Board Agenda Item #	
Date:	06.21.2016
To:	MPS Board of Directors
From:	Caprice Young, Ed.D., CEO & Superintendent
Staff Lead:	Kelly Hourigan for the C Team
RE:	Closure of MSA Santa Clara

This is a continuation document from the June 13, 2016 Board meeting.

Proposed Board Recommendation

I move that the board direct staff to take the necessary actions to close MSA Santa Clara by June 30, 2016 due to low enrollment at the new site at the NHU facility in east San Jose and the impact on the budget, as well as our inability to find facilities in close proximity to our student population in Santa Clara, and that the board approves the transfer of assets and liabilities in accordance with the equity transfer proposed in this document.

Background

Please also refer to the previous board documents on this topic, attached.

Transfer of Outstanding Debt

Several scenarios have been considered by senior management to transfer the outstanding debt from MSA-SC:

1. Debt Transfer to Home Office – This method will require that the MSA-SC's intra-company loans and current liabilities are transferred to the home office, and that the home office secures a commercial line of credit to pay for MSA-SC's current obligations. The Home Office line of credit will be paid using the contingency reserves received via CMO Fees. Total amount of $892,700 will be spread-out over the repayment period of the loan, and will not have an additional financial impact to the remaining ten schools' net income/loss for the year. The home office will accumulate a portion of the 5.0% reserves until the amount has been paid in full.

2. One Time CMO Fee Allocation – This method will require the write-off of MSA-SC's intra-company loans and liabilities using the MPS CMO Fee allocation structure and by performing a one-time allocation to all MPS' schools. This methodology will require each school to absorb the accumulated MSA-SC debt as additional CMO fees, and will reflect an increase of expenditures to the organization totaling $892,700. Financial impact will be a one-time allocation to all schools totaling $892,700 in Fiscal Year 2015-16, and will increase overall expenses for the organization.

3. Equity Transfer from MSA-SC to MPS Schools – This method will require a debt transfer from MSA-SC to all MPS schools via an equity transfer. The transfer of intra-company loans and financial commitments from MSA-SC to the schools will reduce the "Beginning Fund Balances" of each the schools based on

fund availability. No financial impact will be reflected in the Statement of Activities (net income/loss) of the current fiscal year. Transfer will decrease the reserves for each of the schools, by reducing the accumulated Fund Balances by a total of $892,700.

The purpose of this report is to provide an update and analysis of the decision points regarding the treatment of assets and liabilities relating to the closure of Santa Clara. The individuals consulted for this analysis include our charter law attorney Jerry Simmons, our auditor Matt Miller from Vavernick Trine and Day, the charter office team at the Santa Clara Office of Education, LAUSD's charter finance manager Aaron Earlywine, CCSA, and several peer charter management organization leaders, as well as Serdar Orasov and Noel Russell-Unteberger.

The first step in this process is to ensure we have a complete and well-documented inventory of all physical and financial assets and liabilities. Kelly Hourigan, Frank Gonzales, Ylimaz Ak and Erdinc Acar have taken responsibility for the review and disposition of all physical assets according to generally accepted accounting principals and charter school regulations. We are transferring all assets useful by other Magnolia schools to the those schools (primarily Santa Ana) and donating remaining items to schools in the Bay Area that may have a need for the items that would not be cost effective to transport to our other schools. From an accounting perspective, all items will be documented as returning to the home office account and redistributed to whichever entity takes possession of them. The reason for this process is that Aaron Earlywine, from LAUSD, said that they will be looking for transparent centralized allocation and reallocation of our assets and liabilities.

With regards to the financial assets and liabilities, each funding source must be audited and accounted for. In some cases, we have receive grants that apply to multiple years and we will need to work with the California Department of Education to ensure that close out paperwork unique to those resources are completed in a timely manner. As with the physical assets, the financial assets and liabilities (mainly liabilities) will be consolidated into the home office account. The primary criteria we need to consider in addressing these liabilities from an accounting perspective are:

1. Compete transparency;
2. Consistency with GAAP and federal OMB regulations;
3. Segregation of resources and disposition according to the regulations regarding those resources;
4. Consistency with the language in the LAUSD settlement agreement;
5. Consistency with the State Auditors report and recommendations;
6. Preserving the attractiveness of Magnolia as a grant receiving entity; and,
7. Preserving operational flexibility for Magnolia's schools and as a consolidated entity.

Analysis of Debt Transfer

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Based on conversations with our authorizers, legal counsel, and external auditors, the proposal criteria would argue for a hybrid option of scenario one and three as described in the previous paragraph.

As identified in option one, all assets and liabilities will return to the home office prior to disposition. In the analysis of whether to do an equity transfer of non-LCFF and non-categorical reserves from our schools with significant long term reserves versus creating a loan of those reserve dollars from those schools to the home office and paying down that loan over the course of three to five years from revenue collected from the schools for administrative services. In order to move forward using the long-term loan, we would need to decrease the planned creation of the "rainy day" reserve by the repayment terms. An example of how that would work is identified below in a table documenting the annual payments for a three year loan and its impact on our planned reserve fund. The loan option also would decrease Magnolia's attractiveness to philanthropic funders because of concerns they may have regarding ensuring that their funds are used only for the grant purposes.

Debt Transfer Repayment from Home Office

	2016-17 (1)	2017-18	2018-19	Total
Total Revenue	6,119,230	6,368,492	6,615,858	
Total Expenses	5,827,315	5,959,670	6,132,586	
Operating Income	291,915	408,822	483,272	
Accumulated Reserves	-	58,383	140,147	
Projected Increase in Home Office Reserves	291,915	408,822	483,272	
Less: Reserves applied to MSA-SC Liabilities	***233,532***	***327,058***	***332,110***	***892,700***
Projected Home Office Ending Reserves for the year	58,383	140,147	291,309	

Notes:

(1) projections as of 05-27-2016

In addition, the prospective loan would significantly limit the operating flexibility of our school sites because the funds they would need to use to pay for the loan payment portion of the CMO fee would need to come from general funds, excluding LCFF and categorical funds which make up approximately 98 percent of the schools' budgets (it varies somewhat from school to school depending on student demographics).

The reason why LCFF funds cannot be used for this purpose is that they must be spent in accordance with our Local Control Accountability Plans, which are school specific. Fees the schools pay for services are allowable, but loan payments for other schools may be ruled ineligible. As the LCFF is a new funding source, there is some uncertainty as to how the limitations on its use will be interpreted, so this is a conservative view of the potential limitations. In addition, the state seems inclined to grant new resources going forward through the LCFF formula that will further limit schools' flexibility.

Conclusion

For the reasons above stated, a hybrid of option one and option three makes the most sense, with the liability attributed to the home office and addressed through an equity transfer of non-LCFF, non-categorical reserve funds. This option has been constructed with the advice of counsel and our auditors, both of whom will provide

letters providing documentation of the reasonableness of this approach. The table below shows the schools from which the unrestricted long-term reserves would be allocated. In addition, attached is a resolution the board would need to adopt in order to implement this option.

Estimated Accumulated Net Assets for FY 2015-16

	MSA-1	MSA-2	MSA-3	MSA-4	MSA-5	MSA-6	MSA-7	MSA-Bell	MSA-SD
Unrestricted Fund Balances prior to LCFF	*1,415,789*	*288,287*	*495,537*		*529,477*			*2,000,923*	
LCFF Fund Balances	1,023,336	807,001	352,335	567,722	421,657	938,327	922,105	1,018,998	934,663
Designated									118,998
2015-16 Total Net Assets, End of the Year	2,439,125	1,095,288	847,872	567,722	951,134	938,327	922,105	3,019,921	1,053,661

If the board chooses instead to select the loan option, an alternate resolution has been attached.

Impact of Closure on the Organization

Based on a preliminary conversation with our external auditors, MSA-SC charter will need to close on or before June 30, 2016 in order to avoid a Going Concern Opinion. MPS' management is working closely with Vavrinek, Trine, Day, LLP in order to ensure that all closure requirements are met before the June 30th deadline if the Board of Directors approves the closure of MSA-SC. Our external auditors and legal counsel will be on the call to answer questions relating to the financial impact to the organization.

Name of Staff Originator: C Team Members