-term Debt (Note 7)		10,623		
Total Due Within One Year:				288,118
Due After One Year:				
Capital Lease Obligations (Note 6)		186,736		
Early Retirement Incentives (Note 12)		318,410		
Other Long-term Debt (Note 7)		70,824		
Total Due After One Year:				575,970
Total Liabilities			$	1,273,609
NET ASSETS				
Invested in Capital Assets, Net of Related Debt			$	10,553,908
Restricted For:				
Capital Projects				1,010,668
Education Programs				281,538
Unrestricted				(390,065)
Total Net Assets			$	11,456,049

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MIDDLETOWN UNIFIED SCHOOL DISTRICT

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2006

Governmental Activities	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets: Governmental Activities
Instruction	$ 8,019,179	$ 212,553	$ 1,497,082	$ (962)	$ (6,310,506)
Instruction-related services:					
Supervision of instruction	167				(167)
Instructional library, media and technology	110,915		3,226		(107,689)
School site administration	1,097,065	761	113,874		(982,430)
Pupil Services:					
Home-to school transportation	444,302	32,124	127,677		(284,501)
Food services	427,031	215,428	251,473		39,870
All other pupil services	465,710	2,808	118,934		(343,968)
General administration:					
Data processing	113,233				(113,233)
All other general administration	1,158,059	25,245	118,684		(1,014,130)
Plant services	1,838,569	1,517	94,103		(1,742,949)
Ancillary services	185,911				(185,911)
Interest on long-term debt	29,685				(29,685)
Other Outgo	221,917		118		(221,799)
Total Governmental Activities	$ 14,111,743	$ 490,436	$ 2,325,171	$ (962)	(11,297,098)

General Revenues:	
Property Taxes Levied For:	
General Purposes	4,044,446
Federal and State Aid not Restricted to Specific Purposes	6,183,817
Interest and Investment Earnings	50,100
Miscellaneous	858,585
Total General Revenue	11,136,948
Change in Net Assets	(160,150)
Net Assets Beginning	11,616,199
Net Assets Ending	$ 11,456,049

MIDDLETOWN UNIFIED SCHOOL DISTRICT
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2006

	General Fund	Special Reserve Fund for Postemployment Benefits	Capital Facilities	Other Governmental Funds	Total Governmental Funds
Assets					
Cash in County Treasury (Note 2)	$ 652,208	$ 175	$ 864,609	$ 196,385	$ 1,713,377
Cash on Hand and in Banks (Note 2)				400	400
Cash in Revolving Fund (Note 2)	2,500				2,500
Accounts Receivable (Note 3)	683,622		17,440	97,845	798,907
Due From Other Funds (Note 4)	102,352	83,825		12	186,189
Stores Inventories (Note 1H)				1,998	1,998
Total Assets	$ 1,440,682	$ 84,000	$ 882,049	$ 296,640	$ 2,703,371
Liabilities and Fund Balances					
Liabilities:					
Accounts Payable	$ 243,476		$ 12,758	$ 76,073	$ 332,307
Deferred Revenue (Note 1H)	77,214				77,214
Due to Other Funds (Note 4)	83,838	$ 84,000		18,351	186,189
Total Liabilities	404,528	84,000	12,758	94,424	595,710
Fund Balances (Note 1H):					
Reserved	2,500			1,998	4,498
Legally Restricted Balances	281,474				281,474
Unreserved:					
Designated	661,269				661,269
Undesignated	90,911		869,291	200,218	1,160,420
Total Fund Balances	1,036,154	0	869,291	202,216	2,107,661
Total Liabilities and Fund Balances	$ 1,440,682	$ 84,000	$ 882,049	$ 296,640	$ 2,703,371

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MIDDLETOWN UNIFIED SCHOOL DISTRICT
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO THE STATEMENT OF NET ASSETS
JUNE 30, 2006

Total fund balance – governmental funds		$ 2,107,661
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets: In governmental funds, only current assets are reported. In the statement of net assets, all assets are reported, including capital assets $15,237,766 and accumulated depreciation $(5,025,290).		10,212,476
Long-term liabilities are not due and payable in the current period and therefore are not reported as liabilities in the funds. Long-term liabilities at year-end consist of:		
Other postemployment benefits	$ 382,092	
Compensated absences payable	57,941	
Capital leases payable	342,608	
Other general long-term debt	81,447	
		(864,088)
Total net assets-governmental activities		$11,456,049

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MIDDLETOWN UNIFIED SCHOOL DISTRICT
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	General Fund	Special Reserve Fund for Postemployment Benefits	Capital Facilities	Other Governmental Funds	Total Governmental Funds
REVENUES					
Revenue Limit Sources:					
State Apportionments	$ 5,442,679			$ 3,053	$ 5,445,732
Local Sources	4,044,443				4,044,443
Total Revenue Limit	9,487,122			3,053	9,490,175
Federal Revenue	735,264			241,853	977,117
Other State Revenue	1,499,474			84,463	1,583,937
Other Local Revenue	933,936	$ 4,239	$ 720,530	242,614	1,901,319
Total Revenues	12,655,796	4,239	720,530	571,983	13,952,548
EXPENDITURES					
Certificated Salaries	6,121,703			2,447	6,124,150
Classified Salaries	1,946,881			137,363	2,084,244
Employee Benefits	2,672,524			40,417	2,712,941
Books and Supplies	731,468		29,495	269,620	1,030,583
Services and Other Operating Expenditures	897,636		85,245	298,210	1,281,091
Capital Outlay	39,189			220,755	259,944
Debt Service:					
Principal Retirement			165,113		165,113
Interest and Fiscal Charges			29,685	961	30,646
Other Outgo	151,186		47,426	23,127	221,739
Total Expenditures	12,560,587	0	356,964	992,900	13,910,451
Excess of Revenues Over (Under) Expenditures	95,209	4,239	363,566	(420,917)	42,097
Other Financing Sources (Uses):					
Operating Transfers In (Note 4)	149,470	107,746		84,269	341,485
Operating Transfers Out (Note 4)	(175,621)	(138,466)	(27,398)		(341,485)
Total Other Financing Sources (Uses)	(26,151)	(30,720)	(27,398)	84,269	0
Excess of Revenues and Other Financing Sources Over (Under) Expenditures and Other Uses	69,058	(26,481)	336,168	(336,648)	42,097
Fund Balances - July 1, 2005	967,096	26,481	533,123	538,864	2,065,564
Fund Balances - June 30, 2006	$ 1,036,154	$ 0	$ 869,291	$ 202,216	$ 2,107,661

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MIDDLETOWN UNIFIED SCHOOL DISTRICT
RECONCILIATION OF THE GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2006

Net change in fund balances – Total governmental funds		$ 42,097
Amounts reported for governmental activities in the statement of activities are different because:		
Capital outlay: In governmental funds, the cost of capital assets are reported as expenditures in the period when the assets are acquired. In the statement of activities, costs of capital assets are allocated over their estimated useful lives as depreciation expense. The difference between capital outlay expenditures and depreciation expense for the period is:		
Expenditures for capital outlay:	$ 239,335	
Depreciation expense:	(410,655)	
Net		(171,320)
Gain or loss from disposal of capital assets: In governmental funds, the entire proceeds from disposal of capital assets are reported as revenue. In the statement of activities, only the resulting gain or loss is reported. The difference between the proceeds from disposal of capital assets and the resulting gain or loss is:		(239,718)
Debt service: In governmental funds, repayments of long-term debt are reported as expenditures. In the government-wide statements, repayments of long-term debt are reported as reductions of liabilities. Expenditures for repayment of the principal portion of long-term debt were:		228,795
Compensated absences: In governmental funds, compensated absences are measured by the amounts paid during the period. In the statement of activities compensated absences are measured by the amounts earned. The difference between compensated absences paid and compensated absences earned was:		(20,004)
Total change in net assets-governmental activities		$(160,150)

MIDDLETOWN UNIFIED SCHOOL DISTRICT
STATEMENT OF NET ASSETS
FIDUCIARY FUNDS
JUNE 30, 2006

	Expendable Trust Scholarship Fund	Agency Fund	Total
ASSETS			
Cash on Hand and in Bank	$ 7,921	$143,657	$151,578
Accounts Receivable	1,000	0	1,000
Total Assets	8,921	143,657	152,578
LIABILITIES			
Liabilities:			
Due to Student Groups	0	143,657	143,657
Total Liabilities	0	143,657	143,657
NET ASSETS			
Reserved for scholarships	8,921	0	8,921
Total Net Assets	$ 8,921	$ 0	$ 8,921

MIDDLETOWN UNIFIED SCHOOL DISTRICT
STATEMENT OF CHANGES IN NET ASSETS
FIDUCIARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2006

	Expendable Trust Scholarship Fund
Additions	
Interest Income	$ 132
Total Additions	132
Deductions	
Scholarships	0
Change in net assets	132
Net assets – July 1, 2005	8,789
Net assets – June 30, 2006	$8,921

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

The District accounts for its financial transactions in accordance with the policies and procedures of the Department of Education's *California School Accounting Manual.* The accounting policies of the District conform to accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB) and the American Institute of Certified Public Accountants (AICPA).

A. Reporting Entity

The District includes all funds that are controlled by or dependent on the District's governing board for financial reporting purposes. The District has considered all potential component units in determining how to define the reporting entity, using criteria set forth in generally accepted accounting principles. The District determined that there are no potential component units that meet the criteria for inclusion within the reporting entity.

B. Basis of Presentation

Government-wide Financial Statements:

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the District and its component units.

The government-wide statements are prepared using the economic resources measurement focus. This is the same approach used in the preparation of the proprietary fund and fiduciary fund financial statements but differs from the manner in which governmental fund financial statements are prepared. Governmental fund financial statements, therefore, include a reconciliation with brief explanations to better identify the relationship between the government-wide statements and the statements for the governmental funds.

The government-wide statement of activities presents a comparison between direct expenses and program revenues for each function or program of the district's governmental activities. 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. Program revenues include charges paid by the recipients of goods or services offered by a program, as well as grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues, which are not classified as program revenues, are presented as general revenues of the District, with certain exceptions. The comparison of direct expenses with program revenues identifies the extent to which each governmental function is self-financing or draws from the general revenues of the District.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Basis of Presentation (Concluded)

Fund Financial Statements:

Fund financial statements report detailed information about the District. The focus of governmental fund financial statements is on major funds rather than reporting funds by type. Each major governmental fund is presented in a separate column, and all non-major funds are aggregated into one column. Fiduciary funds are reported by fund type.

The accounting and financial treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a flow of current financial resources measurement focus. With this measurement focus, only current asset and current liabilities are generally included on the balance sheet. The Statement of Revenues, Expenditures, and Changes in Fund Balances for these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

Fiduciary funds are reported using the economic resources measurement focus.

C. Basis of Accounting

Basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting. Fiduciary funds use the accrual basis of accounting.

Revenues - exchange and non-exchange transactions:

Revenue resulting from exchange transactions, in which each party gives and receives essentially equal value, is recorded under 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 the resources will be collected within the current fiscal year or are expected to be collected soon enough thereafter to be used to pay liabilities of the current fiscal year. For the District," available" means collectible within the current period or within 60 days after year-end.

Non-exchange transactions, in which the District receives value without directly giving equal value in return, include property taxes, grants, and entitlements. Under the accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants and entitlements is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are to be used or the fiscal year when use is first permitted; matching requirements, in which the District must provide local resources to be used for a specific purpose; and expenditure requirements, in which the resources are provided to the District on a reimbursement basis. Under the modified accrual basis, revenue from non-exchange transactions must also be available before it can be recognized.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Basis of Accounting (Concluded)

Deferred revenue:

Deferred revenue arises when assets are received before revenue recognition criteria have been satisfied. Grants and entitlements received before eligibility requirements are met are recorded as deferred revenue. On governmental fund financial statements, receivables associated with non-exchange transactions that will not be collected within the availability period have also been recorded as deferred revenue.

Expenses/expenditures:

On the accrual basis of accounting, expenses are recognized at the time a liability is incurred. On the modified accrual basis of accounting, expenditures are generally recognized in the accounting period in which the related fund liability is incurred, as under the accrual basis of accounting. However, under the modified accrual basis of accounting, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due. Allocations of cost, such as depreciation and amortization, are not recognized in the governmental funds.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

D. Fund Accounting

The accounts of the District are organized on the basis of funds, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures or expenses, as appropriate. District resources are allocated to and accounted for in individual funds based upon the purpose for which they are to be spent and the means by which spending activities are controlled. The District's accounts are organized into major, non-major and fiduciary funds as follows:

MAJOR GOVERNMENTAL FUNDS:

1. General Fund is the general operating fund of the District. It is used to account for all financial resources except those required to be accounted for in another fund.

2. The Special Reserve Fund for Postemployment Benefits is used to accumulate funds to pay future costs of retirement agreements with District employees.

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Fund Accounting (Concluded)

NON-MAJOR GOVERNMENTAL FUNDS:

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes. The District maintained three non-major special revenue fund:

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

2. Cafeteria Fund is used to account for revenues received and expenditures made to operate the District's cafeteria program

3. Deferred Maintenance Fund is used for the purpose of major repairs or replacement of District property.

Capital Projects Fund is used to account for the acquisition and/or construction of all major governmental general fixed assets. The District maintains two non-major capital projects fund:

1. State School Building Fund is used to account for resources received from the State and other District funds for the purpose of capital facility construction/modernization..

2. County School Facilities Fund is for the combination of accounting related to the modernization projects at District sites.

Agency Funds are used to account for assets of others for which the District acts as an agent. The District maintains an agency fund for the student body accounts at six schools.

E. Budgets and Budgetary Accounting

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds. By state law, the District's governing board must adopt a final budget no later than July 1. A public hearing must be conducted to receive comments prior to adoption. The District's governing board satisfied these requirements.

These budgets are revised by the District's Board of Trustees and District Superintendent during the year to give consideration to unanticipated income and expenditures. The original and final revised are presented for the General Fund and major Special Revenue Funds as required supplementary information in the financial statements.

Formal budgetary integration was employed as a management control device during the year for all budgeted funds. The District employs budget control by minor object and by individual appropriation accounts. Expenditures cannot legally exceed appropriations by major object account.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. Encumbrances

Encumbrance accounting is used in all budgeted funds to reserve portions of applicable appropriations for which commitments have been made. Encumbrances are recorded for purchase orders, contracts, and other commitments when they are written. Encumbrances are liquidated when the commitments are paid. All encumbrances are liquidated at June 30.

G. 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.

H. Assets, Liabilities and Equity

1. Deposits and Investments

Cash balances held in banks and in revolving funds are insured to $100,000 by the Federal Deposit Insurance Corporation.

In accordance with *Education Code* Section 41001, the District maintains substantially all of its cash in the County Treasury. The county pools these funds with those of other districts in the county and invests the cash. These pooled funds are carried at cost, which approximates market value. Interest earned is deposited quarterly into participating funds. Any investments losses are proportionately shared by all funds in the pool.

The county is authorized to deposit cash and invest excess funds by California *Government Code* Section 53648 et seq. The funds maintained by the county either are secured by federal depository insurance or are collateralized.

Investments Valuation - In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, highly liquid market investments with maturities of one year or less at time of purchase are stated at amortized cost. All other investments are stated at fair value. Market value is used as fair value for those securities for which market quotations are readily available. However, the District's financial statements do not reflect the fair value of investments as the differences between total investment cost and fair value has been determined to be immaterial.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Assets, Liabilities and Equity (Continued)

2. Stores Inventories

Inventories are recorded using the consumption method, in that inventory acquisitions are initially recorded in inventory (asset) accounts, and are charged as expenditures when used. Reported inventories are equally offset by a fund balance reserve, which indicates that these amounts are not "available for appropriation and expenditure" even though they are a component of net current assets.

The District's cafeteria inventory valuation is First-in-First-out (FIFO).

3. Capital Assets

Capital assets purchased or acquired with an original cost of $5,000 or more are reported at historical cost or estimated historical cost. Contributed assets are reported at fair market value as of the date received. Additions, improvements, and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

Asset Class	Examples	Estimated Useful Life in Years
Land		N/A
Site improvements	Paving, flagpoles, retaining walls, sidewalks, fencing, outdoor lighting	20
School buildings		50
Portable classrooms		25
HVAC systems	Heating, ventilation and air conditions systems	20
Roofing		20
Interior construction		25
Carpet replacement		7
Electrical/Plumbing		30
Sprinkler/fire system	Fire suppression systems	25
Outdoor equipment	Playground, radio towers, fuel tanks, pumps	20
Machinery & tools	Shop & maintenance equipment, tools	15
Kitchen equipment	Appliances	15
Custodial equipment	Floor scrubbers, vacuums, other	15
Science & engineering	Lab equipment, scientific apparatus	10
Furniture & accessories	Classroom & other furniture	20
Business machines	Fax, duplicating & printing equipment	10
Copiers		5
Communication equipment	Mobile, portable radios, non-computerized	10
Computer hardware	PCs, printers, network hardware	5
Computer software	Instructional, other short-term	5 to 10
Computer software	Administrative or long-term	10 to 20

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Assets, Liabilities and Equity (Continued)

3. Capital Assets (Concluded)

Asset Class	Examples	Estimated Useful Life in Years
Audio visual equipment	Projectors, cameras (still & digital)	10
Athletic equipment	Gymnastics, football, weight machines, wrestling mats	10
Musical instruments	Pianos, strings, brass, percussion	10
Library books	Collections	5 to 7
Licensed vehicles	Buses, other on-road vehicles	8
Contractor's equipment	Major off-road vehicles, front-end loaders, large tractors, mobile air compressor	10
Grounds equipment	Mowers, tractors, attachments	15

4. Deferred Revenue

Cash received for federal and state special projects and programs is recognized as revenue to the extent that qualified expenditures have been incurred. Deferred revenue is recorded to the extent that cash received on specific projects and programs exceeds qualified expenditures.

5. Compensated Absences

All vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in the governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

Accumulated sick leave benefits are not recognized as liabilities of the District. The District's policy is to record sick leave as an operating expense in the period taken, since such benefits do not vest, nor is payment probable; however, unused sick leave is added to the creditable service period for calculation of retirement benefits when the employee retires.

6. 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.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Assets, Liabilities and Equity (Continued)

7. Net Assets

In the government-wide financial statements, net assets are classified in the following categories:

Invested in Capital Assets, net of Related Debt - This amount consists of capital assets net of accumulated depreciation and reduced by outstanding debt that attributed to the acquisition, construction, or improvement of the assets.

Restricted Net Assets - This amount is restricted by external creditors, grantors, contributors, laws or regulations of other governments.

Unrestricted Net Assets - This amount is all net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted net assets."

8. Use of Restricted/Unrestricted Net Assets

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, the District's policy is to apply restricted net assets first.

9. Fund Balance Reserves and Designations

The District's fund balances at June 30, 2006 consisted of the following:

	General Fund	Capital Facilities	Other Governmental Funds	Total
Reserved For:				
Revolving Fund	$ 2,500			$ 2,500
Stores Inventories			$ 1,998	1,998
Legally Restricted Balances	281,474			281,474
Unreserved:				
Designated For:				
Economic Uncertainties	636,804			636,804
Other Designations	24,465			24,465
Undesignated, Reported in:				
General Fund	90,911			90,911
Capital Projects Funds		$869,291	12	869,303
Special Revenue Funds			200,206	200,206
Total Fund Balances	$1,036,154	$869,291	$202,216	$2,107,661

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)

H. Assets, Liabilities and Equity (Concluded)

9. Fund Balance Reserves and Designations (Concluded)

Reservations of the ending fund balance indicate the portions of fund balance not appropriable for expenditure or amounts legally segregated for a specific future use. The reserve for revolving fund and reserve for stores inventory reflects the portions of fund balance represented by revolving fund cash and stores inventory, respectively. These amounts are not available for appropriation and expenditure at the balance sheet date.

Designations of the ending fund balance indicate tentative plans for financial resource utilization in a future period.

10. Revenue Limit/Property Tax

The District's revenue limit is received from a combination of local property taxes, state apportionments, and other local sources.

The county is responsible for assessing, collecting, and apportioning property taxes. Taxes are levied for each fiscal year on taxable real and personal property in the county. The levy is based on the assessed values as of the preceding January 1, which is also the lien date. Property taxes on the secured roll are due on November 1 and February 1, and taxes become delinquent after December 10 and April 10, respectively. Property taxes on the unsecured roll are due on the lien date (January 1), and become delinquent if unpaid by August 31.

Secured property taxes are recorded as revenue when apportioned, in the fiscal year of the levy. The county apportions secured property tax revenue in accordance with the alternate method of distribution prescribed by Section 4705 of the California *Revenue and Taxation Code*. This alternate method provides for crediting each applicable fund with its total secured taxes upon completion of the secured tax roll - approximately October 1 of each year.

The County Auditor reports the amount of the District's allocated property tax revenue to the California Department of Education. Property taxes are recorded as local revenue limit sources by the District.

The California Department of Education reduces the District's entitlement by the District local property tax revenue. The balance is paid from the state General Fund, and is known as the State Apportionment.

The District's Base Revenue Limit is the amount of general-purpose tax revenue, per average daily attendance (ADA), that the District is entitled to by law. This amount is multiplied by the second period ADA to derive the District's total entitlement.

NOTE 2 - CASH AND INVESTMENTS

A. Cash

The District had the following cash at June 30, 2006

	Fair Value	Carrying Amount	Credit Quality Rating
Cash on Hand and in Bank	$ 151,978	$ 151,978	Not Rated
Cash in Revolving Fund	2,500	2,500	Not Rated
Cash in County Treasury	1,709,367	1,713,377	Not Rated
Total Cash	$1,863,845	$1,867,855	

Cash in Banks and in Revolving Fund

Cash balances in banks, and revolving funds are insured up to $100,000 by the Federal Deposit Insurance Corporation (FDIC). These amounts are held within various financial institutions. As of June 30, 2006, the carrying amount of the District's accounts was $154,478.

The California Government Code requires California banks and savings and loan associations to secure the District's cash deposits by pledging securities as collateral. This Code states that collateral pledged in this manner shall have the effect of perfecting a security interest in such collateral superior to those of a general creditor. Thus, collateral for cash deposits is considered to be held in the District name.

According to California law, the market value of pledged securities with banking institutions must equal at least 110% of the District cash deposits. California law also allows institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the District's total cash deposits. The District may waive collateral requirements for cash deposits, which are fully insured up to $100,000 by the Federal Deposit Insurance Corporation. (The District, however, has not waived the collateralization requirements.)

The District follows the practice of pooling cash and investments of all funds, except for funds required to be held by fiscal agents under the provisions of bond indentures. Interest income earned on pooled cash and investments is allocated on a quarterly basis to the various funds based on average daily cash and investment balances. Interest income from cash and investments with fiscal agents is credited directly to the related fund.

NOTE 2 - CASH AND INVESTMENTS (CONCLUDED)

A. Cash (Concluded)

Cash in County Treasury

In accordance with *Education Code* Section 41001, the District maintains substantially all of its cash with the County Treasury as part of the common investment pool, which totaled $1,713,377 as of June 30, 2006. The fair market value of this pool as of that date, as provided by the pool sponsor, was $1,709,367. The District is considered to be an involuntary participant in the external investment pool. Interest is deposited into participating funds. The county is restricted by *Government Code* Section 53635, pursuant to Section 53601, to invest in time deposits, U.S. government securities, state registered warrants, notes or bonds, State Treasurer's investment pool, bankers' acceptances, commercial paper, negotiable certificates of deposit, and repurchase or reverse repurchase agreements.

B. Summary of Cash and Investments

The following is a summary of cash and investments at June 30, 2006:

Governmental Activities	Fiduciary Funds Statement of Net Assets	Total
$1,716,277	$151,578	$1,867,855

C. Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from rising interest rates, the District's investment policy required that at least 30% of the District's investment portfolio mature in less than one year. Additional limitations are that the average maturity of the investment portfolio will not exceed three years, and no investment will have a maturity of more than five years from its date of purchase. At June 30, 2006, the District had the following investment maturities:

	Investment Maturities (In Years)			
Investment Type	Fair Value	Less than 1	1 to 2	2 or More
County Treasury	$1,709,367	$1,389,715	$123,074	$196,578

NOTE 3 - ACCOUNTS RECEIVABLE

Accounts receivable at June 30,2006 consist of the following:

	General Fund	Capital Facilities Fund	Expendable All Other Governmental Funds	Trust Scholarship Fund	Total
Federal Government					
Categorical Aid Program	$130,411		$72,201		$202,612
State Government					
Revenue Limit Sources	285,097		3,053		288,150
Categorical Aid Programs	50,623				50,623
Other	106,344		5,827		112,171
Total State Government	442,064	$ 0	8,880	$ 0	450,944
Local Government	44,688				44,688
Miscellaneous	66,459	17,440	16,764	1,000	101,663
Total Accounts Receivable	$683,622	$17,440	$97,845	$1,000	$799,907

NOTE 4 - INTERFUND TRANSACTIONS

Interfund transactions are reported as either loans, services provided, reimbursements, or transfers. Loans are reported as interfund receivables and payables, as appropriate, and are subject to elimination upon consolidation. Services provided, deemed to be at market or near market rates, are treated as revenues and expenditures/expenses. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund, and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers among governmental or proprietary funds are netted as part of the reconciliation to the government-wide financial statements.

Interfund Transfers

Interfund transfers consist of operating transfers from funds receiving revenue to funds through which the resources are to be expended. Interfund transfers for the 2005-2006 fiscal year were as follows:

Funds	Transfers In	Transfers Out
General Fund	$149,470	$175,621
Deferred Maintenance Fund	67,231	
Special Reserve Fund for Postemployment Benefits	107,746	138,466
Capital Facilities Fund		27,398
State School Building Fund	661	
County School Facilities Fund	16,377	
Total	$341,485	$341,485

NOTE 4 - INTERFUND TRANSACTIONS (CONCLUDED)

Interfund Transfers (Concluded)

Transfer of $67,231 from the General Fund to the Deferred Maintenance Fund to support State match requirements.

Transfer of $107,746 from the General Fund to the Special Reserve Fund for Postemployment Benefits Fund to cover deficit spending to close the Special Reserve Fund.

Transfer of $644 from the General Fund to the State School Building Fund to cover deficit spending to close the State School Building Fund.

Transfer of $138,466 from the Special Reserve Fund for Postemployment Benefits to the General Fund to provide resources for the payment of postemployment benefits.

Transfer of $11,004 from the Capital Facilities Fund to the General Fund for indirect cost associated with developer fees.

Transfer of $16,377 from the Capital Facilities Fund to the County School Facilities Fund to cover deficit spending to close the County School Facilities Fund.

Transfer of $17 from the Capital Facilities Fund to the State School Building Fund to cover deficit spending to close the State School Building Fund.

Interfund Receivables/Payables (Due From/Due To)

Individual fund interfund receivable and payable balances at June 30, 2006 are as follows:

	Interfund Receivables	Interfund Payables
General Fund	$102,352	$ 83,838
Cafeteria Fund		18,349
Adult Education Fund		2
Special Reserve Fund for Postemployment Benefits	83,825	84,000
State School Building Fund	12	
Total	$186,189	$186,189

NOTE 5 - CAPITAL ASSETS AND DEPRECIATION

Capital asset activity for the year ended June 30, 2006, is shown below:

	Balance July 1, 2005	Additions	Deductions	Balance June 30, 2006
Capital assets, not being depreciated:				
Land	$ 678,969			$ 678,969
Work in progress		$ 19,750		19,750
Total capital assets, not being depreciated	678,969	19,750	$ 0	698,719
Capital assets being depreciated:				
Buildings	12,857,140	58,187	255,974	12,659,353
Sites and Improvements		14,865		14,865
Equipment	1,718,296	146,533		1,864,829
Total capital assets, being depreciated	14,575,436	219,585	255,974	14,539,047
Less accumulated depreciation for:				
Buildings	3,557,678	240,427	15,174	3,782,931
Equipment	1,073,213	170,228	1,082	1,242,359
Total accumulated depreciation	4,630,891	410,655	16,256	5,025,290
Total capital assets, being depreciated, net	9,944,545	(191,070)	239,718	9,513,757
Governmental activities capital assets, net	$10,623,514	$(171,320)	$ 239,718	$10,212,476

Depreciation expense was charged to governmental activities as follows:

Governmental Activities:

Instruction	$271,032
Home-to-school transportation	114,984
Food services	4,107
Plant services	20,532
Total	$410,655

NOTE 6 - CAPITAL LEASE OBLIGATIONS

The District leases equipment and portable classrooms originally valued at $1,166,592. Future minimum lease payments are as follows:

Year Ending June 30	Lease Payment
2007	$173,660
2008	92,953
2009	107,864
Total	374,477
Less amounts representing interest	31,869
Present Value of Net Minimum Lease Payments	$342,608

The District will receive neither sublease rental revenues nor any contingent rentals for this equipment.

NOTE 7 - OTHER LONG-TERM DEBT

On October 4, 2001, the District obtained a loan of $131,559 from the State of California, California Energy Commission evidenced by a promissory note. Payments of $6,493.90 are due each December and June through 2013 and include interest of 3%. A schedule of loan payments is shown below:

Year Ended June 30	Payment	Principal	Interest
2007	$12,988	$10,623	$2,365
2008	12,988	10,939	2,049
2009	12,988	11,275	1,713
2010	12,988	11,616	1,372
2011	12,988	11,967	1,022
2012-2013	25,976	25,027	948
Totals	$90,916	$81,447	$9,469

NOTE 8 - GENERAL LONG-TERM DEBT - SCHEDULE OF CHANGES

A schedule of changes in long-term debt for the year ended June 30, 2006 is shown below:

	Balance July 1, 2005	Additions	Deductions	Balance June 30, 2006	Due Within One Year
Compensated Absences	$ 37,937	$20,004		$ 57,941	$57,941
Early Retirement Incentives	445,774		$ 63,682	382,092	63,682
Capital Lease Obligations	497,409		154,801	342,608	155,872
Other Long-Term Debt	91,759		10,312	81,447	10,623
Totals	$1,072,879	$20,004	$228,795	$864,088	$288,118

The early retirement incentives and compensated absences will be paid by the General Fund. Payments towards the capital lease obligations is made from the General Fund and Capital Facilities Fund. Payments on the California Energy Commission Loan are paid from the Capital Facilities Fund.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

A. State and Federal Allowances, Award, and Grants

The District has received state and federal funds for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under terms of the grants, it is believed that any required reimbursement will not be material.

B. Joint Ventures (Joint Powers Agreements)

The Middletown Unified School District participates in three joint ventures under joint powers agreements (JPA's): the School Insurance Group Northern Alliance (SIGNAL and SIGNAL II) and the Self-Insured Schools of California (SISC). The relationship between the Middletown Unified School District and the JPAs are such that the JPAs are not component units of the Middletown Unified School District for financial reporting purposes.

SIGNAL arranges for and provides workers' compensation, SIGNAL II arranges for and provides property and liability insurance. SISC provides health benefits insurance for members.

NOTE 9 - COMMITMENTS AND CONTINGENCIES (CONCLUDED)

B. Joint Ventures (Joint Powers Agreements) (Concluded)

A board consisting of a representative from each Member District governs each joint venture. Each board controls the operations of the JPA independent of any influence by the member Districts beyond their representation on the board. Each member District pays a premium commensurate with the level of coverage requested and shares surpluses and deficits proportionate to their participation in the JPA.

NOTE 10 - POSTEMPLOYMENT HEALTH CARE BENEFITS

In addition to the pension benefits described in Note 11, the District provides postemployment health care, dental and vision benefits to all eligible employees up to the age of 65. To be eligible to receive these postemployment benefits, retirees must be age 55 and have completed a minimum of 10 years of continuous service with the District immediately prior to retirement. Employees hired after June 30, 1995 are not eligible for postemployment medical benefits.

During the year ended June 30, 2006, there were 21 retirees and their spouses who meet these eligibility requirements for a total cost to the District of $132,708.

The District contributes 100% of the cap towards the health care premiums for both the retiree and their spouse if they were full time employees of the District. For part time employees eligible for benefits, the District contributes a pro-rata share of the medical premiums depending on the percent of full time employment for each employee at retirement.

The District elected to report the cost of retiree's benefits on a "pay as you go" basis. That is, the cost of providing the benefits are reported as expenditures when the payments are made. The Government Accounting Standards Board (GASB) has issued statements 43 and 45 which will require the District to utilize periodic actuarial valuations to measure and disclose the liability for retiree healthcare benefits. The District obtained an actuarial study that reported the present value of the actuarial liability at July 1, 2004 was $2,051,891. The annual requirement contributions under GASB 45 according to the actuarial study would be $179,166 for 2004-05.

NOTE 11 - EMPLOYEE RETIREMENT SYSTEMS

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

NOTE 11 - EMPLOYEE RETIREMENT SYSTEMS

A. State Teachers' Retirement System (STRS)

Plan Description. The District contributes to the State Teachers' Retirement System (STRS), a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by STRS. The plan provides retirement, disability, and survivor benefits to beneficiaries. Benefit provisions are established by state statutes, as legislatively amended, within the State Teachers' Retirement Law. STRS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the STRS annual financial report may be obtained from the STRS, 7667 Folsom Boulevard, Sacramento, California 95826.

Funding Policy (STRS). Active plan members are required to contribute 8.00% of their salary and the Middletown Unified School District is required to contribute an actuarially determined rate. The actuarial methods and assumptions used for determining the rate are those adopted by the STRS Teachers' Retirement Board. The required employer contribution rate for fiscal year 2005-2006 was 8.25% of annual payroll. The contribution requirements of the plan members are established by state statute. The District's contributions to STRS for the fiscal year ending June 30, 2006, 2005, and 2004 were \$495,314, \$470,257 and \$453,651, respectively, and equal 100% of the required contributions for each year.

B. California Public Employees Retirement System (CalPERS)

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

Funding Policy. Active plan members are required to contribute 7.0% of their salary, and the District is required to contribute an actuarially determined rate. The actuarial methods and assumptions used for determining the rate are those adopted by the CalPERS Board of Administration. The required employer contribution rate for fiscal year 2005-2006 was 9.112% of annual payroll. The contribution requirements of the plan members are established by state statute. The Middletown Unified School District's contributions to CalPERS for the fiscal year ending June 30, 2006, 2005, and 2004 were \$171,861, \$190,356 and \$195,014, respectively, and equal 100% of the required contributions for each year.

NOTE 11 - EMPLOYEE RETIREMENT SYSTEMS (CONCLUDED)

C. Social Security

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

D. On Behalf Payment

The State of California makes contributions to STRS and PERS on behalf of the District. Under accounting principles generally accepted in the United States of America, these amounts are to be reported as revenues and expenditures, however, guidance received from the California Department of Education advises local education agencies not to record these amounts in the Annual Financial and Budget Report. These amounts also have not been recorded in these financial statements.

NOTE 12 – EARLY RETIREMENT INCENTIVE PROGRAM

In addition to the benefits described in Note 10 and Note 11, the District has adopted an early retirement incentive program, pursuant to *Education Code* Sections 22714 and 44929, whereby the service credit to eligible employees is increased by two years. Eligible employees must have five or more years of service under the State Teachers' Retirement System and retire during a period of not more than 120 days or less than 60 days from the date of the formal action taken by the District.

A total of six employees retired in 2003-2004 in exchange for the additional two years of service credit.

The District has agreed to pay STRS the amount due under the following payment plan:

Year Ending June 30	Principal	Interest	Total
2007	$ 63,682	$ 2,866	$ 66,548
2008	63,682	2,389	66,071
2009	63,682	1,911	65,593
2010	63,682	1,434	65,116
2011	63,682	957	64,639
2012	63,682	477	64,159
Total	$382,092	$10,034	$392,126

NOTE 13 - STUDENT BODY FUNDS

The Student Body Funds often engage in activities, which involve cash transactions. These transactions are not subject to adequate internal accounting control prior to deposits being recorded in the bank accounts. It has been determined on a cost benefit basis that providing increased internal control in this area does not justify the additional costs that would be necessary to control receipts prior to the point of deposit.

REQUIRED SUPPLEMENTARY INFORMATION SECTION

MIDDLETOWN UNIFIED SCHOOL DISTRICT
STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES - BUDGET (NON-GAAP) AND ACTUAL
GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	Budgeted Amounts			
	Original	Final	Actual (Budgetary Basis)	Variance with Final Budget Positive-(Negative)
REVENUES				
Revenue Limit Sources:				
State Apportionments	$ 5,914,470	$ 5,492,091	$ 5,442,679	$ (49,412)
Local Sources	3,453,674	3,996,957	4,044,443	47,486
Total Revenue Limit	9,368,144	9,489,048	9,487,122	(1,926)
Federal Revenue	646,184	762,554	735,264	(27,290)
Other State Revenue	1,407,547	1,565,541	1,499,474	(66,067)
Other Local Revenue	779,801	886,431	933,936	47,505
Total Revenues	12,201,676	12,703,574	12,655,796	(47,778)
EXPENDITURES				
Certificated Salaries	6,126,946	6,176,608	6,121,703	54,905
Classified Salaries	1,888,653	1,996,563	1,946,881	49,682
Employee Benefits	2,626,668	2,664,332	2,672,524	(8,192)
Books and Supplies	646,037	1,005,343	731,468	273,875
Services and Other Operating Expenditures	793,280	894,744	897,636	(2,892)
Capital Outlay	24,652	47,535	39,189	8,346
Other Outgo	33,576	91,956	151,186	(59,230)
Total Expenditures	12,139,812	12,877,081	12,560,587	316,494
Excess of Revenues Over (Under) Expenditures	61,864	(173,507)	95,209	268,716
Other Financing Sources (Uses):				
Operating Transfers In	123,172	149,470	149,470	
Operating Transfers Out	(75,514)	(102,212)	(175,621)	(73,409)
Total Other Financing Sources (Uses)	47,658	47,258	(26,151)	(73,409)
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	109,522	(126,249)	69,058	195,307
Fund Balances - July 1, 2005	967,096	967,096	967,096	0
Fund Balances - June 30, 2006	$ 1,076,618	$ 840,847	$ 1,036,154	$ 195,307

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MIDDLETOWN UNIFIED SCHOOL DISTRICT
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - BUDGET (NON-GAAP) AND ACTUAL
SPECIAL RESERVE FUND FOR POSTEMPLOYMENT BENEFITS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	Budgeted Amounts			
	Original	Final	Actual (Budgetary Basis)	Variance with Final Budget Positive-(Negative)
REVENUES				
Other Local Revenue		$ 4,239	$ 4,239	
Total Revenues	$ 0	4,239	4,239	$ 0
Excess of Revenues Over (Under) Expenditures	0	4,239	4,239	0
Other Financing Sources (Uses):				
Operating Transfers In	(90,086)	(31,678)	(107,746)	(76,068)
Operating Transfers Out	141,204	139,617	138,466	(1,151)
Total Other Financing Sources (Uses)	51,118	107,939	30,720	(77,219)
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	(51,118)	(103,700)	(26,481)	(77,219)
Fund Balances - July 1, 2005	26,481	26,481	26,481	0
Fund Balances - June 30, 2006	$ (24,637)	$ (77,219)	$ 0	$ (77,219)

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

SUPPLEMENTARY INFORMATION SECTION

MIDDLETOWN UNIFIED SCHOOL DISTRICT

MIDDLETOWN, CALIFORNIA

JUNE 30, 2006

ORGANIZATION

The Middletown Unified School District is a political subdivision of the State of California. The District was formed on July 1, 1963. It is located in and around the community of Middletown, Lake County, California. There were no boundary changes during the year. The District operates the following schools and provides instruction for pupils in kindergarten through the twelfth grade and adults:

Cobb Mountain Elementary	Grades K-6
Coyote Valley Elementary	Grades K-6
Minnie Cannon Elementary	Grades K-6
Middletown Middle School	Grades 7-8
Middletown High School	Grades 9-12
Loconoma Continuation School	Grades 9-12
Middletown Community Day Schools	Grades K-12

BOARD OF EDUCATION

Name	Office	Term Expires
Kim Bladel	President	November, 2008
Armond Urbano	Clerk	November, 2006
James Comstock	Member	November, 2006
Leona Boylan	Member	November, 2006
William Wright	Member	November, 2008

ADMINISTRATION

Donald Martin, Ed.D., Superintendent/Secretary to the Board
Teri Malvino, Business Manager

MIDDLETOWN UNIFIED SCHOOL DISTRICT

SCHEDULE OF AVERAGE DAILY ATTENDANCE

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	Second Period Report	Annual Report
Elementary		
Kindergarten	110	110
First through Third	381	383
Fourth through Sixth	366	368
Seventh and Eighth	246	245
Special Education - Master Plan	23	23
Community Day School	8	10
Elementary Totals	1,134	1,139
High School		
Ninth through Twelfth - Regular Classes	501	497
Continuation Education	30	31
Special Education - Master Plan	8	8
Special Education – Non Public	2	1
Community Day School	5	5
High School Totals	546	542
Average Daily Attendance Totals	1,680	1,681
Classes for Adults		
Adults Enrolled	1	1
Adult Totals	1	1

Summer School	Hours of Attendance	
Elementary	17,251	17,967
High School	6,003	6,214
Total Summer School Hours	23,254	24,181

Average daily attendance is a measurement of the numbers 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 the school districts. This schedule provides information regarding the attendance of students at various grade levels and in different programs.

MIDDLETOWN UNIFIED SCHOOL DISTRICT

SCHEDULE OF INSTRUCTIONAL TIME

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Grade Level	1986-87 Minutes Requirement	1982-83 Actual Minutes	2005-2006 Actual Minutes	Number of Days Traditional Calendar	Status
Kindergarten	36,000	36,000	39,600	180	In compliance
Grades One through Three	50,400	50,400	53,000	180	In compliance
Grades Four through Six	54,000	54,000	55,320	180	In compliance
Grades Seven through Eight	54,000	54,000	57,180	180	In compliance
Grades Nine through Twelve	64,800	64,800	67,145	180	In compliance

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

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

MIDDLETOWN UNIFIED SCHOOL DISTRICT

SCHEDULE OF CHARTER SCHOOLS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

This schedule is provided to list 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. The District is the Chartering District for the Lake County International Charter School. The Charter School is independent of the District and the financial statements for the District do not include activity for the Charter School.

MIDDLETOWN UNIFIED SCHOOL DISTRICT

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Program Name:	Federal Catalog Number	Pass-Through Entity Identifying Number	Program Expenditures
US Department of Agriculture:			
Forest Reserve	10.665	N/A	$ 10,122
Passed Through California Department of Education (CDE):			
National School Lunch	10.555	13524	186,131
Basic School Breakfast	10.553	13525	19,250
Especially Needy School Breakfast	10.553	13526	36,472
Total US Department of Agriculture			251,975
US Department of Education:			
Passed through California Department of Education (CDE)			
NCLB - Title I Basic Grants	84.010	14329	232,667
Special Education Basic Local Assistance	84.027	13379	290,852
Special Ed. IDEA Preschool Grants	84.173	13430	8,334
Special Ed. IDEA Preschool Local Entitlement	84.027A	13682	10,497
NCLB - Title II - Teacher Quality	84.367	14341	151,909
NCLB - Title IV - Drug Free Schools	84.186	14347	7,627
NCLB - Title II - Enhancing through Technology	84.318	14334	5,322
NCLB - Title V - Innovative Education	84.298A	14354	4,941
NCLB - Title III - Limited English Proficiency	N/A	14488	11,190
			1,803
Total US Department of Education			725,142
Total Federal Programs			$ 977,117

SEE NOTES TO SUPPLEMENTARY INFORMATION

MIDDLETOWN UNIFIED SCHOOL DISTRICT
RECONCILIATION OF UNAUDITED ACTUAL FINANCIAL REPORT
WITH AUDITED FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Auditor's Comment:

The audited financial statements for all funds were in agreement with the Unaudited Actual Financial Report for the year ended June 30, 2006.

MIDDLETOWN UNIFIED SCHOOL DISTRICT

SCHEDULE OF FINANCIAL TRENDS AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

General Fund	(Budget) 2006-2007	2005-2006	2004-2005	2003-2004
Revenues and Other Financial Sources	$ 13,025,005	$ 12,805,266	$ 12,159,759	$ 11,207,138
Expenditures	12,690,893	12,560,587	11,852,470	11,332,715
Other Uses and Transfers Out	103,580	175,621	87,314	107,434
Total Outgo	12,794,473	12,736,208	11,939,784	11,440,149
Change in Fund Balance	230,532	69,058	219,975	(233,011)
Ending Fund Balance	$ 941,304	$ 1,036,154	$ 967,096	$ 747,121
Available Reserves	$ 827,629	$ 727,715	$ 746,475	$ 437,366
Designated for Economic Uncertainties	$ 639,724	$ 636,804	$ 0	$ 389,930
Undesignated Fund Balance	$ 187,905	90,911	$ 746,475	$ 47,436
Available Reserves as a Percentage of Total Outgo	6.5%	5.7%	6.2%	3.8%
Total Long-Term Debt	633,911	$ 864,088	$ 1,072,879	$ 1,370,009
Average Daily Attendance at P-2 (exclusive of Adult Education)	1,660	1,680	1,708	1,712

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.

The General Fund Balance increased $69,058 during fiscal year 2005-2006. The General Fund Balance has increased $56,022 during the past three years. The fiscal year 2006-2007 budget projects an increase of $230,532. The amounts reported as budgeted for 2006-2007 are representations made by the District and have not been audited. The amounts are included for analytical purposes to improve the evaluation and reporting of the going concern status of the District. For a District this size the state recommends available reserves of at least 3% of total general fund expenditures, transfers out, and other uses (total outgo).

Total long-term debt has decreased $505,921 during the past two years. Average daily attendance has decreased 32 during the past two years.

SEE NOTES TO SUPPLEMENTARY INFORMATION

MIDDLETOWN UNIFIED SCHOOL DISTRICT
COMBINING BALANCE SHEET
NON-MAJOR FUNDS
JUNE 30, 2006

	Adult Education	Cafeteria	Deferred Maintenance	State School Building	Totals
ASSETS					
Cash in County Treasury	$ 13,763	$ 535	$ 182,087		$ 196,385
Cash on Hand and in Bank		400			400
Accounts Receivable					
Federal Government		72,201			72,201
State Government	3,053	5,827			8,880
Miscellaneous		16,764			16,764
Due from Other Funds				$ 12	12
Stores Inventory		1,998			1,998
Total Assets	$ 16,816	$ 97,725	$ 182,087	$ 12	$ 296,640
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts Payable	$ 16,814	$ 18,537	$ 40,722		$ 76,073
Due to Other Funds	2	18,349			18,351
Total Liabilities	16,816	36,886	40,722		94,424
Fund Balances:					
Reserved		1,998			1,998
Unreserved					
Undesignated		58,841	141,365	$ 12	200,218
Total Fund Balances	0	60,839	141,365	12	202,216
Total Liabilities and Fund Balances	$ 16,816	$ 97,725	$ 182,087	$ 12	$ 296,640

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MIDDLETOWN UNIFIED SCHOOL DISTRICT
COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
NON-MAJOR FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	Adult Education	Cafeteria	Deferred Maintenance	State School Building	County School Facilities	Totals
REVENUES						
Revenue Limit Sources:						
State Apportionment	$ 3,053					$ 3,053
Federal Sources:						
Child Nutrition Program		$ 241,853				241,853
Other State Sources:						
State Nutrition Program		17,232				17,232
Other			$ 67,231			67,231
Other Local Sources:						
Food Service Sales		234,623				234,623
Interest	367	236	7,388			7,991
Total Revenues	3,420	493,944	74,619			571,983
EXPENDITURES						
Certificated Salaries	2,447					2,447
Classified Salaries	1,199	117,755	18,409			137,363
Employee Benefits	603	38,916	898			40,417
Books and Supplies	526	258,265	10,829			269,620
Services and Other Operating Expenditures		9,703	288,507			298,210
Capital Outlay		7,291	20,135		$ 193,329	220,755
Debt Service:						
Interest and Fiscal Charges				$ 649	312	961
Other Outgo	257	22,870				23,127
Total Expenditures	5,032	454,800	338,778	649	193,641	992,900
Excess of Revenues Over (Under) Expenditures	(1,612)	39,144	(264,159)	(649)	(193,641)	(420,917)
Other Financing Sources (Uses):						
Operating Transfers In			67,231	661	16,377	84,269
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	(1,612)	39,144	(196,928)	12	(177,264)	(336,648)
Fund Balances - July 1, 2005	1,612	21,695	338,293	0	177,264	538,864
Fund Balances - June 30, 2006	$ 0	$ 60,839	$ 141,365	$ 12	$ 0	$ 202,216

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

MIDDLETOWN UNIFIED SCHOOL DISTRICT

NOTES TO SUPPLEMENTARY INFORMATION

FOR THE YEAR ENDED JUNE 30, 2006

NOTE 1 - PURPOSE OF STATEMENTS AND SCHEDULES

A. Schedule of Revenues, Expenditures, and Changes in Fund Balances - Budget and Actual

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, the District is required to present a Schedule of Revenues, Expenditures, and Changes in Fund Balance budgetary comparison for the General Fund and each Major Special Revenue Fund that has an adopted budget. This schedule presents the original adopted budget, final adopted budget, and the actual revenues and expenditures of each of these funds by object.

B. Schedule of Average Daily Attendance

Average daily attendance 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.

C. Schedule of Instructional Time

The District has received incentive funding for increasing instructional time as provided by the Incentives for Longer Instructional Day. This schedule presents information on the amount of instructional time and number of days offered by the District and whether the District complied with the provisions of Education Code Sections 46201 through 46206.

D. Schedule of Charter Schools

This schedule is provided to list 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.

E. Schedule of Expenditures of Federal Awards

OMB Circular A-133 requires a disclosure of the financial activities of all federally funded programs. To comply with Circular A-133 requirements, this schedule was prepared for the District.

F. Reconciliation of Unaudited Actual Financial Report with Audited Financial Statements

This schedule provides the information necessary to reconcile the fund balances of all funds and the total liabilities balance of the general long-term debt account group as reported on the Unaudited Actual Financial Report to the audited financial statements.

G. Schedule of Financial Trends and Analysis

This schedule is presented to improve the evaluation and reporting of the going concern status of the District.

H. Non-Major Fund Statements

Non-Major Fund statements are presented for purposes of additional analysis, and are not a required part of the District's basic financial statements. These statements present more detailed information about the financial position and financial activities of the District's individual funds.

OTHER INDEPENDENT AUDITORS REPORTS SECTION

GOODELL, PORTER & FREDERICKS LLP
CERTIFIED PUBLIC ACCOUNTANTS

RICHARD J. GOODELL, CPA
JOHN L. GOODELL, CPA
VIRGINIA K. PORTER, CPA
BEVERLY A. SANCHEZ, CPA

REPORT ON STATE COMPLIANCE

Board of Education
Middletown Unified School District
Middletown, California

We have audited the accompanying financial statements of the governmental fund activities, each major fund and the aggregate remaining fund information of the Middletown Unified School District, as of and for the year ended June 30, 2006, and have issued our report thereon dated September 29, 2006.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards for financial and compliance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *Standards and Procedures for Audits of California K-12 Local Education Agencies 2005-06*, published by the Education Audit Appeals Panel. 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 opinion.

The District's management is responsible for the District's compliance with laws and regulations. In connection with the audit referred to above, we selected and tested transactions and records to determine the District's compliance with the state laws and regulations applicable to the following items:

Description	Procedures in the Audit Guide	Procedures Performed
Attendance reporting	8	Yes
Kindergarten continuance	3	Yes
Independent study	22	Yes
Continuation education	10	Yes
Adult education	9	No (see below)
Regional Occupational Center/Programs	6	Not Applicable
Instructional Time:		
School Districts	4	Yes
County Offices of Education	3	Not Applicable

1435 River Park Drive ■ Suite 400 ■ Sacramento, CA 95815 ■ (916) 929-0264 ■ FAX (916) 929-5179

Description	Procedures in the Audit Guide	Procedures Performed
Community Day Schools	9	No (see below)
Morgan-Hart Class Size Reduction Program	7	Not Applicable
Instructional Materials:		
General Requirements	12	Yes
K-8 only	1	Yes
Grades 9-12 only	1	Yes
Ratios of Administrative Employees to Teachers	1	Yes
Early Retirement Incentive Program	4	Not Applicable
GANN Limit calculation	1	Yes
School Construction Funds:		
School District Bonds	3	Yes
State School Facilities Funds	1	Yes
Alternative Pension Plans	2	Not Applicable
Proposition 20 Lottery Funds (Cardenas Textbook Act of 2000)	2	Yes
State Lottery Funds (California State Lottery Act of 1984)	2	Yes
California School Age Families Education (Cal-Safe) Program	3	Not Applicable
School Accountability Report Card	3	Yes
Class Size Reduction:		
General Requirements	7	Yes
Option One	3	Yes
Option Two	4	Not Applicable
Districts or Charter Schools with only one school serving K-3	4	Not Applicable
Charter Schools:		
Contemporaneous Records of Attendance	1	Not Applicable
Nonclassroom-Based Instruction/Independent Study	15	Not Applicable
Additional Nonclassroom-Based Instruction	1	Not Applicable
Determination of Funding for Nonclassroom-Based Instruction	3	Not Applicable
Annual Instructional Minutes - Classroom Based	3	Not Applicable

Procedures were not performed for Adult Education and Community Day School attendance because the average daily attendance generated by the programs was below the level required for testing.

Based on our audit, we found that, for the items tested, the Middletown Unified School District complied with the state laws and regulations referred to above, except as described in the Findings and Recommendations Section of this report. Further, based on the examination, for items not tested, nothing came to our attention to indicate that the Middletown School District had not complied with the state laws and regulations.

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

Goodell, Porter & Fredericks, LLP

GOODELL, PORTER & FREDERICKS, LLP
Certified Public Accountants

September 29, 2006

GOODELL, PORTER & FREDERICKS, LLP
CERTIFIED
PUBLIC
ACCOUNTANTS

RICHARD J. GOODELL, CPA
JOHN L. GOODELL, CPA
VIRGINIA K. PORTER, CPA
BEVERLY A. SANCHEZ, CPA

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

Board of Education
Middletown Unified School District
Middletown, California

We have audited the financial statements of Middletown Unified School District as of and for the year ended June 30, 2006, and have issued our report thereon dated September 29, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Middletown Unified School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

1435 River Park Drive ■ Suite 400 ■ Sacramento, CA 95815 ■ (916) 929-0264 ■ FAX (916) 929-5179

Internal Control over Financial Reporting

In planning and performing our audit, we considered Middletown Unified School District's internal control over financial reporting 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 over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Middletown Unified School District's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are included in the Findings and Recommendations Section of the report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended solely for the information of the District Board, management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

Goodell, Porter & Fredericks, LLP

GOODELL, PORTER & FREDERICKS, LLP
Certified Public Accountants

September 29, 2006

GOODELL, PORTER & FREDERICKS LLP
CERTIFIED PUBLIC ACCOUNTANTS

RICHARD J. GOODELL, CPA
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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of Education
Middletown Unified School District
Middletown, CA

Compliance

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

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

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

1435 River Park Drive ■ Suite 400 ■ Sacramento, CA 95815 ■ (916) 929-0264 ■ FAX (916) 929-5179

Internal Control Over Compliance

The management of Middletown Unified School District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Middletown Unified School District's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level of risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal controls over compliance and its operation that we consider to be material weaknesses

This report is intended solely for the information and use of the Governing Board, management, federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than the specified parties.

Goodell, Porter & Fredericks, LLP

GOODELL, PORTER & FREDERICKS, LLP
Certified Public Accountants

September 29, 2006

FINDINGS AND RECOMMENDATION COSTS

MIDDLETOWN UNIFIED SCHOOL DISTRICT

SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness(es) identified?	___ Yes	_x_ No
Reporting condition(s) identified not considered to be material weaknesses?	_x_ Yes	___ None reported
Noncompliance material to financial statements noted?	___ Yes	_x_ No

Federal Awards

Internal control over financial reporting:		
Material weakness(es) identified?	___ Yes	_x_ No
Reporting condition(s) identified not considered to be material weaknesses?	___ Yes	_x_ None reported
Type of auditor's report issued on compliance for major programs	Unqualified	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133	___ Yes	_x_ No

Identification of major programs

CFDA Number	Name of Federal Program or Cluster
84.010	NCLB: Title I Basic Grants
84.027, 84.027A, 84.173	Special Education Program Cluster

Dollar threshold used to distinguish between Type A and Type B programs:	$300,000	
Auditee qualified as low-risk auditee?	_x_ Yes	___ No

State Awards

Internal control over state programs:		
Material weakness(es) identified?	___ Yes	_x_ No
Reporting conditions(s) identified not considered to be material weaknesses?	_x_ Yes	___ None reported
Type of auditor's report issued on compliance for state programs:	Qualified	

Section II - Financial Statements Findings

2006 - 1 - STUDENT BODY CASH RECEIPTS - LOCONOMA & COYOTE VALLEY - 30000

Specific Requirement That Was Not Complied With: Sound accounting practices require that cash receipts be counted by at least two individuals.

Finding: During our review of the student body cash receipts at the Loconoma Continuation School and the Coyote Valley Elementary School, we noted that the supporting documentation for cash received is being counted by one individual. We also noted that in the supporting documentation records, the actual receipt from the bank at the time of deposit is not being included.

Effect: The student body accounts are at risk of misappropriation with one individual counting the receipts.

Recommendation: All cash counting should be done by at least two individuals in order to minimize the potential risk of loss. The receipt from the bank at the time of deposit should also be attached with the supporting documentation to provide a clear audit trail.

District Response: The District agrees with the recommendation and will implement during 2006-07.

2006 - 2 - STUDENT BODY BANK RECONCILIATIONS - LOCONOMA - 30000

Specific Requirement That Was Not Complied With: Sound accounting practices require completion of a reconciliation of the monthly bank statement balance with the District's balance.

Finding: During our audit of the student body account at the Loconoma Continuation High School, we noted the check register balance was not reconciled accurately to the monthly bank statement.

Effect: Without monthly bank reconciliations, errors may occur and not be detected in a timely manner.

Recommendation: We recommend that monthly cash reconciliations be performed timely with differences promptly resolved.

District Response: The District agrees with the recommendation and will implement during 2006-07.

Section III - Federal Award Findings and Questioned Costs

No matters are reported.

Section IV - State Award Findings and Questioned Costs

2006 - 3 - ATTENDANCE - MIDDLETOWN MIDDLE SCHOOL - 10000

Finding: To test the attendance reported for the Middletown Middle School, we reviewed the records supporting attendance for the fifth attendance month. We determined teachers are entering daily attendance directly into the electronic attendance system. Weekly attendance reports are printed that provide detail to support the apportionment attendance claimed for each student. We determined the weekly class attendance reports were not signed by the teacher responsible for the claimed attendance.

Effect: Unless the weekly class attendance reports are reviewed and verified by the teacher, errors could occur and not be detected. We were able to satisfy ourselves that the attendance claimed by the District is accurate and no correction to the State attendance report submitted by the District is necessary.

Recommendation: To improve the attendance audit trail, we recommend the Middle School print the weekly attendance reports and require teachers to review the class roster forms timely and identify any errors that may need to be corrected. The teachers' review should be documented by a signature and date.

District Response: District management has reviewed the finding and recommendation with attendance personnel. Management will monitor to ensure the recommendation is implemented during 2006-07.

2006 - 4 - ATTENDANCE - MIDDLETOWN HIGH SCHOOL - 10000

Finding: During our audit of the fifth school month attendance at Middletown High School, we noted the attendance scantron forms prepared by the teachers are not signed in a timely manner.

Effect: Registers not signed by a teacher have not been certified as accurate by the certificated teacher responsible for taking attendance. We were able to satisfy ourselves that the attendance claimed by the District is accurate and no correction to the State attendance report, submitted by the District, is necessary.

Recommendation: We recommend the Middletown High School teachers sign all attendance registers or approved substitute form in a timely manner to certify that the attendance is accurate.

District Response: District management has reviewed the finding and recommendation with attendance personnel. Management will monitor to ensure the recommendation is implemented during 2006-07.

MIDDLETOWN UNIFIED SCHOOL DISTRICT

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

JUNE 30, 2006

Findings/Recommendations	Current Status	Explanation if Not Fully Implemented
1. The District should deposit money it receives at the District Office to the County Treasury at least weekly or more frequently if a large number of checks are received in any given time period.	Accepted Implemented	
2. The District should follow its policy requiring proper authorization which is documented by the completion and encumbering of a purchase order prior to disbursement to improve internal and budgetary controls.	Accepted Implemented	
3. Middletown High School teachers should sign all attendance registers in a timely manner. Additionally, the District should implement procedures to detect and correct errors in their attendance records.	Accepted Partially Implemented	See Current Year Finding 2006-4
4. The District should ensure that all teachers take attendance on a daily basis. Additionally, the District should implement controls to detect instances where a teacher has not recorded attendance.	Accepted Implemented	

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APPENDIX C

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This CONTINUING DISCLOSURE CERTIFICATE (the "Disclosure Certificate") is executed and delivered by the MIDDLETOWN UNIFIED SCHOOL DISTRICT (the "District") in connection with the issuance by the Board of Supervisors of Lake County (the "Board") in the name of the District of $4,999,986.80 Middletown Unified School District (Lake County, California) General Obligation Bonds, Election of 2006, Series 2007 (the "Bonds"). The Bonds are being issued pursuant to a resolution adopted by the Board of Trustees of the District on February 21, 2007, and a resolution adopted by the Board on February 27,2007 (collectively, the "Resolution"). The District covenants and agrees as follows:

Section 1. Purpose of the Disclosure Certificate. This Disclosure Certificate is being executed and delivered by the District for the benefit of the holders and beneficial owners of the Bonds and in order to assist the Participating Underwriters in complying with S.E.C. Rule 15c2-12(b)(5).

Section 2. Definitions. In addition to the definitions set forth in the Resolution, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section 2, the following capitalized terms shall have the following meanings:

"Annual Report" shall mean any Annual Report provided by the District pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

"Dissemination Agent" shall mean the District, or any successor Dissemination Agent designated in writing by the District and which has filed with the District a written acceptance of such designation.

"Listed Events" shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule.

"Participating Underwriter" shall mean Piper Jaffray Inc., as original underwriter of the Bonds, required to comply with the Rule in connection with offering of the Bonds.

"Repository" shall mean each National Repository and each State Repository.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State Repository" shall mean any public or private repository or entity designated by the State of California as a state repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of this Disclosure Certificate, there is no State Repository.

Section 3. Provision of Annual Reports.

(a) The District shall, or upon written direction shall cause the Dissemination Agent to, not later than eight months after the end of the District's fiscal year (which date would be March 1), commencing with the report for the 2007-08 fiscal year, provide to each Repository and the Participating Underwriter an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Certificate. Not later than fifteen (15) Business Days prior to said date, the District shall provide the Annual Report to the Dissemination Agent (if other than the District). The Annual Report may be submitted as a single document or as separate documents comprising a package, and may include by reference other information as provided in Section 4 of this Disclosure Certificate; provided that the audited financial statements of the District may be submitted separately from the balance of the Annual Report, and later than the date required above for the filing of the Annual Report if not available by that date. If the District's fiscal year changes, it shall give notice of such change to the Municipal Securities Rulemaking Board and each State Repository. The District shall provide a written certification with each Annual Report furnished to the Dissemination Agent to the effect that such Annual Report constitutes the Annual Report required to be furnished by the District hereunder.

(b) If the District is unable to provide to the Repositories an Annual Report by the date required in subsection (a), the District shall send a notice to the Municipal Securities Rulemaking Board and each State Repository in substantially the form attached as Exhibit A.

(c) The Dissemination Agent shall:

(i) determine each year prior to the date for providing the Annual Report the name and address of each National Repository and each State Repository, if any; and

(ii) if the Dissemination Agent is other than the District, file a report with the District certifying that the Annual Report has been provided pursuant to this Disclosure Certificate, stating the date it was provided and listing all the Repositories to which it was provided.

Section 4. Content of Annual Reports. The District's Annual Report shall contain or incorporate by reference the following:

(a) Audited Financial Statements prepared in accordance with the laws of the State of California and including all statements and information prescribed for inclusion therein by the Controller of the State of California. If the District's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(b) Unless otherwise provided in the audited financial statements filed on or prior to the annual filing deadline for Annual Reports provided for in Section 3 above, financial information and operating data with respect to the District for preceding fiscal year, substantially similar to that provided in the corresponding tables and charts in the official statement for the Bonds:

(i) The District's approved budget for the then current fiscal year; and

(ii) Assessed value of taxable property in the District as shown on the recent equalized assessment role.

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the District or related public entities, which have been submitted to each of the Repositories or the Securities and Exchange Commission. If the document included by reference is a final official statement, it must be available from the Municipal Securities Rulemaking Board. The District shall clearly identify each such other document so included by reference.

(c) In addition to any of the information expressly required to be provided under this Disclosure Certificate, the District shall provide such further material information, if any, as may be necessary to make the specifically required statements, in the light of the circumstances under which they are made, not misleading.

Section 5. Reporting of Significant Events.

(a) Pursuant to the provisions of this Section 5, the District shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material:

(i) Principal and interest payment delinquencies.
(ii) Non-payment related defaults.
(iii) Unscheduled draws on debt service reserves reflecting financial difficulties,
(iv) Unscheduled draws on credit enhancements reflecting financial difficulties.
(v) Substitution of credit or liquidity providers, or their failure to perform,
(vi) Adverse tax opinions or events affecting the tax-exempt status of the security,
(vii) Modifications to rights of security holders,
(viii) Contingent or unscheduled bond calls.
(ix) Defeasances.
(x) Release, substitution, or sale of property securing repayment of the securities,
(xi) Rating changes.

(b) Whenever the District obtains knowledge of the occurrence of a Listed Event, the District shall as soon as possible determine if such event would be material under applicable Federal securities law. The Dissemination Agent shall have no role nor any responsibility for such determination.

(c) If the District determines that knowledge of the occurrence of a Listed Event would be material under applicable Federal securities law, the District shall promptly file a notice of such occurrence with the Municipal Securities Rulemaking Board and each Repository with a copy to the Participating Underwriter. Notwithstanding the foregoing, notice of Listed Events described in subsections (a) (viii) and (ix) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to holders of affected Bond owners pursuant to the Resolution.

Section 6. Termination of Reporting Obligation. The District's obligations under this Disclosure Certificate shall terminate upon the legal defeasance, prior prepayment or payment in full of all of the Bonds.

Section 7. Dissemination Agent. The District may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The initial Dissemination Agent shall be the District. Any Dissemination Agent may resign by providing thirty days' written notice to the District.

Section 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the District may amend this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived, provided that the following conditions are satisfied:

(a) if the amendment or waiver relates to the provisions of Sections 3(a) or 4, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of an obligated person with respect to the Bonds, or type of business conducted;

(b) the undertakings herein, as proposed to be amended or waived, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the

Rule at the time of the primary offering of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) the proposed amendment or waiver either (i) is approved by holders of the Bonds in the manner provided in the Resolution for amendments to the Resolution with the consent of holders, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the holders or beneficial owners of the Bonds.

If the annual financial information or operating data to be provided in the Annual Report is amended pursuant to the provisions hereof, the first annual financial information filed pursuant hereto containing the amended operating data or financial information shall explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

If an amendment is made to the undertaking specifying the accounting principles to be followed in preparing financial statements, the annual financial information for the year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles. The comparison shall include a qualitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information, in order to provide information to investors to enable them to evaluate the ability of the District to meet its obligations. To the extent reasonably feasible, the comparison shall be quantitative. A notice of the change in the accounting principles shall be sent to the Municipal Securities Rulemaking Board and each Repository.

Section 9. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the District from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the District chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the District shall have no obligation under this Disclosure Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Section 10. Default. In the event of a failure of the District to comply with any provision of this Disclosure Certificate any holder or beneficial owner of the Bonds may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the District to comply with its obligations under this Disclosure Certificate. A default under this Disclosure Certificate shall not be deemed an Event of Default under the Resolution, and the sole remedy under this Disclosure Certificate in the event of any failure of the District to comply with this Disclosure Certificate shall be an action to compel performance.

Section 11. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Certificate, and the District agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which they may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The Dissemination Agent shall be paid compensation by the District for its services provided hereunder in accordance with its schedule of fees as amended from time to time and all expenses, legal fees and advances made or incurred by the Dissemination Agent in the performance of its duties hereunder. The Dissemination Agent shall have no duty or obligation to review any information provided to it by the District and shall not be deemed to be acting in any fiduciary capacity for the District, the Bond holders or any other party. The obligations of the District under this Section 10 shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

Section 12. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the District, the Dissemination Agent, the Participating Underwriters and holders and beneficial owners from time to time of the Bonds, and shall create no rights in any other person or entity.

Section 13. Alternative Filing Location. Any filing under this Disclosure Certificate may be made solely by transmitting such filing to the Texas Municipal Advisory Council (the "MAC") as provided at http://www.disclosureusa.org.

Date: March 22, 2007

MIDDLETOWN UNIFIED SCHOOL DISTRICT

By ____________________________________

Superintendent

EXHIBIT A

NOTICE TO MUNICIPAL SECURITIES RULEMAKING BOARD AND EACH STATE REPOSITORY OF FAILURE TO FILE ANNUAL REPORT

Name of Issuer:	Middletown Unified School District
Name of Issue:	$4,999,986.80 Middletown Unified School District (Lake County, California) General Obligation Bonds, Election of 2006, Series 2007
Date of Issuance:	March 22, 2007

NOTICE IS HEREBY GIVEN that the Middletown Unified School District (the "District") has not provided an Annual Report with respect to the above-named Bonds as required by Section 6 of the resolution adopted by the Board of Trustees of the District on February 21, 2007. The District anticipates that the Annual Report will be filed by ______________________.

Dated: __________

MIDDLETOWN UNIFIED SCHOOL DISTRICT

By:_________________________

Title:________________________

APPENDIX D

BOOK-ENTRY ONLY SYSTEM

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the District believes to be reliable, but the District takes no responsibility for the accuracy or completeness thereof. The District cannot and does not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of interest, principal or premium, if any, with respect to the Bonds, (b) Bonds representing ownership interest in or other confirmation or ownership interest in the Bonds, or (c) prepayment or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Bonds, or that they will so do on a timely basis or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Official Statement. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedure" of DTC to be followed in dealing with DTC Participants are on file with DTC.

General

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond will be issued for each maturity of the Bonds, in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities Bonds. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation and Emerging Markets Clearing Corporation (NSCC, FICC and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive Bonds representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the District (or the Trustee on behalf thereof) as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, premium, if any, and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the District or Paying Agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, the Paying Agent, or the District, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, premium, if any, and interest payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the

District or the Paying Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

A Beneficial Owner shall give notice to elect to have its Bonds purchased or tendered, through its Participant, to the Paying Agent, and shall effect delivery of such Bonds by causing the Direct Participant to transfer the Participant's interest in the Bonds, on DTC's records, to the Paying Agent. The requirement for physical delivery of Bonds in connection with an optional tender or a mandatory purchase will be deemed satisfied when the ownership rights in the Bonds are transferred by Direct Participants on DTC's records and followed by a book-entry credit of tendered Bonds to the Paying Agent's DTC account.

DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to the District or the Paying Agent. Under such circumstances, in the event that a successor depository is not obtained, Bonds are required to be printed and delivered.

The District may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). Discontinuance of use of the system of book-entry transfers through DTC may require the approval of DTC Participants under DTC's operational arrangements. In that event, Bonds will be printed and delivered.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the District believes to be reliable, but the District takes no responsibility for the accuracy thereof.

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APPENDIX E

FORM OF BOND
INSURANCE POLICY

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FINANCIAL SECURITY ASSURANCE®

MUNICIPAL BOND INSURANCE POLICY

ISSUER:

BONDS:

Policy No.: -N

Effective Date:

Premium: $

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of the Owners or, at the election of Financial Security, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, Financial Security will disburse to or for the benefit of each Owner of a Bond the face amount of principal of and interest on the Bond that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by Financial Security, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in Financial Security. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, who may submit an amended Notice of Nonpayment. Upon disbursement in respect of a Bond, Financial Security shall become the owner of the Bond, any appurtenant coupon to the Bond or right to receipt of payment of principal of or interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by Financial Security hereunder. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment made to an Owner by or on behalf of the Issuer which has been recovered from such Owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud), whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be canceled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature] FINANCIAL SECURITY ASSURANCE INC.

By ______________________ By ______________________
Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd. (212) 826-0100
31 West 52nd Street, New York, N.Y. 10019

FINANCIAL SECURITY ASSURANCE®

ENDORSEMENT NO. 1 TO MUNICIPAL BOND INSURANCE POLICY (California Insurance Guaranty Association)

ISSUER:

Policy No.: -N

BONDS:

Effective Date:

Notwithstanding the terms and provisions contained in this Policy, it is further understood that the insurance provided by this Policy is not covered by the California Insurance Guaranty Association established pursuant to Article 14.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

Nothing herein shall be construed to waive, alter, reduce or amend coverage in any other section of the Policy. If found contrary to the Policy language, the terms of this Endorsement supersede the Policy language.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Endorsement to be executed on its behalf by its Authorized Officer.

FINANCIAL SECURITY ASSURANCE INC.

By: ______________________________
Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.
31 West 52nd Street, New York, N.Y. 10019

(212) 826-0100

Form 560NY (CA 1/91)

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APPENDIX F

ACCRETED VALUE TABLE

DATE	08/01/2008 @ 11.6751429%	08/01/2009 @ 11.6751429%	08/01/2010 @ 11.6751429%
03/22/2007	4,285.80	3,826.05	3,415.65
08/01/2007	4,463.65	3,984.84	3,557.38
02/01/2008	4,724.22	4,217.45	3,765.05
08/01/2008	5,000.00	4,463.65	3,984.84
02/01/2009		4,724.22	4,217.45
08/01/2009		5,000.00	4,463.65
02/01/2010			4,724.22
08/01/2010			5,000.00

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