



**MAGNOLIA EDUCATIONAL &
RESEARCH FOUNDATION**

ANNUAL FINANCIAL REPORT

JUNE 30, 2017

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

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

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Magnolia Educational & Research Foundation and affiliates
(A California Nonprofit Public Benefit Corporation)
Los Angeles, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Magnolia Educational & Research Foundation (MERF) (A California Nonprofit Public Benefit Corporation) and affiliates, which are comprised of the consolidated statement of financial position as of June 30, 2017 and 2016, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Charter School, as of June 30, 2017 and 2016, and the changes in its net assets, and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary information such as the Schedule of Expenditures of Federal Awards, as required by Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* and the other supplementary information as listed on the table of contents are presented for purposes of additional analysis and are not a required part of the consolidated financial statements.

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2017, on our consideration of MERF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of MERF's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MERF's internal control over financial reporting and compliance.

Varinik, Tein, Day & Co., LLP

Rancho Cucamonga, California
December 19, 2017

FINANCIAL STATEMENTS

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

	<u>2017</u>	<u>2016</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 9,834,842	\$ 9,875,931
Restricted cash	648,760	6,327,515
Accounts receivable	3,194,412	4,317,399
Prepaid expenses and other current assets	1,620,157	141,671
Total Current Assets	<u>15,298,171</u>	<u>20,662,516</u>
Non-Current Assets:		
Debt issue costs, net	358,782	371,596
Security deposits	64,690	144,150
Fixed assets	30,157,534	23,391,744
Less: accumulated depreciation	<u>(3,115,417)</u>	<u>(2,338,891)</u>
Total Non-Current Assets	<u>27,465,589</u>	<u>21,568,599</u>
Total Assets	<u>\$ 42,763,760</u>	<u>\$ 42,231,115</u>
LIABILITIES		
Current Liabilities:		
Accounts payable and accruals	\$ 3,212,491	\$ 3,117,074
Deferred revenue	519,063	507,918
Current portion of long-term obligations	3,129,116	190,871
Total Current Liabilities	<u>6,860,670</u>	<u>3,815,863</u>
Long-Term Obligations:		
Non-current portion of long-term obligations	14,424,680	17,553,792
Total Liabilities	<u>21,285,350</u>	<u>21,369,655</u>
NET ASSETS		
Unrestricted	20,413,178	19,874,309
Designated	1,065,232	987,151
Total Net Assets	<u>21,478,410</u>	<u>20,861,460</u>
Total Liabilities and Net Assets	<u>\$ 42,763,760</u>	<u>\$ 42,231,115</u>

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

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

CONSOLIDATED STATEMENT OF ACTIVITIES
(With comparative financial information at June 30, 2016)

FOR THE YEAR ENDED JUNE 30, 2017

	<u>2017</u>	<u>2016</u>
CHANGES IN UNRESTRICTED NET ASSETS		
REVENUES		
State apportionments	\$ 34,483,963	\$ 28,674,688
Federal revenue	3,756,458	2,983,400
Proposition 1D Grant construction revenue	-	6,666,280
Other state revenue	6,383,153	7,631,875
Local revenue	1,400,619	1,805,798
Total Revenues	<u>46,024,193</u>	<u>47,762,041</u>
EXPENSES		
Program services:		
Salaries and benefits	28,939,908	24,182,556
Student services	2,248,614	2,028,885
Materials and supplies	839,491	1,237,521
Student nutrition	1,670,987	1,312,016
Other expenses	1,221,591	1,139,571
Subtotal	<u>34,920,591</u>	<u>29,900,549</u>
Management and general:		
Amortization	12,814	12,814
Depreciation	907,827	543,494
Management fee	326,637	642,960
Occupancy	1,809,451	1,785,885
Operating expenses	6,546,835	6,342,425
Debt service	360,088	554,340
Interest	173,344	126,635
Subtotal	<u>10,137,786</u>	<u>10,008,553</u>
Total Expenses	<u>45,058,377</u>	<u>39,909,102</u>
CHANGE IN NET ASSETS BEFORE EXTRAORDINARY ITEM	<u>965,816</u>	<u>7,852,939</u>
Extraordinary item - MSA Santa Clara	<u>(348,866)</u>	<u>-</u>
CHANGE IN NET ASSETS	<u>616,950</u>	<u>7,852,939</u>
NET ASSETS, BEGINNING OF YEAR	<u>20,861,460</u>	<u>13,008,521</u>
NET ASSETS, END OF YEAR	<u>\$ 21,478,410</u>	<u>\$ 20,861,460</u>

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

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

CONSOLIDATED STATEMENT OF CASH FLOWS
(With comparative financial information at June 30, 2016)

FOR THE YEAR ENDED JUNE 30, 2017

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 616,950	\$ 7,852,939
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation expense	907,827	543,494
Changes in operating assets and liabilities:		
(Increase) Decrease in assets		
Accounts receivable	1,122,987	(146,488)
Prepaid expenses and other current assets	(1,478,486)	(111,817)
Security deposits	79,460	(33,589)
Increase in liabilities		
Accounts payable and accruals	95,417	547,829
Deferred revenue	11,145	62,193
Net Cash Provided by Operating Activities	<u>1,355,300</u>	<u>8,714,561</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	<u>(6,897,091)</u>	<u>(12,675,137)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Loan principal payments	(190,867)	(53,521)
Proceeds from long-term debt obligation	-	9,290,754
Restricted cash	5,678,755	(5,329,223)
Debt issue cost payments	12,814	(244,747)
Net Cash Provided by Financing Activities	<u>5,500,702</u>	<u>3,663,263</u>
NET CHANGE IN CASH	<u>(41,089)</u>	<u>(297,313)</u>
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>9,875,931</u>	<u>10,173,244</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 9,834,842</u>	<u>\$ 9,875,931</u>
Supplemental cash flow disclosure:		
Cash paid during the period for interest	<u>\$ 173,344</u>	<u>\$ 126,635</u>

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

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

NOTE 1 - ORGANIZATION AND MISSION

Magnolia Educational & Research Foundation

Magnolia Educational & Research Foundation (MERF) is a California not-for-profit organization. During the fiscal year ended June 30, 2017, MERF operated ten Magnolia Science Academy (MSA) kindergarten through grade twelve charter schools serving 3,320 students throughout California dedicated to inspiring students to choose career paths in science, technology, engineering, and math (STEM), while providing a robust, standards-based education program within a supportive culture of excellence.

To ensure students have the tools to succeed, the charter schools offer the following programs, which are mostly free of charge:

- Academic programs
- Student support programs
- After school programs
- Parent involvement programs

The charter schools operate under the approval of the California State Board of Education, Santa Clara County Office of Education, Los Angeles Unified School District and San Diego Unified School District. Each school receives public per-pupil funding from the State of California, in addition to grants from various government sources.

Other Related Entities

MPM Sherman Way, LLC

Magnolia Educational & Research Foundation, (MERF), formed the MPM Sherman Way, LLC (the LLC) exclusively for the acquisition of property and assets of Magnolia Science Academy Charter Schools, for charitable purposes as specified in Section 501(c)(3) of the Internal Revenue Service. The Charter Schools makes lease payments to the LLC, in accordance with the lease agreement specifically for the MSA 1 Reseda Project. Accordingly, the financial activities of the LLC have been included in the consolidated financial statements of MERF. MERF is the sole member of the LLC.

Joint Powers Agency and Risk Management Pools

Magnolia Science Academy Charter Schools are associated with the California Charter Schools Joint Powers Authority (CCS-JPA) *dba* CharterSAFE. CharterSAFE does not meet the criteria for inclusion as a component unit of MERF. Additional information is presented in Note 15 to the financial statements.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant policies followed by MERF are described below to enhance the use of the consolidated financial statements to the reader.

Financial Statement Presentation

MERF is required to report information about its financial position and activities in three classes of net assets: unrestricted, temporarily restricted, and permanently restricted net assets. MERF had no temporarily or permanently restricted net assets, as of June 30, 2017 and 2016, respectively. In addition, MERF is required to present a Statement of Cash Flows.

Accounting Method - Basis of Accounting

The financial statements were prepared on the accrual basis in accordance with the AICPA's Audit and Accounting Guide, Not-for-Profit Organizations accounting principles generally accepted in the United States of America as applicable to not-for-profit organizations. Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported on the financial statements. Basis of accounting relates to the timing of measurement made, regardless of the measurement focus applied. The Charter School uses the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recognized in the accounting period in which the liability is incurred.

Revenue Recognition

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted depending upon the existence and/or nature of any donor restrictions.

All donor-restricted contributions are recorded as increases in temporarily or permanently restricted net assets depending on the nature of the restriction. When a restriction expires, either by the passage of time or when the purpose is satisfied, the temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as "net assets released from restrictions". MERF and the LLC had no temporarily or permanently restricted net assets at June 30, 2017 and 2016, respectively.

In-kind contributions are recorded at their estimated fair values at the date of donation. Donated services are recorded if they create or enhance non-financial assets or require a specialized skill that MERF would otherwise need to purchase. As of June 30, 2017 and 2016, respectively, no in-kind contributions of services were received.

Government grants are recognized as revenue in accordance with the terms of the applicable grant agreement, which generally require revenue recognition upon incurrence of expenses related to the specified services. Deferred revenue is recorded to the extent cash received on specific grants exceeds qualified expenses.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

Income Taxes

MERF is a nonprofit public benefit corporation that is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and classified by the Internal Revenue Service as other than a private foundation and qualifies for deductible contributions as a public charity described in Section 509(a)(1) Type 1 supporting organizations and is exempt from State franchise and income taxes under Section 23701(d) of the California Revenue and Taxation Code. Accordingly, no provision for income taxes has been reflected in these financial statements. The statute of limitations for Federal and California State purposes is generally three and four years, respectively.

MERF has adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740 that clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the consolidated financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. MERF management has determined that all income tax positions are more likely than not of being sustained upon potential audit or examination; therefore, no disclosures of uncertain income tax positions are required.

Cash and Cash Equivalents

For purposes of the Consolidated Statement of Cash Flows, MERF considers all highly liquid investments available for current use with an initial maturity of three months or less to be considered as cash equivalents.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from the outstanding balance. Management provides an analysis of the probable collection of the accounts through a provision for bad debt expense and an adjustment to a valuation allowance. At June 30, 2017 and 2016, respectively, management had determined all accounts receivable are fully collectible and no allowance for bad debts has been established.

Intra-company Receivable/Payable

Intra-company receivable/payable results from a net cumulative difference between resources provided by MERF Headquarters to each individual charter school and reimbursement for those resources from each individual charter school to MERF Headquarters.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

Fixed Assets

All assets with a useful life of greater than one year and costing more than \$5,000 will be capitalized and (except for land) will be recorded in the depreciation records. Property and equipment is capitalized at cost or fair market value on the date of receipt in the case of donated property. Depreciation is provided on the straight-line method over the estimated useful lives of the assets ranging from 3 to 10 years. Bulk computer, software, and other technology purchases with an aggregate value of \$25,000 or more are captured as fixed assets regardless of individual price of item. In addition, remodeling modifications and replacement costs of integral structural components are only capitalized when such costs incurred exceed \$50,000. Leasehold improvements are depreciated over the lease term (including options) or the useful life. Major additions are capitalized, and repairs and maintenance that do not improve or extend the life of the assets are expensed. When assets are sold or retired, their cost and the related accumulated depreciation are removed from the accounts with the resulting gain or loss reflected in the Statement of Activities. Depreciation expense for the year ended June 30, 2017 and 2016, was \$907,827 and \$543,494, respectively.

Deferred Revenue

Deferred revenue arises when potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period or when resources are received by MERF prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when MERF has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and revenue is recognized. Certain grants received before the eligibility requirements are met are recorded as deferred revenue.

Use of Estimates

The preparation of 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 reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include the value of the beneficial interest in a charitable remainder trust.

Net Asset Classes

Magnolia Science Academy is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted and permanently restricted.

Net assets of the Magnolia Science Academy consist of the following:

Unrestricted - All resources over which the governing board has discretionary control to use in carrying on the general operations of MERF and the LLC.

Temporarily restricted - These net assets are restricted by donors to be used for specific purposes. MERF and the LLC do not have temporarily restricted net assets.

Permanently restricted - These net assets are permanently restricted by donors and cannot be used. MERF and the LLC do not have permanently restricted net assets.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

Unrestricted/Designated Net Assets

Designations of the ending net assets indicate tentative plans for financial resource utilization in a future period. The grant portion of the Charter School Facilities Program is classified as designated assets until the funds are used for the purchase of the land and the construction of the facility. As of June 30, 2017 and 2016, the amount of restricted cash was \$648,760 and \$6,327,515, respectively. As of June 30, 2017 and 2016, there was a designated balance of \$1,065,232 and \$987,151, respectively, for California Clean Energy Jobs Act, Educator Effectiveness, and College Readiness funds.

Consolidation

The consolidated financial statements include the accounts of MERF, the LLC, and all MSA charter schools. All significant intra-company accounts and transactions have been eliminated in consolidation.

NOTE 3 - CASH AND CASH EQUIVALENTS

Cash at June 30, 2017 and 2016, consisted of the following:

	June 30, 2017		June 30, 2016	
	Reported Amount	Bank Balance	Reported Amount	Bank Balance
Deposits				
Cash on hand and in banks	\$ 9,043,882	\$ 10,098,608	\$ 9,660,499	\$ 11,540,537
County pooled investment funds	790,960	N/A	215,432	N/A
Total	<u>\$ 9,834,842</u>	<u>\$ 10,098,608</u>	<u>\$ 9,875,931</u>	<u>\$ 11,540,537</u>

The majority of MERF's cash is held in bank accounts, which are subject to federally insured limits of \$250,000. MERF has not experienced any losses in such accounts. At June 30, 2017 and 2016, MERF had \$9,204,748 and \$8,386,998, respectively, in excess of FDIC insured limits in bank accounts.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

NOTE 4 - RESTRICTED CASH

At June 30, 2017 and 2016, cash held for restricted purposes consisted of the following:

	June 30, 2017		June 30, 2016	
	Reported Amount	Bank Balance	Reported Amount	Bank Balance
Bond reserve	\$ 446,563	\$ 446,563	\$ 446,563	\$ 446,563
Facility reserve	202,197	202,197	5,880,952	5,933,661
Current Restricted Cash	<u>\$ 648,760</u>	<u>\$ 648,760</u>	<u>\$ 6,327,515</u>	<u>\$ 6,380,224</u>

The majority of MERF's restricted cash is held in bank accounts, which are subject to federally insured limits of \$250,000. MERF has not experienced any losses in such accounts. At June 30, 2017 and 2016, MERF had \$196,563 and \$6,235,953, respectively, in excess of FDIC insured limits in bank accounts.

NOTE 5 - INVESTMENTS (CASH EQUIVALENTS)

Summary of Investments

Two MSA charter schools have investments held in county investment pools. Investments as of June 30, 2017 and 2016, are classified in the accompanying financial statements as follows:

Magnolia Science Academy San Diego

Investment Type	June 30, 2017		June 30, 2016	
	Reported Amount	Fair Market Value	Reported Amount	Fair Market Value
San Diego County Pooled Investment Funds	<u>\$ 14,476</u>	<u>\$ 14,427</u>	<u>\$ 68,077</u>	<u>\$ 68,100</u>

Magnolia Science Academy Santa Ana

Investment Type	June 30, 2017		June 30, 2016	
	Reported Amount	Fair Market Value	Reported Amount	Fair Market Value
Orange County Pooled Investment Funds	<u>\$ 776,484</u>	<u>\$ 775,242</u>	<u>\$ 147,355</u>	<u>\$ 147,718</u>

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

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Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The charter schools do not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. MERF manages exposure to interest rate risk by investing in the County Pool.

Weighted Average Maturity

MERF monitors the interest rate risk inherent in its portfolio by measuring the weighted average maturity of its portfolio.

NOTE 6 - MARKET VALUE OF FINANCIAL ASSETS AND LIABILITIES

MERF determines the fair market values of certain financial instruments based on the fair value hierarchy established in FASB ASC 820-10-50, which requires an entity to maximize the use of observable inputs and minimize the use unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

The following provides a summary of the hierarchical levels used to measure fair value:

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

Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities may include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and other instruments whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes U.S. Government and agency mortgage-backed debt securities, corporate debt securities, derivative contracts, residential mortgage, and loans held-for-sale.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, residential MSRs, asset-backed securities (ABS), highly structured or long-term derivative contracts and certain collateralized debt obligations (CDO) where independent pricing information was not able to be obtained for a significant portion of the underlying assets.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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Uncategorized - Investments in the Orange and San Diego County Treasury Investment Pools are not measured using the input levels above because the charter schools' transactions are based on a stable net asset value per share. All contributions and redemptions are transacted at \$1.00 net asset value per share.

The fair value measurements are as follows at June 30, 2017:

Magnolia Science Academy San Diego

Investment Type	Level	Fair Value	Weighted Average Maturity in Days
San Diego County Investment Pool	Uncategorized	\$ 14,427	417

Magnolia Science Academy Santa Ana

Investment Type	Level	Fair Value	Weighted Average Maturity in Days
Orange County Pooled Investment Funds	Uncategorized	\$ 775,242	325

NOTE 7 - ACCOUNTS RECEIVABLE

Accounts receivable at June 30, 2017 and 2016, consisted of the following:

	2017	2016
Local Control Funding Formula	\$ 2,018,722	\$ 2,661,849
Federal receivable	699,232	682,725
State receivable	58,203	473,020
Due From LACOE	16,815	48,105
Local receivable	21,902	111,782
Lottery	379,538	339,918
Total Accounts Receivable	\$ 3,194,412	\$ 4,317,399

Revenue

MERF received 94 and 94 percent of its revenue in the form of fees and grants from government programs for the years ended June 30, 2017 and 2016, respectively. The balance due from those programs accounted for 96 and 96 percent of accounts receivable at June 30, 2017 and 2016, respectively. Without these sources of revenue, MERF would have difficulty maintaining its operations.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

NOTE 8 - FIXED ASSETS

Fixed assets at June 30, 2017 and 2016, consisted of the following:

	<u>2017</u>	<u>2016</u>
Land	\$ 2,386,854	\$ 2,386,854
Building improvements	24,123,767	5,961,968
Leasehold improvements	374,818	384,879
Computer and equipment	2,536,238	2,618,137
Work in progress	<u>735,857</u>	<u>12,039,906</u>
Subtotal	30,157,534	23,391,744
Less: accumulated depreciation	<u>(3,115,417)</u>	<u>(2,338,891)</u>
Total Fixed Assets	<u>\$ 27,042,117</u>	<u>\$ 21,052,853</u>

During the years ended June 30, 2017 and 2016, \$907,827 and \$543,494, respectively, was charged to depreciation expense.

NOTE 9 - ACCOUNTS PAYABLE AND ACCRUALS

Accounts payable at June 30, 2017 and 2016, consisted of the following:

	<u>2017</u>	<u>2016</u>
Salaries and benefits	\$ 751,947	\$ 266,645
Compensated absences	-	196,523
Vendor payables	2,324,075	1,773,573
Due to other agencies	136,469	349,552
State principal apportionment	<u>-</u>	<u>530,781</u>
Total Accounts Payable and Accruals	<u>\$ 3,212,491</u>	<u>\$ 3,117,074</u>

NOTE 10 - DEFERRED REVENUE

Deferred revenue at June 30, 2017, consisted of the following:

	<u>2017</u>	<u>2016</u>
State sources	\$ 446,563	\$ 507,918
Other	<u>72,500</u>	<u>-</u>
Total Deferred Revenue	<u>\$ 519,063</u>	<u>\$ 507,918</u>

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NOTE 11 - LONG-TERM OBLIGATIONS

At June 30, 2017, MERF's long-term obligations summary is as follows:

	Balance			Balance	Due in
	July 1, 2016	Additions	Deductions	June 30, 2017	One Year
Bonds payable	\$ 5,950,000	\$ -	\$ 80,000	\$ 5,870,000	\$ 85,000
Loans	8,950,465	-	66,669	8,883,796	244,116
Capital leases	44,198	-	44,198	-	-
Note payable	2,800,000	-	-	2,800,000	2,800,000
Total	<u>\$ 17,744,663</u>	<u>\$ -</u>	<u>\$ 190,867</u>	<u>\$ 17,553,796</u>	<u>\$ 3,129,116</u>

At June 30, 2016, MERF's long-term obligations summary is as follows:

	Balance			Balance	Due in
	July 1, 2015	Additions	Deductions	June 30, 2016	One Year
Bonds payable	\$ 6,020,000	\$ -	\$ 70,000	\$ 5,950,000	\$ 80,000
Loans	2,400,841	6,666,290	116,666	8,950,465	66,673
Capital leases	86,589	-	42,391	44,198	44,198
Note payable	-	2,800,000	-	2,800,000	-
Total	<u>\$ 8,507,430</u>	<u>\$ 9,466,290</u>	<u>\$ 229,057</u>	<u>\$ 17,744,663</u>	<u>\$ 190,871</u>

California School Finance Authority (CSFA) School Facility Revenue Bonds

In June 2014, the CSFA issued \$6,020,000 in School Facilities Revenues, Series 2014A and Series 2014B for the purpose of a loan to MPM Sherman Way, LLC. The proceeds from the bonds will be used for the purpose of purchase, renovations, and improvement of charter school facilities. The bonds mature in August 2044 with monthly interest payments due commencing July 1, 2044. At June 30, 2017, the principal balance outstanding was \$5,870,000.

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The bonds mature through 2045 as follows:

Repayment Year	Principal	Interest to Maturity	Total
2018	\$ 85,000	\$ 354,313	\$ 439,313
2019	90,000	348,188	438,188
2020	100,000	342,238	442,238
2021	105,000	336,681	441,681
2022	110,000	331,038	441,038
2023-2027	645,000	1,557,969	2,202,969
2028-2032	850,000	1,339,438	2,189,438
2033-2037	1,145,000	1,040,469	2,185,469
2038-2042	1,555,000	625,156	2,180,156
2043-2045	1,185,000	114,219	1,299,219
Total	<u>\$ 5,870,000</u>	<u>\$ 6,389,709</u>	<u>\$ 12,259,709</u>

Debt Service Coverage and Cash Days on Hand

Under the current bonding agreement, MPM Sherman Way (the Lessee) or Magnolia Educational and Research Foundation (MERF) is required to maintain a Debt Service Coverage Ratio of 1.10 to 1.00 and Cash Days on Hand of 45 days.

The Debt Service Coverage Ratio is calculated by dividing the Combined Net Income Available for Debt Service from Magnolia Science Academy (MSA) by the Maximum Annual Debt Service for all outstanding indebtedness. As of June 30, 2017, MSA had a 4.35 Debt Service Coverage Ratio and was in compliance with the 1.10 to 1.00 required ratio and cash on hand of 45 days.

Debt Service Coverage

Net Income	\$ 715,565
Depreciation	907,824
Rent	484,203
Income Available for Coverage	2,107,592
Debt Service	484,203

Debt Service Coverage	4.35
Limit	1.10
Compliance	Yes

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The Days Cash on Hand is calculated by reducing non-cash expenses from total expenses and divided by 365 days. As of June 30, 2017, MSA had 81 days cash on hand and was in compliance with the 45 days required.

Days Cash on Hand

Total Expenses	\$ 44,959,762
Depreciation	907,824
Cash Expenses	44,051,938
Expense/Day	120,690
Cash	9,834,842

Days Cash on Hand	81
Limit	45
Compliance	Yes

Loans

Summarized below are MERF's loans at June 30, 2017:

	Balance July 1, 2016	Additions	Deductions	Balance June 30, 2017	Due in One Year
MERF	\$ 16,667	\$ -	\$ 16,667	\$ -	\$ -
MSA 2	25,000	-	25,000	-	-
MSA SD	151,806	-	-	151,806	-
MSA SA (Revolving)	50,000	-	25,000	25,000	25,000
MSA SA (CCSFP)	8,706,990	-	-	8,706,990	219,116
Total	<u>\$ 8,950,463</u>	<u>\$ -</u>	<u>\$ 66,667</u>	<u>\$ 8,883,796</u>	<u>\$ 244,116</u>

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Magnolia Educational & Research Foundation (MERF)

In March 2010, the California Department of Education (CDE) awarded a \$250,000 loan to Pacific Technology School - Orangevale (CDS Code: 09-76596-0119529) for a five-year tenet through the Charter School Revolving Loan Fund Program (CSRLF). Effective July 1, 2013, Assembly Bill 86 (Chapter 48, Statutes of 2013) authorized the transfer of the administration of the Charter School Revolving Loan Fund from the CDE to the California School Finance Authority (Authority). Pacific Technology School - Orangevale (PTS - Orangevale) closed in June 2013. Due to the closure, the school was unable to pay their fourth year through the intercept based on the original agreement. To repay the PTS - Orangevale revolving loan, MERF has been in communication with the California School Finance Authority to arrange a payment schedule of the remaining loan totaling \$100,000. The repayment schedule will be in accordance with the documentation provided by the California School Finance Authority, and will include 18 monthly payments of \$5,593 that include principal and interest. At June 30, 2017, the balance was paid in full.

Magnolia Science Academy 2 (MSA 2)

Magnolia Science Academy 2 applied for, and was accepted into, the California School Finance Authority Charter School Revolving Loan Program. The Charter School received a loan in the amount of \$100,000. The loan bears an interest rate of 0.24 percent. The terms of the loan require four annual payments of \$25,000 over the next four years and are to be withheld from the apportionment payments. At June 30, 2017, the loan was paid in full.

Magnolia Science Academy Santa Ana (MSA SA)

Magnolia Science Academy Santa Ana received unsecured revolving loan payable to the California Department of Education totaling \$150,000 on November 30, 2012. The loan balance as of June 30, 2017, was \$75,000. The loan has an interest rate of 0.53 percent and it matures in five years. The repayment terms require six monthly payments each year in five fiscal years beginning on October 30, 2013. The State Controller's Office deducts the loan payments from MSA SA's State School Fund Apportionments.

Future payments are as follows:

Fiscal Year Ending	Payments
<u>June 30,</u> 2018	<u>\$ 25,000</u>

Magnolia Science Academy Santa Ana has been approved by the State of California's Charter School Facilities Program (CCSFP) for \$17,413,956 for constructing a new facility, which will cost the same amount. The State will fund 50 percent of the total amount of \$17,413,956; the State will fund 50 percent of the total project cost through a loan in the amount of \$8,706,990 and the other 50 percent through a grant in the amount of \$8,706,978. The loan has an annual interest rate of 3.00 percent and it matures 30 years after the completion of the project. The outstanding loan balance as of June 30, 2017, was \$8,706,990. The current portion due in 2017-2018 is \$219,116.

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Magnolia Science Academy San Diego (MSA SD)

Magnolia Science Academy San Diego has been approved by the State of California's Charter School Facilities Program (CCSFP) for \$3,036,122 for constructing a new facility, which will cost the same amount. The State will fund 50 percent of the total amount of \$3,036,122; the State will fund 50 percent of the total project cost through a loan in the amount of \$1,518,061 and the other 50 percent through a grant in the amount of \$1,518,061. The loan has an annual interest rate of 2.00 percent and it matures 30 years after the completion of the project, which is estimated to be in the middle of calendar year 2016. The repayment schedule will be determined after completion of the project. The State Controller's Office will deduct the loan payments from MSA SD's State School Fund Apportionments. The outstanding loan balance as of June 30, 2017, was \$151,806.

Capital Leases

Chrome Books

MSA SC entered into a capital lease to purchase 450 Chrome Books for \$128,744. The terms of the loan require 36 monthly payments of \$4,276 with an interest rate of 8.00 percent and a maturity date of June 30, 2017. The balance outstanding as of June 30, 2017, is \$44,198. At June 30, 2017, the balance was paid in full.

Note Payable

Magnolia Science Academy (MSA 1)

MSA entered into a promissory note agreement with Luxor Properties, Inc. and Michael William Spivak, to purchase the property located at 18220-18228 Sherman Way, Los Angeles, California. MSA 1 received a loan in the amount of \$2,800,000. The loan bears an interest rate of 6.50 percent. The terms of the loan require monthly interest payments of \$15,667 for a 23-month period and the remaining principal balance on the final payment. The maturity date is November 1, 2017.

Future payments are as follows:

Fiscal Year Ending	
<u>June 30,</u>	<u>Payments</u>
2018	\$ 2,875,833
Less: Amount Representing Interest	(75,833)
Total	<u>\$ 2,800,000</u>

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NOTE 12 - FACILITIES USES AGREEMENTS/OPERATING LEASES

Total rental and facility expenses were \$2,428,940 for year ended June 30, 2017, for the sole purpose of operating the Charter Schools' education programs, related Charter Schools' activities. Future rental and facility expenses are as follows:

Fiscal Year Ending	Future Lease Commitments
2018	\$ 607,656
2019	616,764
2020	621,664
2021	627,148
2022	632,368
Thereafter	5,579,526
Total	<u>\$ 8,685,126</u>

NOTE 13 - FAIR VALUE FINANCIAL INSTRUMENTS

The carrying amounts and estimated fair values of MERF financial instruments as of June 30, 2017 are as follows:

	June 30, 2017		June 30, 2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 9,834,842	\$ 9,833,550	\$ 9,875,931	\$ 9,876,317
Restricted cash and cash equivalents	648,760	648,760	6,327,515	6,327,515
Revolving and CCSF loans	8,883,796	8,883,796	8,950,465	8,950,465
Notes payable	2,800,000	2,800,000	2,800,000	2,800,000
Bonds payable	5,870,000	5,870,000	5,950,000	5,950,000
Capital leases	-	-	44,198	44,198

NOTE 14 - EMPLOYEE RETIREMENT SYSTEMS

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

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The risks of participating in these multi-employer defined benefit pension plans are different from single-employer plans because: (a) assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers, (b) the required member, employer, and State contribution rates are set by the California Legislature, and (c) if Magnolia Science Academy charter schools chooses to stop participating in the multi-employer plan, it may be required to pay a withdrawal liability to the plan. Magnolia Science Academy charter schools has no plans to withdraw from this multi-employer plan.

The details of each plan are as follows:

California State Teachers' Retirement System (CalSTRS)

Plan Description

Magnolia Science Academy charter schools contributes to the State Teachers Retirement Plan (STRP) administered by the California State Teachers' Retirement System (CalSTRS). STRP is a cost-sharing multiple-employer public employee retirement system defined benefit pension plan. Benefit provisions are established by State statutes, as legislatively amended, within the State Teachers' Retirement Law. According to the most recently available Comprehensive Annual Financial Report and Actuarial Valuation Report for the year ended June 30, 2016, total actuarial value of assets are \$170 billion, the actuarial obligation is \$267 billion, contributions from all employers totaled \$3.3 billion, and the plan is 63.7 percent funded. Magnolia Science Academy charter schools did not contribute more than five percent of the total contributions to the plan.

A full description of the pension plan regarding benefit provisions, assumptions (for funding, but not accounting purposes), and membership information is listed in the June 30, 2015, annual actuarial valuation report, Defined Benefit Program Actuarial Valuation. This report and CalSTRS audited financial information are publically available reports that can be found on the CalSTRS website under Publications at: <http://www.calstrs.com/member-publications>.

Benefits Provided

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

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

Magnolia Science Academy charter schools contributes exclusively to the STRP Defined Benefit Program, thus disclosures are not included for the other plans.

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The STRP provisions and benefits in effect at June 30, 2017, are summarized as follows:

	<u>STRP Defined Benefit Program</u>	
	On or before	On or after
Hire date	December 31, 2012	January 1, 2013
Benefit formula	2% at 60	2% at 62
Benefit vesting schedule	5 Years of Service	5 Years of Service
Benefit payments	Monthly for Life	Monthly for Life
Retirement age	60	62
Monthly benefits as a percentage of eligible compensation	2.0% - 2.4%	2.0% - 2.4%
Required employee contribution rate	10.25%	9.205%
Required employer contribution rate	12.58%	12.58%
Required state contribution rate	8.828%	8.828%

Contributions

Required member, Charter School and State of California contributions rates are set by the California Legislature and Governor and detailed in Teachers' Retirement Law. The contributions rates are expressed as a level percentage of payroll using the entry age normal actuarial method. In accordance with AB 1469, employer contributions into the CalSTRS will be increasing to a total of 19.1 percent of applicable member earnings phased over a seven-year period. The contribution rates for each plan for the year ended June 30, 2017 and 2016, are presented above and Magnolia Science Academy charter schools' total contributions were \$1,445,389 and \$1,322,909, respectively.

California Public Employees Retirement System (CalPERS)

Plan Description

Qualified employees are eligible to participate in the School Employer Pool (SEP) under the California Public Employees' Retirement System (CalPERS), a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by CalPERS. Benefit provisions are established by State statutes, as legislatively amended, within the Public Employees' Retirement Law. According to the most recently available Actuarial Valuation Report for the year ended June 30, 2015, the Schools Pool total plan assets are \$57 billion, the total accrued liability is \$72 billion, contributions from all employers totaled \$1.3 billion, and the plan is 79.2 percent funded. Magnolia Science Academy charter schools did not contribute more than five percent of the total contributions to the plan.

A full description of the pension plan regarding benefit provisions, assumptions (for funding, but not accounting purposes), and membership information is listed in the June 30, 2015, annual actuarial valuation report, Schools Pool Actuarial Valuation, 2015. This report and CalPERS audited financial information are publically available reports that can be found on the CalPERS website under Forms and Publications at: <https://www.calpers.ca.gov/page/forms-publications>.

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Benefits Provided

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

The CalPERS provisions and benefits in effect at June 30, 2017, are summarized as follows:

	School Employer Pool (CalPERS)	
	On or before December 31, 2012	On or after January 1, 2013
Hire date	December 31, 2012	January 1, 2013
Benefit formula	2% at 55	2% at 62
Benefit vesting schedule	5 Years of Service	5 Years of Service
Benefit payments	Monthly for Life	Monthly for Life
Retirement age	55	62
Monthly benefits as a percentage of eligible compensation	1.1% - 2.5%	1.0% - 2.5%
Required employee contribution rate	7.00%	6.00%
Required employer contribution rate	13.888%	13.888%

Contributions

Section 20814(c) of the California Public Employees' Retirement Law requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. Total plan contributions are calculated through the CalPERS annual actuarial valuation process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Magnolia Science Academy charter schools is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. The contributions rates are expressed as percentage of annual payroll. The contribution rates for each plan for the years ended June 30, 2017 and 2016, respectively, are presented above and the total Charter School contributions were \$256,041 and \$169,607, respectively.

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On Behalf Payments

The State of California makes contributions to CalSTRS on behalf of Magnolia Science Academy charter schools. These payments consist of State General Fund contributions to CalSTRS in the amount of \$949,183 (8.828 percent of the Magnolia Science Academy charter schools' salaries subject to CalSTRS). Under accounting principles generally accepted in the United States of America, these amounts are to be reported as revenues and expenditures. Accordingly, these amounts have been recorded in these financial statements.

NOTE 15 - PARTICIPATION IN JOINT POWERS AUTHORITY

Magnolia Science Academy Charter Schools are participants in the California Charter Schools Joint Powers Authority (CCS-JPA) *dba* CharterSAFE for risk management services for workers' compensation and charter school liability insurance. The relationship between MERF and CharterSAFE is such that CharterSAFE is not considered a component unit of MERF for financial reporting purposes.

CharterSAFE has budgeting and financial reporting requirements independent of member units and CharterSAFE's financial statements are not presented in these financial statements; however, transactions between CharterSAFE and Magnolia Science Academy Charter Schools are included in these statements. Audited financial statements for CharterSAFE were not available for fiscal year 2016-2017 at the time this report was issued. However, financial statements should be available from the respective agency.

During the years ended June 30, 2017 and 2016, Magnolia Science Academy Charter Schools made payments of \$392,554 and \$325,230, respectively, to CharterSAFE for services received. At June 30, 2017 and 2016, MERF had no recorded accounts receivable or accounts payable to CharterSAFE.

NOTE 16 - CONTINGENCIES

Grants

MERF has received State and Federal funds for specific purposes that are subject to review and audit by the grantor agencies. The LAUSD Office of Inspector General has been in the process of reviewing prior year's activity. Per the LAUSD Office of Inspector General letter dated November 6, 2017, "unless the Office of Inspector General receives new information or is directed otherwise by the Board, the Office of Inspector General will not be moving forward on this matter at this time". Although such audits could generate disallowances under terms of the grants, it is believed that any reimbursement, if required, would not be material.

Litigation

MERF is not currently a party to any legal proceedings.

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NOTE 17 - EXTRAORDINARY ITEM (MSA SANTA CLARA CLOSING)

On July 1, 2016, the Board of MERF voted to close MSA Santa Clara, and to transfer the June 30, 2016, operating deficit of \$(731,580) to MERF. MSA Santa Clara also had an additional loss during 2016-2017 in the amount of \$(36,870) for miscellaneous revenues repaid and expenses directly related to final settlement of MSA Santa Clara for a total deficit of \$(768,450).

MSA Santa Clara's remaining assets and liabilities assumed by MERF resulted in an extraordinary item during 2016-2017 for write-offs of accounts receivable and fixed assets in the amount of \$348,866.

NOTE 18 - SUBSEQUENT EVENTS

MERF's management has evaluated events or transactions that may occur for potential recognition or disclosure in the consolidated financial statements through December 19, 2017, which is the date the consolidated financial statements were available to be issued. Management has determined that there were no subsequent events or transactions, other than those noted below, that would have a material impact on the current year consolidated financial statements.

MERF, Magnolia Science Academy, Magnolia Science Academy San Diego, Magnolia Science Academy Santa Ana

On September 6, 2017, Magnolia Property Management, Inc. received funding through California School Finance Authority Charter School Revenue Bonds in the amount of \$25,000,000 (under a loan agreement). Additional Equity Contribution of \$435,668 was provided by Magnolia Property Management, Inc. The total proceeds of the Bond/equity contribution will be used to finance/refinance the acquisition, construction, equipping and/or improvement of projects for "MSA 1 Facility", "San Diego Facility", and "Santa Ana Facility". Total allocation for each project, along with required reserves, are approximately \$9.2 million, \$10.3 million, and \$4.2 million, respectively. Additional costs of issuance and underwriter discount for the entire proceeds were approximately \$935,000.

Magnolia Science Academy

In September 2017, MSA used proceeds from the Charter School Revenue Bonds to pay off a loan from Luxor in the amount of approximately \$2.8 million.

Magnolia Science Academy 4

On November 7, 2017, Los Angeles Unified School District approved the renewal of MSA 4's charter petition beginning July 1, 2018 and ending June 30, 2023, (five-year term).

Magnolia Science Academy 5

On November 17, 2017, MSA 5 filed an appeal to Los Angeles County Office of Education after Los Angeles Unified School District denied the petition at the November 2017 board meeting. A board appeals hearing is scheduled for December 19, 2017, at the County Office of Education.

SUPPLEMENTARY INFORMATION

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
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CONSOLIDATED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2017

Federal Grantor/Pass-Through Grantor/Program	CFDA Number	Pass-Through Entity Identifying Number	Program Expenditures
U.S. DEPARTMENT OF EDUCATION			
Passed through California Department of Education (CDE):			
Special Education:			
Basic Local Assistance Entitlement, Part B, Section 611	84.027	13379	\$ 604,937
Title I, Part A, Basic Grants Low Income and Neglected	84.010	14329	1,504,431
Title I, Part G: Advanced Placement (AP) Test Fee Reimbursement Program	84.330B	14831	13,984
Title II, Part A, Improving Teacher Quality Local Grants	84.367	14341	28,812
Title III, English Learner Student Program	84.365	14346	64,325
Title V, Part B - Public Charter Schools Grant Program	84.282A	14941	265,075
State Charter School Facilities Incentive Grants	84.242D	[1]	390,475
Total U.S. Department of Education			<u>2,872,039</u>
U.S. DEPARTMENT OF AGRICULTURE			
Passed through California Department of Education (CDE):			
Child Nutrition Cluster:			
Basic School Breakfast Program	10.553	13525	108,538
Especially Needy Breakfast	10.553	13526	190,053
National School Lunch Program	10.555	13524	755,577
Meal Supplement	10.555	13396	2,457
Food Distribution	10.555	13524	42,912
Total Child Nutrition Cluster			<u>1,099,537</u>
Total U.S. Department of Agriculture			<u>1,099,537</u>
Total Federal Programs			<u>\$ 3,971,576</u>

[1] Pass-Through Entity Identifying Number not available.

See accompanying note to supplementary information.

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**LOCAL EDUCATION AGENCY ORGANIZATION STRUCTURE
FOR THE YEAR ENDED JUNE 30, 2017**

ORGANIZATION

MERF operates ten schools in California under ten charters. Each school is operated on the same tax identification number as MERF. Charters were granted for each school for up to five years, with an opportunity for renewal. Charters may be revoked by the charter authorizer for material violations of the charter, failure to meet or make progress toward student outcomes identified in the charter, failure to meet generally accepted standards of fiscal management, or violation of any provision of the law. As of June 30, 2017, the charter schools operated by MERF were as follows:

Charter School Name	Charter Number	Sponsoring District	Charter Expiration	Grades Served	Number of Students Served
Magnolia Science Academy	0438	Los Angeles USD	June 30, 2017	6-12	525
Magnolia Science Academy 2	0906	Los Angeles USD	June 30, 2017	6-12	475
Magnolia Science Academy 3	0917	Los Angeles USD	June 30, 2017	6-12	445
Magnolia Science Academy 4	0986	Los Angeles USD	June 30, 2018	6-12	180
Magnolia Science Academy 5	0987	Los Angeles USD	June 30, 2018	6-12	150
Magnolia Science Academy 6	0988	Los Angeles USD	June 30, 2019	6-8	175
Magnolia Science Academy 7	0989	Los Angeles USD	June 30, 2019	K-5	290
Magnolia Science Academy Bell	1236	Los Angeles USD	June 30, 2020	6-8	495
Magnolia Science Academy San Diego	0698	San Diego USD	June 30, 2020	6-8	420
Magnolia Science Academy Santa Ana	1686	CDE	June 30, 2019	K-12	165

See accompanying note to supplementary information.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

LOCAL EDUCATION AGENCY ORGANIZATION STRUCTURE, *Continued*
FOR THE YEAR ENDED JUNE 30, 2017

BOARD OF DIRECTORS

<u>MEMBER</u>	<u>OFFICE</u>	<u>TERM EXPIRES</u>
Ms. Noel Russell-Unterburger	President	October 10, 2017
Mr. Serdar Orazov	Treasurer	September 9, 2020
Dr. Umit Yapanel, Ph.D.	Secretary	October 10, 2017
Mr. Haim Beliak	Director	February 8, 2022
Dr. Salih Dikbas	Director	December 10, 2019
Mrs. Diane Gonzalez	Director	December 2019
Mr. Nguyen Huynh	Director	October 10, 2017
Dr. Remzi Oten, Ph.D.	Director	March 11, 2020
Mr. Saken Sherkanov	Director	December 11, 2018

ADMINISTRATION

Caprice Young, Ed.D.	Chief Executive Officer, Superintendent
Nanie Montijo	Chief Financial Officer

See accompanying note to supplementary information.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

CONSOLIDATING STATEMENT OF FINANCIAL POSITION
JUNE 30, 2017

	MERF	MSA-1	MSA-2	MSA-3	MSA-4	MSA-5	MSA-6
ASSETS							
Current Assets:							
Cash and cash equivalents	\$ 52,671	\$ 1,311,426	\$ 780,732	\$ 178,629	\$ 776,350	\$ 1,000,807	\$ 754,059
Restricted cash and cash equivalents	-	-	-	-	-	-	-
Accounts receivable	463	878,726	372,689	317,618	175,940	226,139	168,102
Intra-company receivable	2,798,858	472,932	143,253	91,362	253,943	152,180	450,000
Prepaid expenses and other current assets	417,711	280,865	21,802	320,505	8,944	121,849	17,566
Total Current Assets	<u>3,269,703</u>	<u>2,943,949</u>	<u>1,318,476</u>	<u>908,114</u>	<u>1,215,177</u>	<u>1,500,975</u>	<u>1,389,727</u>
Non-Current Assets:							
Debt issue cost, net	-	-	-	-	-	-	-
Security deposits	16,000	-	-	-	-	-	-
Fixed assets	134,513	4,731,515	384,728	226,873	169,911	134,541	153,988
Less: accumulated depreciation	(116,790)	(892,019)	(236,637)	(158,991)	(116,181)	(112,184)	(102,255)
Total Non-Current Assets	<u>33,723</u>	<u>3,839,496</u>	<u>148,091</u>	<u>67,882</u>	<u>53,730</u>	<u>22,357</u>	<u>51,733</u>
Total Assets	<u>\$ 3,303,426</u>	<u>\$ 6,783,445</u>	<u>\$ 1,466,567</u>	<u>\$ 975,996</u>	<u>\$ 1,268,907</u>	<u>\$ 1,523,332</u>	<u>\$ 1,441,460</u>
LIABILITIES							
Current Liabilities:							
Accounts payable and accruals	\$ 443,504	\$ 361,845	\$ 553,995	\$ 230,779	\$ 210,556	\$ 113,039	\$ 156,147
Intra-company payable	3,554,200	235,325	15,486	113,256	28,192	34,736	26,392
Deferred revenue	72,500	-	-	-	-	-	-
Current portion of long-term obligations	-	2,800,000	-	-	-	-	-
Total Current Liabilities	<u>4,070,204</u>	<u>3,397,170</u>	<u>569,481</u>	<u>344,035</u>	<u>238,748</u>	<u>147,775</u>	<u>182,539</u>
Long-Term Obligations:							
Non-current portion of long-term obligations	-	-	-	-	-	-	-
Total Liabilities	<u>4,070,204</u>	<u>3,397,170</u>	<u>569,481</u>	<u>344,035</u>	<u>238,748</u>	<u>147,775</u>	<u>182,539</u>
NET ASSETS							
Unrestricted (deficit)	(766,778)	3,220,044	788,456	518,637	906,855	1,304,697	1,204,609
Designated	-	166,231	108,630	113,324	123,304	70,860	54,312
Total Net Assets	<u>(766,778)</u>	<u>3,386,275</u>	<u>897,086</u>	<u>631,961</u>	<u>1,030,159</u>	<u>1,375,557</u>	<u>1,258,921</u>
Total Liabilities and Net Assets	<u>\$ 3,303,426</u>	<u>\$ 6,783,445</u>	<u>\$ 1,466,567</u>	<u>\$ 975,996</u>	<u>\$ 1,268,907</u>	<u>\$ 1,523,332</u>	<u>\$ 1,441,460</u>

See accompanying note to supplementary information.

MSA-7	MSA-Bell	MSA-SD	MSA-SA	MSA-SC	LLC	Elimination	Total	Memo 2016 Total
\$ 830,140	\$ 925,839	\$ 620,061	\$ 1,480,920	\$ -	\$ 1,123,208	\$ -	\$ 9,834,842	\$ 9,875,931
-	-	106,607	95,590	-	446,563	-	648,760	6,327,515
271,398	384,871	250,662	147,804	-	-	-	3,194,412	4,317,399
-	2,073,307	11,025	15,416	-	-	(6,462,276)	-	-
135,483	20,446	246,037	28,949	-	-	-	1,620,157	141,671
<u>1,237,021</u>	<u>3,404,463</u>	<u>1,234,392</u>	<u>1,768,679</u>	<u>-</u>	<u>1,569,771</u>	<u>(6,462,276)</u>	<u>15,298,171</u>	<u>20,662,516</u>
-	-	-	-	-	358,782	-	358,782	371,596
4,000	-	25,000	19,690	-	-	-	64,690	144,150
135,974	313,302	649,284	18,333,010	-	4,789,895	-	30,157,534	23,391,744
(104,385)	(129,618)	(341,993)	(563,281)	-	(241,083)	-	(3,115,417)	(2,338,891)
<u>35,589</u>	<u>183,684</u>	<u>332,291</u>	<u>17,789,419</u>	<u>-</u>	<u>4,907,594</u>	<u>-</u>	<u>27,465,589</u>	<u>21,568,599</u>
<u>\$ 1,272,610</u>	<u>\$ 3,588,147</u>	<u>\$ 1,566,683</u>	<u>\$ 19,558,098</u>	<u>\$ -</u>	<u>\$ 6,477,365</u>	<u>\$ (6,462,276)</u>	<u>\$ 42,763,760</u>	<u>\$ 42,231,115</u>
\$ 109,231	\$ 208,560	\$ 136,429	\$ 688,406	\$ -	\$ -	\$ -	\$ 3,212,491	\$ 3,117,074
151,049	13,188	29,762	2,260,690	-	-	(6,462,276)	-	-
-	-	-	-	-	446,563	-	519,063	507,918
-	-	-	244,116	-	85,000	-	3,129,116	190,871
<u>260,280</u>	<u>221,748</u>	<u>166,191</u>	<u>3,193,212</u>	<u>-</u>	<u>531,563</u>	<u>(6,462,276)</u>	<u>6,860,670</u>	<u>3,815,863</u>
-	-	151,806	8,487,874	-	5,785,000	-	14,424,680	17,553,792
<u>260,280</u>	<u>221,748</u>	<u>317,997</u>	<u>11,681,086</u>	<u>-</u>	<u>6,316,563</u>	<u>(6,462,276)</u>	<u>21,285,350</u>	<u>21,369,655</u>
959,589	3,309,032	1,063,588	7,743,647	-	160,802	-	20,413,178	19,874,309
52,741	57,367	185,098	133,365	-	-	-	1,065,232	987,151
<u>1,012,330</u>	<u>3,366,399</u>	<u>1,248,686</u>	<u>7,877,012</u>	<u>-</u>	<u>160,802</u>	<u>-</u>	<u>21,478,410</u>	<u>20,861,460</u>
<u>\$ 1,272,610</u>	<u>\$ 3,588,147</u>	<u>\$ 1,566,683</u>	<u>\$ 19,558,098</u>	<u>\$ -</u>	<u>\$ 6,477,365</u>	<u>\$ (6,462,276)</u>	<u>\$ 42,763,760</u>	<u>\$ 42,231,115</u>

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

CONSOLIDATING STATEMENT OF ACTIVITIES
JUNE 30, 2017

	MERF	MSA-1	MSA-2	MSA-3	MSA-4	MSA-5	MSA-6
CHANGES IN UNRESTRICTED NET ASSETS							
REVENUES							
State apportionments	\$ -	\$ 5,303,302	\$ 4,239,354	\$ 4,255,160	\$ 1,828,007	\$ 1,652,001	\$ 1,552,530
Federal revenue	-	877,014	464,894	477,370	216,088	213,304	148,639
Other State revenue	-	1,303,726	688,822	813,720	331,828	231,392	303,769
Proposition 1D Grant construction revenue	-	-	-	-	-	-	-
Rent revenue	-	-	-	-	-	-	-
Local revenue	6,522,442	170,676	100,029	66,643	51,712	175,803	28,043
Total Revenues	6,522,442	7,654,718	5,493,099	5,612,893	2,427,635	2,272,500	2,032,981
EXPENSES							
Program services:							
Salaries and benefits	3,522,067	3,840,332	3,362,975	3,532,808	1,317,209	1,199,271	1,116,288
Student services	-	308,972	287,754	237,598	216,473	137,126	76,545
Materials and supplies	12,200	214,078	102,589	-	17,584	12,627	57,669
Student nutrition	28,445	261,320	304,100	264,096	51,818	67,687	48,940
Other expenses	107,407	171,166	116,495	114,460	40,550	95,173	40,095
Subtotal	3,670,119	4,795,868	4,173,913	4,148,962	1,643,634	1,511,884	1,339,537
EXPENSES (Continued)							
Management and general:							
Amortization	-	-	-	-	-	-	-
Depreciation	1,440	146,154	56,349	19,096	15,656	7,177	19,778
Insurance	790	-	-	-	-	-	-
Management fee	-	1,055,710	953,736	954,479	90,995	90,202	89,797
Occupancy	157,972	571,057	7,682	278,867	104,583	91,457	113,421
Operating expenses	2,368,307	686,864	545,218	554,952	205,098	273,738	168,792
Debt service	-	-	-	-	-	-	-
Interest	74	173,203	67	-	-	-	-
Subtotal	2,528,583	2,632,988	1,563,052	1,807,394	416,332	462,574	391,788
Total Expenses	6,198,702	7,428,856	5,736,965	5,956,356	2,059,966	1,974,458	1,731,325
CHANGE IN UNRESTRICTED NET ASSETS BEFORE EXTRAORDINARY ITEM							
	323,740	225,862	(243,866)	(343,463)	367,669	298,042	301,656
Extraordinary item - equity transfer	(768,450)	-	-	-	-	-	-
Extraordinary item - MSA Santa Clara	(348,866)	-	-	-	-	-	-
Total Extraordinary item	(1,117,316)	-	-	-	-	-	-
CHANGE IN UNRESTRICTED NET ASSETS NET ASSETS (DEFICIT), BEGINNING OF YEAR							
	26,798	3,160,413	1,140,952	975,424	662,490	1,077,515	957,265
NET ASSETS (DEFICIT) , END OF YEAR	\$ (766,778)	\$ 3,386,275	\$ 897,086	\$ 631,961	\$ 1,030,159	\$ 1,375,557	\$ 1,258,921

See accompanying note to supplementary information.

MSA-7	MSA-Bell	MSA-SD	MSA-SA	MSA-SC	LLC	Elimination	Total	Memo 2016 Total
\$ 2,586,389	\$ 4,526,038	\$ 3,033,354	\$ 5,507,828	\$ -	\$ -	\$ -	\$ 34,483,963	\$ 28,674,688
230,631	309,446	107,314	713,091	(1,333)	-	-	3,756,458	2,983,400
716,536	786,188	594,225	644,077	(31,130)	-	-	6,383,153	7,631,875
-	-	-	-	-	-	-	-	6,666,280
-	-	-	-	-	446,911	(446,911)	-	-
87,049	71,939	111,765	89,144	373	-	(6,074,999)	1,400,619	1,805,798
<u>3,620,605</u>	<u>5,693,611</u>	<u>3,846,658</u>	<u>6,954,140</u>	<u>(32,090)</u>	<u>446,911</u>	<u>(6,521,910)</u>	<u>46,024,193</u>	<u>47,762,041</u>
1,738,555	2,989,946	2,405,010	3,914,288	1,159	-	-	28,939,908	24,182,556
172,011	197,709	173,608	440,818	-	-	-	2,248,614	2,028,885
101,080	27,006	18,074	276,599	(15)	-	-	839,491	1,237,521
117,260	163,222	35,299	329,069	(269)	-	-	1,670,987	1,312,016
78,570	185,334	61,812	206,887	3,642	-	-	1,221,591	1,139,571
<u>2,207,476</u>	<u>3,563,217</u>	<u>2,693,803</u>	<u>5,167,661</u>	<u>4,517</u>	<u>-</u>	<u>-</u>	<u>34,920,591</u>	<u>29,900,549</u>
-	-	-	-	-	12,814	-	12,814	12,814
20,286	67,806	39,157	434,567	-	80,361	-	907,827	543,494
-	-	-	-	-	-	-	790	-
656,701	1,052,849	377,766	1,079,401	-	-	(6,074,999)	326,637	642,960
293,806	235,424	330,000	72,093	-	-	(446,911)	1,809,451	1,785,885
377,358	412,091	331,827	622,327	263	-	-	6,546,835	6,342,425
-	-	-	-	-	360,088	-	360,088	554,340
-	-	-	-	-	-	-	173,344	126,635
<u>1,348,151</u>	<u>1,768,170</u>	<u>1,078,750</u>	<u>2,208,388</u>	<u>263</u>	<u>453,263</u>	<u>(6,521,910)</u>	<u>10,137,786</u>	<u>10,008,553</u>
<u>3,555,627</u>	<u>5,331,387</u>	<u>3,772,553</u>	<u>7,376,049</u>	<u>4,780</u>	<u>453,263</u>	<u>(6,521,910)</u>	<u>45,058,377</u>	<u>39,909,102</u>
64,978	362,224	74,105	(421,909)	(36,870)	(6,352)	-	965,816	7,852,939
-	-	-	-	768,450	-	-	-	-
-	-	-	-	-	-	-	(348,866)	-
-	-	-	-	768,450	-	-	(348,866)	-
<u>64,978</u>	<u>362,224</u>	<u>74,105</u>	<u>(421,909)</u>	<u>731,580</u>	<u>(6,352)</u>	<u>-</u>	<u>616,950</u>	<u>7,852,939</u>
947,352	3,004,175	1,174,581	8,298,921	(731,580)	167,154	-	20,861,460	13,008,521
<u>\$ 1,012,330</u>	<u>\$ 3,366,399</u>	<u>\$ 1,248,686</u>	<u>\$ 7,877,012</u>	<u>\$ -</u>	<u>\$ 160,802</u>	<u>\$ -</u>	<u>\$ 21,478,410</u>	<u>\$ 20,861,460</u>

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

FOUNDNTATION ONLY COMPARATIVE STATEMENT OF FINANCIAL POSITION
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

	<u>2017</u>	<u>2016</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 52,671	\$ 82,468
Accounts receivable	463	98,615
Intra-company receivable	2,798,858	2,555,550
Prepaid expenses and other current assets	417,711	40,728
Total Current Assets	<u>3,269,703</u>	<u>2,777,361</u>
Non-Current Assets:		
Security deposits	16,000	17,525
Fixed assets	134,513	134,513
Less: accumulated depreciation	(116,790)	(115,350)
Total Non-Current Assets	<u>33,723</u>	<u>36,688</u>
Total Assets	<u>\$ 3,303,426</u>	<u>\$ 2,814,049</u>
LIABILITIES		
Current Liabilities:		
Accounts payable and accruals	\$ 443,504	\$ 582,797
Intra-company payable	3,554,200	2,187,787
Deferred revenue	72,500	-
Current portion of long-term obligation	-	16,667
Total Liabilities	<u>4,070,204</u>	<u>2,787,251</u>
NET ASSETS		
Unrestricted	<u>(766,778)</u>	<u>26,798</u>
Total Liabilities and Net Assets	<u>\$ 3,303,426</u>	<u>\$ 2,814,049</u>

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

FOUNDATION ONLY COMPARATIVE STATEMENT OF ACTIVITIES
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

	<u>2017</u>	<u>2016</u>
CHANGES IN UNRESTRICTED NET ASSETS		
REVENUES		
Local revenue	\$ 6,522,442	\$ 5,853,081
EXPENSES		
Program services:		
Salaries and benefits	3,522,067	3,063,199
Materials and supplies	12,200	17,167
Student nutrition	28,445	34,328
Other expenses	107,407	90,373
Subtotal	<u>3,670,119</u>	<u>3,205,067</u>
Management and general:		
Depreciation	1,440	7,666
Insurance	790	-
Occupancy	157,972	194,984
Operating expenses	2,368,307	2,453,803
Interest	74	406
Subtotal	<u>2,528,583</u>	<u>2,656,859</u>
Total Expenses	<u>6,198,702</u>	<u>5,861,926</u>
CHANGE IN UNRESTRICTED NET ASSETS		
BEFORE EXTRAORDINARY ITEM	<u>323,740</u>	<u>(8,845)</u>
Extraordinary item - equity transfer	(768,450)	-
Extraordinary item - MSA Santa Clara	(348,866)	-
Total extraordinary items	<u>(1,117,316)</u>	<u>-</u>
CHANGE IN UNRESTRICTED NET ASSETS	(793,576)	(8,845)
NET ASSETS, BEGINNING OF YEAR	<u>26,798</u>	<u>35,643</u>
NET ASSETS, END OF YEAR	<u>\$ (766,778)</u>	<u>\$ 26,798</u>

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

FOUNDATION ONLY COMPARATIVE STATEMENT OF CASH FLOWS
(With comparative financial information at June 30, 2016)

JUNE 30, 2017

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Unrestricted Net Assets	\$ (793,576)	\$ (8,845)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation expense	1,440	7,666
Changes in operating assets and liabilities:		
(Increase) Decrease in assets		
Accounts receivable	98,152	(98,615)
Intra-company receivable	(243,308)	(1,462,284)
Prepaid expenses and other current assets	(376,983)	(40,728)
Security deposits	1,525	(16,000)
Increase (Decrease) in liabilities		
Accounts payable and accruals	(139,293)	382,449
Intra-company payable	1,366,413	1,289,893
Deferred revenue	72,500	(88,785)
Net Cash Provided by (Used in) Operating Activities	<u>(13,130)</u>	<u>(35,249)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Loan principal payments	<u>(16,667)</u>	<u>(49,999)</u>
NET CHANGE IN CASH	<u>(29,797)</u>	<u>(101,915)</u>
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>82,468</u>	<u>184,383</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 52,671</u>	<u>\$ 82,468</u>
Supplemental cash flow disclosure:		
Cash paid during the period for interest	<u>\$ 74</u>	<u>\$ 406</u>

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

NOTE TO SUPPLEMENTARY INFORMATION
JUNE 30, 2017

NOTE 1 - PURPOSE OF SUPPLEMENTARY SCHEDULES

Schedule of Expenditures of Federal Awards

The accompanying Schedule of Expenditures of Federal Awards includes the Federal grant activity of Magnolia Science Academy charter schools and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements. Magnolia Science Academy charter schools have not elected to use the ten percent de minimis cost rate as covered in Section 200.414 Indirect (F&A) costs of the Uniform Guidance.

The following schedule provides reconciliation between revenues reported on the Statement of Activities and the related expenditures reported on the Schedule of Expenditures of Federal Awards. The reconciling amounts consist primarily of Title I and II, Part A, and Charter School Facilities Grant Program funds that in the previous period were recorded as revenues but were unspent. These unspent balances have been expended in the current period. In addition, Basic Local Assistance Entitlement, Part B, Title III, Limited English Proficient and National School Lunch Program funds have been recorded in the current period as revenues that have not been expended as of June 30, 2017. These unspent balances are reported within the unrestricted ending balance.

Description	<u>CFDA Number</u>	<u>Amount</u>
Total Federal Revenues From the Statement of Activities and Changes in Fund Balance:		\$ 3,756,458
Basic Local Assistance Entitlement, Part B, Section 611	84.027	(25,849)
Title I, Part A, Basic Grants Low-Income and Neglected	84.010	224,936
Title II, Part A, Improving Teacher Quality	84.367	14,742
Title III, English Learner Student Program	84.365	(1,394)
Title V, Part B, Public Charter Schools Grant	84.282A	3,720
Charter Schools Facility Grant Program	84.242D	632
National School Lunch Program	10.555	(1,669)
Total Schedule of Expenditures of Federal Awards		<u>\$ 3,971,576</u>

Local Education Agency Organization Structure

This schedule provides information about the charter schools operated, members of the governing board, and members of the administration.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

NOTE TO SUPPLEMENTARY INFORMATION
JUNE 30, 2017

Consolidating Statements

The accompanying consolidating financial statements report the individual programs of MERF and are presented on the accrual basis of accounting. Eliminating entries in the consolidated financial statements are due to rent payments between the LLC and MSA 1 and CMO fees paid to MERF from the MSA charter schools in accordance with the structured fee schedule.

Foundation Only Comparative Statements

The accompanying foundation only comparative financial statements report the individual program of MERF and are presented on the accrual basis of accounting.

INDEPENDENT AUDITOR'S REPORTS



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

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

Board of Directors
Magnolia Educational & Research Foundation and affiliates
(A California Nonprofit Public Benefit Corporation)
Los Angeles, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the consolidated financial statements of Magnolia Educational & Research Foundation (MERF) (A California Nonprofit Public Benefit Corporation) and affiliates as of and for the year ended June 30, 2017, which comprise the consolidated statement of financial position as of June 30, 2017, and the related consolidated statements of activities and cash flows for the fiscal year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated December 19, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered MERF and affiliate's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of MERF and affiliate's internal control. Accordingly, we do not express an opinion on the effectiveness of MERF and affiliate's internal control.

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether MERF and affiliate's consolidated financial statements are free from material misstatement, we performed tests of MERF and affiliate's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

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

Vannink, Tinn, Day & Co., LLP

Rancho Cucamonga, California
December 19, 2017



VAVRINEK, TRINE, DAY & CO., LLP
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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

Governing Board
Magnolia Educational & Research Foundation and affiliates
(A California Nonprofit Public Benefit Corporation)
Los Angeles, California

Report on Compliance for Each Major Federal Program

We have audited Magnolia Educational & Research Foundation' compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Magnolia Educational & Research Foundation (MERF) (A California Nonprofit Public Benefit Corporation) and affiliates, major Federal programs for the year ended June 30, 2017. MERF and affiliate's major Federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of MERF's major Federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about MERF's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major Federal program. However, our audit does not provide a legal determination of MERF's compliance.

Opinion on Each Major Federal Program

In our opinion, MERF complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major Federal programs for the year ended June 30, 2017.

Report on Internal Control Over Compliance

Management of MERF is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered MERF's internal control over compliance with the types of requirements that could have a direct and material effect on each major Federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major Federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of MERF's internal control over compliance.

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

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

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

Varrink, Tein, Day & Co., LLP

Rancho Cucamonga, California
December 19, 2017

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

SUMMARY OF AUDITOR'S RESULTS
FOR THE YEAR ENDED JUNE 30, 2017

FINANCIAL STATEMENTS

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

FEDERAL AWARDS

Internal control over major Federal programs:	
Material weakness identified?	<u>No</u>
Significant deficiency identified?	<u>None reported</u>

Type of auditor's report issued on compliance for major Federal programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with Section 200.516(a) of the Uniform Guidance? No

Identification of major Federal programs:

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

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

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

FINANCIAL STATEMENT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2017

None reported.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2017

None reported.

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION
(A California Nonprofit Public Benefit Corporation)

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2017

There were no audit findings reported in the prior year.



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

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Governing Board
Magnolia Educational & Research Foundation
(A California Nonprofit Public Benefit Corporation)
Los Angeles, California

In planning and performing our audit of the financial statements of Magnolia Educational & Research Foundation (MERF) for the year ended June 30, 2017, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

We are pleased to report there are no matters to note for the year ended June 30, 2017.

Vavrinek, Trine, Day & Co., LLP
Rancho Cucamonga, California
December 19, 2017