



**MAGNOLIA EDUCATIONAL &  
RESEARCH FOUNDATION**

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ANNUAL FINANCIAL REPORT

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**JUNE 30, 2016**

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

**TABLE OF CONTENTS**  
**JUNE 30, 2016**

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<b><i>INDEPENDENT AUDITOR'S REPORT</i></b>	1
<b><i>FINANCIAL STATEMENTS</i></b>	
Consolidated Statement of Financial Position	4
Consolidated Statement of Activities and Changes in Net Assets	5
Consolidated Statement of Cash Flows	6
Notes to the Consolidated Financial Statements	7
<b><i>SUPPLEMENTARY INFORMATION</i></b>	
Consolidated Schedule of Expenditures of Federal Awards	28
Local Education Agency Organization Structure	29
Magnolia Educational & Research Foundation Consolidating Statement of Financial Position	31
Magnolia Educational & Research Foundation Consolidating Statement of Activities and Changes in Net Assets	32
Magnolia Educational & Research Foundation Comparative Statement of Financial Position	33
Magnolia Educational & Research Foundation Comparative Statement of Activities and Changes in Net Assets	34
Magnolia Educational & Research Foundation Comparative Statement of Cash Flows	35
Note to Supplementary Information	36
<b><i>INDEPENDENT AUDITOR'S REPORTS</i></b>	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	37
Report on Compliance for Each Major Program and Report on Internal Control Over Compliance Required by the Uniform Guidance	40
<b><i>SCHEDULE OF FINDINGS AND QUESTIONED COSTS</i></b>	
Summary of Auditor's Results	43
Financial Statement Findings	44
Federal Awards Findings and Questioned Costs	45
Summary Schedule of Prior Audit Findings	46
Management Letter	47



## 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, 2016, and the related consolidated statements of activities and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements, which collectively comprise the basic 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of MERF and affiliates as of June 30, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## Report on Summarized Comparative Information

The prior year comparative information has been derived from MERF's consolidated financial statement report dated December 15, 2015, which expressed an unmodified opinion. In our opinion, the comparative information presented herein as of and for the year ended June 30, 2015, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

## Other Matters

### *Other Information*

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements that collectively comprise MERF and affiliate's basic financial statements. 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 basic financial statements.

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

## Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2016, on our consideration of MERF and affiliate'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 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 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 and affiliate's internal control over financial reporting and compliance.

*Vannink, Tin, Day & Co., LLP*

Rancho Cucamonga, California  
December 12, 2016

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***FINANCIAL STATEMENTS***

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

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**  
**JUNE 30, 2016**

	2016	2015
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 9,875,931	\$ 10,173,244
Restricted cash	6,327,515	998,292
Accounts receivable	4,317,399	4,170,911
Prepaid expenses and other current assets	141,671	29,854
Total Current Assets	20,662,516	15,372,301
Non-Current Assets:		
Debt issue costs, net	371,596	126,849
Security deposits	144,150	110,561
Fixed assets	23,391,744	10,716,608
Less: accumulated depreciation	2,338,891	1,795,398
Total Non-Current Assets	21,568,599	9,158,620
Total Assets	\$ 42,231,115	\$ 24,530,921
<b>LIABILITIES</b>		
Current Liabilities:		
Accounts payable and accruals	\$ 3,117,074	\$ 2,569,245
Deferred revenue	507,918	445,725
Current portion of long-term obligations	190,871	244,392
Total Current Liabilities	3,815,863	3,259,362
Long-Term Obligations:		
Non-current portion of long-term obligations	17,553,792	8,263,038
Total Liabilities	21,369,655	11,522,400
<b>NET ASSETS</b>		
Unrestricted	20,861,460	13,008,521
Total Liabilities and Net Assets	\$ 42,231,115	\$ 24,530,921

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 AND CHANGES IN NET ASSETS**  
**FOR THE YEAR ENDED JUNE 30, 2016**

	2016	2015
<b>REVENUES</b>		
State apportionments	\$ 28,674,688	\$ 26,635,709
Federal revenue	2,983,400	2,425,080
Other State revenue	14,298,155	4,313,775
Local revenue	1,358,287	982,894
Total Revenues	47,762,041	34,357,458
<b>EXPENSES</b>		
Program services:		
Salaries and benefits	24,182,556	19,967,246
Student services	2,028,885	2,190,954
Materials and supplies	1,237,521	985,129
Student nutrition	1,312,016	1,182,504
Other expenses	1,139,571	300,509
Subtotal	29,900,549	24,626,342
Management and general:		
Amortization	12,814	-
Depreciation	543,494	286,341
Management fee	642,960	-
Occupancy	1,785,885	2,669,178
Operating expenses	6,342,425	3,704,719
Interest	680,975	8,485
Subtotal	10,008,553	6,668,723
Total Expenses	39,909,102	31,295,065
<b>CHANGE IN NET ASSETS</b>	7,852,939	3,062,393
<b>NET ASSETS, BEGINNING OF YEAR</b>	13,008,521	9,946,128
<b>NET ASSETS, END OF YEAR</b>	\$ 20,861,460	\$ 13,008,521

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**  
**FOR THE YEAR ENDED JUNE 30, 2016**

	<u>2016</u>	<u>2015</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
<b>Change in net assets</b>	\$ 7,852,939	\$ 3,028,348
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation expense	543,493	265,043
Changes in operating assets and liabilities:		
(Increase) Decrease in assets		
Accounts receivable	(146,488)	539,884
Pledge receivable	-	150,000
Prepaid expenses and other current assets	(111,817)	(29,854)
Security deposits	(33,589)	162,823
Increase in liabilities		
Accounts payable and accruals	547,829	335,939
Deferred revenue	62,193	116,704
Net Cash Provided by Operating Activities	<u>8,714,560</u>	<u>4,568,887</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Capital expenditures	<u>(12,675,136)</u>	<u>(5,148,217)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Loan principal payments	(53,521)	114,163
Proceeds from long-term debt obligation	9,290,754	5,945,536
Cash restricted to meet debt obligation	(5,329,223)	(998,292)
Debt issue cost payments	<u>(244,747)</u>	<u>(126,849)</u>
Net Cash Provided by Financing Activities	<u>3,663,263</u>	<u>4,934,558</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<u>10,173,244</u>	<u>5,818,016</u>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u>\$ 9,875,931</u>	<u>\$ 10,173,244</u>
<b>Supplemental cash flow disclosure:</b>		
Cash paid during the period for interest	<u>\$ 680,975</u>	<u>\$ 8,485</u>

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

**MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION**  
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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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***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, 2016, MERF operated eleven Magnolia Science Academy (MSA) kindergarten through grade twelve charter schools serving 3,420 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**  
**(A California Nonprofit Public Benefit Corporation)**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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***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, 2016 and 2015, 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, 2016 and 2015, 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, 2016 and 2015, 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.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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**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, 2016 and 2015, 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**  
**JUNE 30, 2016**

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**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, 2016 and 2015, was \$543,494 and \$286,341, 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**  
**(A California Nonprofit Public Benefit Corporation)**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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**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, 2016 and 2015, the amount of restricted assets was \$5,934,155 and \$551,730, respectively. As of June 30, 2016, there was a designated balance of \$811,147 for California Clean Energy Jobs Act and Educator Effectiveness.

**Prior Year Comparative Financial Information**

The consolidated financial statements include certain prior year comparative information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with MERF's consolidated financial statements for the year ended June 30, 2015, from which the comparative information was derived.

**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, 2016 and 2015, consisted of the following:

	June 30, 2016		June 30, 2015	
	Reported Amount	Bank Balance	Reported Amount	Bank Balance
Deposits				
Cash on hand and in banks	<u>\$ 9,660,499</u>	<u>\$ 10,098,608</u>	<u>\$ 10,002,410</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, 2016 and 2015, MERF had \$8,386,998 and \$9,470,685, respectively, in excess of FDIC insured limits in bank accounts.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**NOTE 4 - RESTRICTED CASH**

At June 30, 2016 and 2015, cash held for restricted purposes consisted of the following:

	June 30, 2016		June 30, 2015	
	Reported Amount	Bank Balance	Reported Amount	Bank Balance
Bond reserve	\$ 446,563	\$ 446,563	\$ 446,563	\$ 446,563
Facility reserve	5,880,952	5,933,661	551,729	551,729
Current Restricted Cash	<u>\$ 6,327,515</u>	<u>\$ 6,380,224</u>	<u>\$ 998,292</u>	<u>\$ 998,292</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, 2016 and 2015, MERF had \$6,235,953 and \$915,345, respectively, in excess of FDIC insured limits in bank accounts.

**NOTE 5 - INVESTMENTS**

**Summary of Investments**

Two MSA charter schools have investments held in county investment pools. Investments as of June 30, 2016 and 2015, are classified in the accompanying financial statements as follows:

*Magnolia Science Academy San Diego*

Investment Type	June 30, 2016		June 30, 2015	
	Reported Amount	Fair Market Value	Reported Amount	Fair Market Value
San Diego County Treasury Investment Pool	<u>\$ 68,077</u>	<u>\$ 68,100</u>	<u>\$ 102,156</u>	<u>\$ 102,103</u>

*Magnolia Science Academy Santa Ana*

Investment Type	June 30, 2016		June 30, 2015	
	Reported Amount	Fair Market Value	Reported Amount	Fair Market Value
Orange County Treasury Investment Pool	<u>\$ 147,355</u>	<u>\$ 147,718</u>	<u>\$ 68,678</u>	<u>\$ 68,550</u>

Deposits with county treasurer are an external investment pool sponsored by the County of San Diego and Orange, respectively. County deposits are not required to be categorized. The pools provided the fair value for these deposits.

**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. The charter schools manage exposure to interest rate risk by investing in the County Pool.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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**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.

**Assets and Liabilities Recorded at Fair Value on a Recurring Basis**

The following table presents the balances of the assets measured at fair value on a recurring basis as of June 30, 2016. MERF did not have any liabilities measured at fair value on a recurring basis as of June 30, 2016.

*Magnolia Science Academy San Diego*

Investment Type	Level	Fair Value	Weighted Average Maturity in Days
San Diego County Investment Pool	2	\$ 68,100	270

*Magnolia Science Academy Santa Ana*

Investment Type	Level	Fair Value	Weighted Average Maturity in Days
Orange County Investment Pool	2	\$ 147,718	319

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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**NOTE 7 - ACCOUNTS RECEIVABLE**

Accounts receivable at June 30, 2016 and 2015, consisted of the following:

	<u>2016</u>	<u>2015</u>
Local Control Funding Formula	\$ 2,661,849	\$ 2,501,465
Federal receivable	682,725	556,876
State receivable	473,020	174,872
Due From LACOE	48,105	360,947
Local receivable	99,954	415,598
Lottery	339,918	161,153
Total Accounts Receivable	<u>\$ 4,305,571</u>	<u>\$ 4,170,911</u>

**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, 2016 and 2015, respectively. The balance due from those programs accounted for 96 and 96 percent of accounts receivable at June 30, 2016 and 2015, respectively. Without these sources of revenue, MERF would have difficulty maintaining its operations.

**NOTE 8 - FIXED ASSETS**

Fixed assets at June 30, 2016 and 2015, consisted of the following:

	<u>2016</u>	<u>2015</u>
Land	\$ 2,386,854	\$ 1,386,754
Building improvements	5,961,968	3,134,064
Leasehold improvements	384,879	402,722
Computer and equipment	2,618,137	1,962,040
Work in progress	12,039,906	3,831,028
Subtotal	23,391,744	10,716,608
Less: accumulated depreciation	<u>(2,338,891)</u>	<u>(1,795,398)</u>
Total Fixed Assets	<u>\$ 21,052,853</u>	<u>\$ 8,921,210</u>

During the years ended June 30, 2016 and 2015, \$543,294 and \$286,341, respectively, was charged to depreciation expense.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**NOTE 9 - ACCOUNTS PAYABLE AND ACCRUALS**

Accounts payable at June 30, 2016 and 2015, consisted of the following:

	2016	2015
Salaries and benefits	\$ 266,645	\$ 301,318
Compensated absences	196,523	-
Vendor payables	1,773,573	729,537
Due to other agencies	349,552	1,538,390
State principal apportionment	530,781	-
Total Accounts Payable and Accruals	<u>\$ 3,117,074</u>	<u>\$ 2,569,245</u>

**NOTE 10 - DEFERRED REVENUE**

Deferred revenue at June 30, 2016, consisted of the following:

	2016	2015
Federal sources	\$ -	\$ 354,000
State sources	507,918	91,725
Total Deferred Revenue	<u>\$ 507,918</u>	<u>\$ 445,725</u>

**NOTE 11 - LONG-TERM OBLIGATIONS**

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

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016	Due in One Year
Bonds payable	\$ 6,020,000	\$ -	\$ 70,000	\$ 5,950,000	\$ 80,000
Revolving and CCSFP loans	2,400,841	6,666,290	116,666	8,950,465	66,673
Capital leases	86,589	-	42,391	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>\$ 146,673</u>

**California School Finance Authority (CSFA) School Facility Revenue Bonds**

In June 2004, 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, 2016, the principal balance outstanding was \$5,950,000.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

The bonds mature through 2045 as follows:

<u>Repayment Year</u>	<u>Principal</u>	<u>Interest to Maturity</u>	<u>Total</u>
2017	\$ 80,000	\$ 360,088	\$ 440,088
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
2022-2026	110,000	331,038	441,038
2027-2031	645,000	1,557,969	2,202,969
2032-2036	850,000	1,339,438	2,189,438
2037-2041	1,145,000	1,040,469	2,185,469
2042-2044	1,555,000	625,156	2,180,156
2045	1,185,000	114,219	1,299,219
Total	<u>\$ 5,950,000</u>	<u>\$ 6,749,797</u>	<u>\$ 12,699,797</u>

**Debt Service Coverage and Cash Days on Hand**

Under the current bonding agreement, 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, 2016, MSA had a 3.24 Debt Service Coverage Ratio and was in compliance with the 1.10 to 1.00 required ratio.

Debt Service Coverage

Net Income	\$ 933,195
Depreciation	162,543
Rent	488,509
Income Available for Coverage	1,584,247
Debt Service	488,509

<b>Debt Service Coverage</b>	<b>3.24</b>
Limit	1.10
Compliance	Yes

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

The Days Cash on Hand is calculated by reducing non-cash expenses from total expenses and divided by 365 days. As of June 30, 2016, MSA had 80 days cash on hand and was in compliance with the 45 days required.

Days Cash on Hand

Total Expenses	\$ 6,559,126
Depreciation	162,543
Cash Expenses	6,396,583
Expense/Day	17,524.88
Cash	1,403,525

<b>Days Cash on Hand</b>	<b>80</b>
Limit	45
Compliance	Yes

**Loans**

Summarized below are MERF's loans at June 30, 2016:

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016	Due in One Year
MERF	\$ 83,333	\$ -	\$ 66,666	\$ 16,667	\$ 16,667
MSA 2	50,000	6	25,000	25,006	25,006
MSA SD	151,806	-	-	151,806	-
MSA SA (Revolving)	75,000	-	25,000	50,000	25,000
MSA SA (CCSFP)	2,040,702	6,666,284	-	8,706,986	-
Total	<u>\$ 2,400,841</u>	<u>\$6,666,290</u>	<u>\$ 116,666</u>	<u>\$ 8,950,465</u>	<u>\$ 66,673</u>

*Magnolia Science Academy 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. The maturity date is June 30, 2017.

Future payments are as follows:

Fiscal Year Ending	<u>Payments</u>
June 30,	<u>\$ 25,006</u>
2017	

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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*Magnolia Science Academy Santa Ana*

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, 2016, 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
June 30,	
2017	\$ 25,000
2018	25,000
Total	<u>\$ 50,000</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 \$8,706,978 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, 2016, was \$8,706,986.

*Magnolia Science Academy San Diego*

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, 2016, was \$151,806.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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*Magnolia Educational & Research Foundation*

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. The outstanding loan balance was \$16,667 as of June 30, 2016. The current portion of long-term obligations as of June 30, 2016, is \$16,667.

**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, 2016, is \$44,198. The current portion of the long-term obligation is \$44,198.

**Note Payable**

*Magnolia Science Academy*

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	Payments
<u>June 30,</u>	
2017	\$ 182,000
2018	<u>2,875,833</u>
Total Payments	3,057,833
Less: Amount Representing Interest	<u>(257,833)</u>
Total	<u>\$ 2,800,000</u>

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**NOTE 12 - FACILITIES USES AGREEMENTS/OPERATING LEASES**

Total rental and facility expenses were \$2,428,940 for year ended June 30, 2016, 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
2017	\$ 1,921,420
2018	609,216
2019	614,616
2020	620,116
2021	626,116
Thereafter	6,197,601
Total	<u>\$ 10,589,085</u>

**NOTE 13 - FAIR VALUE FINANCIAL INSTRUMENTS**

The carrying amounts and estimated fair values of MERF financial instruments as of June 30, 2016 are as follows:

	June 30, 2016		June 30, 2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 9,875,931	\$ 9,876,317	\$ 10,173,244	\$ 10,173,244
Restricted cash and cash equivalents	6,327,515	6,327,515	998,292	998,292
Revolving and CCSF loans	8,950,465	8,950,465	8,950,465	8,950,465
Notes payable	2,800,000	2,800,000	-	-
Bonds payable	5,950,000	5,950,000	6,020,000	6,020,000
Capital leases	44,198	44,198	86,589	86,589

**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).

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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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, 2015, total actuarial value of assets are \$177 billion, the actuarial obligation is \$242 billion, contributions from all employers totaled \$2.6 billion, and the plan is 68.5 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.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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The STRP provisions and benefits in effect at June 30, 2016, are summarized as follows:

	<u>STRP Defined Benefit Program</u>	
	On or before December 31, 2012	On or after January 1, 2013
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	9.20%	8.56%
Required employer contribution rate	10.73%	10.73%
Required state contribution rate	7.12589%	7.12589%

**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, 2016 and 2015, are presented above and Magnolia Science Academy charter schools' total contributions were \$1,322,909 and 1,001,799, 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>.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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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, 2016, are summarized as follows:

	<u>School Employer Pool (CalPERS)</u>	
	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	7.000%	6.000%
Required employer contribution rate	11.847%	11.847%

**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, 2016 and 2015, respectively, are presented above and the total Charter School contributions were \$169,607 and \$94,508, respectively.

**On Behalf Payments**

The State of California makes contributions to CalSTRS on behalf of the Magnolia Science Academy charter schools. These payments consist of State General Fund contributions to CalSTRS in the amount of \$818,253 (7.12589 percent of Magnolia Science Academy charter schools' 2012-2013 creditable compensation 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.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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***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 2015-2016 at the time this report was issued. However, financial statements should be available from the respective agency.

During the years ended June 30, 2016 and 2015, Magnolia Science Academy Charter Schools made payments of \$325,230 and \$344,113, respectively, to CharterSAFE for services received. At June 30, 2016 and 2015, MERF had no recorded accounts receivable or accounts payable to CharterSAFE.

***NOTE 16 - CONTINGENCIES***

MERF has received State and Federal funds for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate disallowances under terms of the grants, it is believed that any reimbursement, if required, would not be material.

**Litigation**

The Charter School is not currently a party to any legal proceedings.

***NOTE 17 - SUBSEQUENT EVENTS***

MERF's management has evaluated events or transactions that may occur for potential recognition or disclosure in the consolidated financial statements from the balance sheet date through December 12, 2016, 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.

On October 18, 2016, Los Angeles Unified School District took action not to extend a five-year renewal for the MSA as of June 30, 2017. In accordance with charter law, Magnolia Educational Research Foundation, working with the MSA, has applied for an appeal and is scheduled for a hearing with Los Angeles County Office of Education on December 6, 2016. Depending on the outcome, alternative appeals are available with the California Department of Education to be concluded by May 2017. Management is 100 percent confident that the continuance of MSA will be ongoing and adhere to all Federal guidelines and State charter laws.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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On October 18, 2016, Los Angeles Unified School District took action not to extend a five-year renewal for the MSA 2 as of June 30, 2017. In accordance with charter law, Magnolia Educational Research Foundation, working with the MSA 2, has applied for an appeal and is scheduled for a hearing with Los Angeles County Office of Education on December 6, 2016. Depending on the outcome, alternative appeals are available with the California Department of Education to be concluded by May 2017. Management is 100 percent confident that the continuance of MSA 2 will be ongoing and adhere to all Federal guidelines and State charter laws.

On October 18, 2016, Los Angeles Unified School District took action not to extend a five-year renewal for the MSA 3 as of June 30, 2017. In accordance with charter law, Magnolia Educational Research Foundation, working with the MSA 3, has applied for an appeal and is scheduled for a hearing with Los Angeles County Office of Education on December 6, 2016. Depending on the outcome, alternative appeals are available with the California Department of Education to be concluded by May 2017. Management is 100 percent confident that the continuance of MSA 3 will be ongoing and adhere to all Federal guidelines and State charter laws.

On July 1, 2016, the Magnolia Educational Research Foundation voted to close MSA Santa Clara as of June 30, 2016. Management has implemented procedures as required in accordance with the California *Education Code* for the closeout of a charter school.

***NOTE 18 - CLOSEOUT PROCEDURES***

On July 1, 2016, the board of the Magnolia Educational and Research Foundation (MERF) voted to close the Magnolia Science Academy Santa Clara Charter School (MSA Santa Clara), effective, June 30, 2016, due to fiscal concerns. MERF acting as MSA Santa Clara's management organization (CMO) will be the responsible party for handling MSA Santa Clara closure. As part of the final audit, MSA Santa Clara is required to determine the net assets or liabilities and disclose required information.

1. MSA SC has an operating deficit of \$(1,230,117) in the 2015-2016 year and an overall deficit of \$(730,580) as of June 30, 2016;
2. MSA SC has outstanding restricted funds due back to government agencies in the amount of \$364,493;
3. MERF has inventoried and assigned a fair market value to all MSA SC usable furnishings, equipment, and supplies and has, as per MERF Board approval, redistributed all usable furnishings, equipment, and supplies to other charter schools operated by MERF's corporation; the receiving charter schools have paid the fair market value MSA SC for receipt of all usable furnishings, equipment, and supplies it has received;
4. No donated materials and property were required to be returned;
5. All grants and restricted categorical funds have been identified and returned to their source according to the terms of the grant or state and federal law;
6. MERF has prepared and submitted final expenditure reports for any entitlement grants and has filed Final Expenditure Reports and Final Performance Reports, as appropriate;
7. A formal plan to resolve the transferring of all remaining assets and liabilities of MSA SC will be completed during 2016-2017, to transfer available surplus reserves not restricted to absorb the overall deficit related to legitimate educational and operational expenses incurred in closing of this charter school, The Charter School's bank accounts for MSA SC were closed with approximately \$5,000 being transferred into MERF's main account;
8. Remaining loan agreements were assigned to MERF and any additional cost incurred subsequently will be recorded in MERF's financial records;

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

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9. MERF is a solvent continuing nonprofit entity operating other charter schools and will not have another charter school, legal entity, or the Board of Directors, or another individual assume liabilities of MSA SC;
10. Student and Employee records maintenance has been completed in accordance with required laws and *Education Code*.

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***SUPPLEMENTARY INFORMATION***

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

**CONSOLIDATED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2016**

Federal Grantor/Pass-Through Grantor/Program	CFDA Number	Pass-Through Entity Identifying Number	Program Expenditures
<b>U.S. DEPARTMENT OF EDUCATION</b>			
Passed through California Department of Education (CDE):			
Individuals with Disabilities Act (IDEA)			
Special Education (IDEA):			
Basic Local Assistance Entitlement, Part B, Section 611	84.027	13379	\$ 572,235
No Child Left Behind Act (NCLB)			
Title I, Part A, Basic Grants Low Income and Neglected	84.010	14981	1,085,025
Title II, Part A, Improving Teacher Quality Local Grants	84.367	14341	17,058
Title III Cluster:			
Title III, Immigrant Education Program	84.365	15146	20,929
Title III, Limited English Proficient (LEP) Student Program	84.365	14346	<u>44,844</u>
Total Title III Cluster			<u>65,773</u>
Title V, Part B - Public Charter Schools Grant Program	84.282	14531	292,645
State Charter School Facilities Incentive Grants	84.242D	[1]	<u>203,452</u>
Total U.S. Department of Education			<u>2,236,188</u>
<b>U.S. DEPARTMENT OF AGRICULTURE</b>			
Passed through California Department of Education (CDE):			
Child Nutrition Cluster:			
Especially Needy Breakfast	10.553	13526	212,766
National School Lunch Program	10.555	13524	<u>531,916</u>
Total U.S. Department of Agriculture			<u>744,682</u>
Total Federal Programs			<u>\$ 2,980,870</u>

See accompanying note to supplementary information.

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

**LOCAL EDUCATION AGENCY ORGANIZATION STRUCTURE**  
**FOR THE YEAR ENDED JUNE 30, 2016**

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**ORGANIZATION**

MERF operates eleven schools in California under eleven 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, 2016, the charter schools operated by MERF were as follows:

<b>Charter School Name</b>	<b>Charter Number</b>	<b>Sponsoring District</b>	<b>Charter Expiration</b>	<b>Grades Served</b>	<b>Number of Students Served</b>
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
Magnolia Science Academy Santa Clara	1116	Santa Clara COE	June 30, 2018	6-12	100

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, 2016**

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**BOARD OF DIRECTORS**

<u>MEMBER</u>	<u>OFFICE</u>	<u>TERM EXPIRES</u>
Dr. Umit Yapanel, Ph.D.	President	October 10, 2017
Ms. Noel Russell-Unterburger	Treasurer	October 10, 2017
Mr. Saken Sherkhonov	Secretary	December 11, 2018
Mrs. Diane Gonzalez	Director	December 2019
Mr. Nguyen Huynh	Director	October 10, 2017
<sup>1</sup> Mr. Ali Korkmaz	Director	September 9, 2020
<sup>2</sup> Dr. Mustafa Kaynak, Ph.D.	Director	December 10, 2019
Mr. Serdar Orazov	Director	September 9, 2020
Dr. Remzi Oten, Ph.D.	Director	March 11, 2020

**ADMINISTRATION**

Caprice Young, Ed.D.	Chief Executive Officer, Superintendent
<sup>3</sup> Oswaldo Diaz	Chief Financial Officer
<sup>4</sup> Nanie Montijo	Interim Chief Financial Officer

<sup>1</sup> Resigned December 8, 2016

<sup>2</sup> Resigned April 20, 2016

<sup>3</sup> Resigned November 18, 2016

<sup>4</sup> Effective November 16, 2016

See accompanying note to supplementary information.

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

**CONSOLIDATING STATEMENT OF FINANCIAL POSITION**  
**JUNE 30, 2016**

	MERF	MSA-1	MSA-2	MSA-3	MSA-4	MSA-5	MSA-6
<b>ASSETS</b>							
Current Assets:							
Cash and cash equivalents	\$ 82,468	\$ 1,403,525	\$ 974,391	\$ 363,932	\$ 494,503	\$ 728,184	\$ 535,854
Restricted cash and cash equivalents	-	-	-	-	-	-	-
Accounts receivable	98,615	853,258	433,591	534,302	198,718	277,438	297,410
Intra-company receivable	2,555,550	332,908	126,413	348,184	203,328	206,150	300,000
Prepaid expenses and other current assets	40,728	14,351	10,859	10,967	5,624	1,232	3,835
Total Current Assets	2,777,361	2,604,042	1,545,254	1,257,385	902,173	1,213,004	1,137,099
Non-Current Assets:							
Debt issue cost, net	-	-	-	-	-	-	-
Security deposits	17,525	39,035	-	-	-	-	-
Fixed assets	134,513	4,458,685	374,363	221,439	164,670	111,918	148,877
Less: accumulated depreciation	115,350	745,865	190,348	139,895	100,526	105,008	82,477
Total Non-Current Assets	36,688	3,751,855	184,015	81,544	64,144	6,910	66,400
Total Assets	\$ 2,814,049	\$ 6,355,897	\$ 1,729,269	\$ 1,338,929	\$ 966,317	\$ 1,219,914	\$ 1,203,499
<b>LIABILITIES</b>							
Current Liabilities:							
Accounts payable and accruals	\$ 582,797	\$ 208,364	\$ 245,448	\$ 243,954	\$ 141,922	\$ 128,016	\$ 136,224
Intra-company payable	2,187,787	187,120	317,863	119,551	161,905	14,383	110,010
Deferred revenue	-	-	-	-	-	-	-
Current portion of long-term obligations	16,667	-	25,006	-	-	-	-
Total Current Liabilities	2,787,251	395,484	588,317	363,505	303,827	142,399	246,234
Long-Term Obligations:							
Non-current portion of long-term obligations	-	2,800,000	-	-	-	-	-
Total Liabilities	2,787,251	3,195,484	588,317	363,505	303,827	142,399	246,234
<b>NET ASSETS</b>							
Unrestricted	26,798	3,160,413	1,140,952	975,424	662,490	1,077,515	957,265
Designated	-	-	-	-	-	-	-
Total Net Assets	26,798	3,160,413	1,140,952	975,424	662,490	1,077,515	957,265
Total Liabilities and Net Assets	\$ 2,814,049	\$ 6,355,897	\$ 1,729,269	\$ 1,338,929	\$ 966,317	\$ 1,219,914	\$ 1,203,499

See accompanying note to supplementary information.

MSA-7	MSA-Bell	MSA-SD	MSA-SA	MSA-SC	LLC	Elimination	Total	Memo 2015 Total
\$ 914,277	\$ 2,029,820	\$ 761,775	\$ 170,647	\$ 31,093	\$ 1,385,462	\$ -	\$ 9,875,931	\$ 10,173,244
-	-	106,607	5,774,345	-	446,563	-	6,327,515	998,292
372,498	479,912	308,121	213,512	250,024	-	-	4,317,399	4,170,911
112,514	612,759	10,064	2,759	20,440	-	(4,831,069)	-	-
28,109	12,091	8,521	5,354	-	-	-	141,671	29,854
<u>1,427,398</u>	<u>3,134,582</u>	<u>1,195,088</u>	<u>6,166,617</u>	<u>301,557</u>	<u>1,832,025</u>	<u>(4,831,069)</u>	<u>20,662,516</u>	<u>15,372,301</u>
-	-	-	-	-	371,596	-	371,596	126,849
4,000	-	-	27,000	56,590	-	-	144,150	110,561
122,900	202,508	644,168	12,030,297	256,588	4,520,818	-	23,391,744	10,716,608
84,099	61,812	302,836	128,715	121,238	160,722	-	2,338,891	1,795,398
42,801	140,696	341,332	11,928,582	191,940	4,731,692	-	21,568,599	9,158,620
<u>\$ 1,470,199</u>	<u>\$ 3,275,278</u>	<u>\$ 1,536,420</u>	<u>\$ 18,095,199</u>	<u>\$ 493,497</u>	<u>\$ 6,563,717</u>	<u>\$ (4,831,069)</u>	<u>\$ 42,231,115</u>	<u>\$ 24,530,921</u>
\$ 389,849	\$ 196,893	\$ 190,591	\$ 201,105	\$ 451,911	\$ -	\$ -	\$ 3,117,074	\$ 2,569,245
132,998	74,210	19,442	776,832	728,968	-	(4,831,069)	-	-
-	-	-	61,355	-	446,563	-	507,918	445,725
-	-	-	25,000	44,198	80,000	-	190,871	244,392
<u>522,847</u>	<u>271,103</u>	<u>210,033</u>	<u>1,064,292</u>	<u>1,225,077</u>	<u>526,563</u>	<u>(4,831,069)</u>	<u>3,815,863</u>	<u>3,259,362</u>
-	-	151,806	8,731,986	-	5,870,000	-	17,553,792	8,263,038
<u>522,847</u>	<u>271,103</u>	<u>361,839</u>	<u>9,796,278</u>	<u>1,225,077</u>	<u>6,396,563</u>	<u>(4,831,069)</u>	<u>21,369,655</u>	<u>11,522,400</u>
947,352	3,004,175	1,174,581	8,298,921	(731,580)	167,154	-	20,861,460	12,010,229
-	-	-	-	-	-	-	-	998,292
<u>947,352</u>	<u>3,004,175</u>	<u>1,174,581</u>	<u>8,298,921</u>	<u>(731,580)</u>	<u>167,154</u>	<u>-</u>	<u>20,861,460</u>	<u>13,008,521</u>
<u>\$ 1,470,199</u>	<u>\$ 3,275,278</u>	<u>\$ 1,536,420</u>	<u>\$ 18,095,199</u>	<u>\$ 493,497</u>	<u>\$ 6,563,717</u>	<u>\$ (4,831,069)</u>	<u>\$ 42,231,115</u>	<u>\$ 24,530,921</u>

**MAGNOLIA PUBLIC SCHOOLS**  
**(A California Nonprofit Public Benefit Corporation)**

**CONSOLIDATING STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS**  
**JUNE 30, 2016**

	MERF	MSA-1	MSA-2	MSA-3	MSA-4	MSA-5	MSA-6
<b>CHANGES IN UNRESTRICTED NET ASSETS</b>							
<b>REVENUES</b>							
State apportionments	\$ -	\$ 4,902,054	\$ 4,104,344	\$ 4,024,495	\$ 1,634,775	\$ 1,245,541	\$ 1,415,790
Federal revenue	-	673,666	242,928	449,664	227,541	218,990	137,157
Other State revenue	-	1,778,747	734,177	979,204	328,641	270,288	387,689
Rent revenue	-	-	-	-	-	-	-
Local revenue	5,853,081	137,854	121,543	96,494	89,919	14,618	38,359
Total Revenues	5,853,081	7,492,321	5,202,992	5,549,857	2,280,876	1,749,437	1,978,995
<b>EXPENSES</b>							
Program services:							
Salaries and benefits	3,063,199	3,359,332	2,633,051	2,983,579	1,099,403	885,733	843,832
Student services	-	243,193	235,108	422,937	159,500	162,880	74,310
Materials and supplies	17,167	171,245	277,624	3,053	111,372	16,125	55,947
Student nutrition	34,328	270,203	53,394	346,028	47,129	51,935	51,330
Other expenses	90,373	133,304	137,503	126,013	29,526	28,553	57,410
Subtotal	3,205,067	4,177,277	3,336,680	3,881,610	1,446,930	1,145,226	1,082,829
Management and general:							
Amortization	-	-	-	-	-	-	-
Depreciation	7,666	162,543	50,973	11,665	9,366	13,602	19,778
Management fee	-	915,722	1,145,791	873,103	342,757	142,214	167,776
Occupancy	194,984	620,993	11,179	225,343	145,840	100,264	109,407
Operating expenses	2,453,803	556,505	511,533	379,541	140,313	125,888	116,497
Debt service	-	-	-	-	-	-	-
Interest	406	126,086	143	-	-	-	-
Subtotal	2,656,859	2,381,849	1,719,619	1,489,652	638,276	381,968	413,458
Total Expenses	5,861,926	6,559,126	5,056,299	5,371,262	2,085,206	1,527,194	1,496,287
<b>CHANGE IN UNRESTRICTED NET ASSETS</b>	<b>(8,845)</b>	<b>933,195</b>	<b>146,693</b>	<b>178,595</b>	<b>195,670</b>	<b>222,243</b>	<b>482,708</b>
<b>NET ASSETS (DEFICIT,</b>							
<b>BEGINNING OF YEAR</b>	35,643	2,227,218	994,259	796,829	466,820	855,272	474,557
<b>NET ASSETS , END OF YEAR</b>	\$ 26,798	\$ 3,160,413	\$ 1,140,952	\$ 975,424	\$ 662,490	\$ 1,077,515	\$ 957,265

See accompanying note to supplementary information.

MSA-7	MSA-Bell	MSA-SD	MSA-SA	MSA-SC	LLC	Elimination	Total	Memo 2015 Total
\$ 2,384,759	\$ 4,186,383	\$ 2,888,409	\$ 1,178,240	\$ 709,898	\$ -	\$ -	\$ 28,674,688	\$ 26,635,709
243,652	300,266	97,228	364,623	27,685	-	-	2,983,400	2,425,080
808,969	936,594	602,791	7,070,882	400,173	-	-	14,298,155	4,313,775
-	-	-	-	-	447,511	-	447,511	-
77,755	124,582	84,976	47,229	5,197	-	(5,333,320)	1,358,287	982,894
<u>3,515,135</u>	<u>5,547,825</u>	<u>3,673,404</u>	<u>8,660,974</u>	<u>1,142,953</u>	<u>447,511</u>	<u>(5,333,320)</u>	<u>47,762,041</u>	<u>34,357,458</u>
1,710,538	3,095,595	1,985,116	1,239,163	1,284,015	-	-	24,182,556	19,967,246
184,561	198,391	128,325	127,714	91,966	-	-	2,028,885	2,190,954
77,871	151,337	172,634	169,969	13,177	-	-	1,237,521	985,129
149,306	181,371	44,650	68,807	13,535	-	-	1,312,016	1,182,504
79,655	196,162	105,525	49,339	106,208	-	-	1,139,571	300,509
<u>2,201,931</u>	<u>3,822,856</u>	<u>2,436,250</u>	<u>1,654,992</u>	<u>1,508,901</u>	<u>-</u>	<u>-</u>	<u>29,900,549</u>	<u>24,626,342</u>
-	-	-	-	-	12,814	-	12,814	-
25,027	44,395	44,619	33,848	39,651	80,361	-	543,494	286,341
545,689	1,000,958	334,759	60,000	-	-	(4,885,809)	642,960	-
280,315	-	305	229,754	315,012	-	(447,511)	1,785,885	2,669,178
352,323	552,106	318,845	325,565	509,506	-	-	6,342,425	3,704,719
-	-	-	-	-	554,340	-	554,340	-
-	-	-	-	-	-	-	126,635	8,485
<u>1,203,354</u>	<u>1,597,459</u>	<u>698,528</u>	<u>649,167</u>	<u>864,169</u>	<u>647,515</u>	<u>(5,333,320)</u>	<u>10,008,553</u>	<u>6,668,723</u>
<u>3,405,285</u>	<u>5,420,315</u>	<u>3,134,778</u>	<u>2,304,159</u>	<u>2,373,070</u>	<u>647,515</u>	<u>(5,333,320)</u>	<u>39,909,102</u>	<u>31,295,065</u>
109,850	127,510	538,626	6,356,815	(1,230,117)	(200,004)	-	7,852,939	3,062,393
837,502	2,876,665	635,955	1,942,106	498,537	367,158	-	13,008,521	9,946,128
<u>\$ 947,352</u>	<u>\$ 3,004,175</u>	<u>\$ 1,174,581</u>	<u>\$ 8,298,921</u>	<u>\$ (731,580)</u>	<u>\$ 167,154</u>	<u>\$ -</u>	<u>\$ 20,861,460</u>	<u>\$ 13,008,521</u>

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

**COMPARATIVE STATEMENT OF FINANCIAL POSITION**  
**JUNE 30, 2016**

	<u>2016</u>	<u>2015</u>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 82,468	\$ 184,383
Accounts receivable	98,615	-
Intra-company receivable	2,555,550	1,093,266
Prepaid expenses and other current assets	40,728	-
Total Current Assets	<u>2,777,361</u>	<u>1,277,649</u>
Non-Current Assets:		
Security deposits	17,525	1,525
Fixed assets	134,513	134,513
Less: accumulated depreciation	<u>115,350</u>	<u>107,684</u>
Total Non-Current Assets	<u>36,688</u>	<u>28,354</u>
Total Assets	<u>\$ 2,814,049</u>	<u>\$ 1,306,003</u>
<b>LIABILITIES</b>		
Current Liabilities:		
Accounts payable and accruals	\$ 582,797	\$ 200,348
Intra-company payable	2,187,787	897,894
Deferred revenue	-	88,785
Current portion of long-term obligation	<u>16,667</u>	<u>66,666</u>
Total Current Liabilities	<u>2,787,251</u>	<u>1,253,693</u>
Long-Term Obligations:		
Non-current portion of long-term obligations	<u>-</u>	<u>16,667</u>
Total Liabilities	<u>2,787,251</u>	<u>1,270,360</u>
<b>NET ASSETS</b>		
Unrestricted	<u>26,798</u>	<u>35,643</u>
Total Liabilities and Net Assets	<u>\$ 2,814,049</u>	<u>\$ 1,306,003</u>

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

**COMPARATIVE STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS**  
**JUNE 30, 2016**

	<u>2016</u>	<u>2015</u>
<b>CHANGES IN UNRESTRICTED NET ASSETS</b>		
<b>REVENUES</b>		
Local revenue	\$ 5,853,081	\$ 4,812,297
<b>EXPENSES</b>		
Program services:		
Salaries and benefits	3,063,199	1,490,317
Student services	-	29,922
Materials and supplies	17,167	29,191
Student nutrition	34,328	6,251
Other expenses	90,373	44,863
Subtotal	<u>3,205,067</u>	<u>1,600,544</u>
Management and general:		
Depreciation	7,666	36,278
Occupancy	194,984	154,681
Operating expenses	2,453,803	1,432,967
Interest	406	3,685
Subtotal	<u>2,656,859</u>	<u>1,627,611</u>
Total Expenses	<u>5,861,926</u>	<u>3,228,155</u>
<b>CHANGE IN UNRESTRICTED NET ASSETS</b>	<u>(8,845)</u>	<u>1,584,142</u>
<b>NET ASSETS, BEGINNING OF YEAR</b>	<u>35,643</u>	<u>(1,548,499)</u>
<b>NET ASSETS, END OF YEAR</b>	<u>\$ 26,798</u>	<u>\$ 35,643</u>

**MAGNOLIA PUBLIC SCHOOLS**  
**(A California Nonprofit Public Benefit Corporation)**

**COMPARATIVE STATEMENT OF CASH FLOWS**  
**JUNE 30, 2016**

	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
<b>Change in Unrestricted Net Assets</b>	\$ (8,845)	\$ 1,584,142
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation expense	7,666	36,278
Changes in operating assets and liabilities:		
(Increase) Decrease in assets		
Accounts receivable	(98,615)	193,451
Intra-company receivable	(1,462,284)	(2,365,516)
Prepaid expenses and other current assets	(40,728)	(34,045)
Security deposits	(16,000)	-
Increase (Decrease) in liabilities		
Accounts payable and accruals	382,449	(177,792)
Intra-company payable	1,289,893	897,894
Deferred revenue	(88,785)	(55,052)
Net Cash Used by Operating Activities	(35,249)	79,360
 <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Capital expenditures	-	(19,887)
 <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Loan proceeds	(66,666)	66,666
Loan principal payments	-	16,667
Net Cash Provided (Used) by Financing Activities	(66,666)	83,333
 <b>NET DECREASE IN CASH</b>	(101,915)	142,806
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	184,383	41,577
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	\$ 82,468	\$ 184,383
 <b>Supplemental cash flow disclosure:</b>		
Cash paid during the period for interest	\$ 406	\$ 3,685

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

**NOTE TO SUPPLEMENTARY INFORMATION**  
**JUNE 30, 2016**

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***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.

**Local Education Agency Organization Structure**

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

**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.

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***INDEPENDENT AUDITOR'S REPORTS***

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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, 2016, and the related notes to the consolidated financial statements, which collectively comprise MERF and affiliate's consolidated financial statements, and have issued our report thereon dated December 12, 2016.

**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*.

We noted certain matters that we reported to management of MERF and affiliates in a separate letter dated December 12, 2016.

## **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.

*Varrinck, Tim, Day & Co., LLP*

Rancho Cucamonga, California  
December 12, 2016



**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, 2016. 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, 2016.

## **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, Tin, Day & Co., LLP*

Rancho Cucamonga, California  
December 12, 2016

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***SCHEDULE OF FINDINGS AND QUESTIONED COSTS***

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

**SUMMARY OF AUDITOR'S RESULTS**  
**FOR THE YEAR ENDED JUNE 30, 2016**

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**FINANCIAL STATEMENTS**

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

**FEDERAL AWARDS**

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

Type of auditor's report issued on compliance for major Federal programs:	<u>Unmodified</u>
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Any audit findings disclosed that are required to be reported in accordance with Section 200.516(a) of the Uniform Guidance?	<u>No</u>
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Identification of major Federal programs:

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
<u>84.010</u>	<u>Title I, Part A, Basic Grants Low</u>
<u>10.553 and 10.555</u>	<u>Income and Neglected</u>
	<u>Child Nutrition Cluster</u>

Dollar threshold used to distinguish between Type A and Type B programs:	<u>\$ 750,000</u>
Auditee qualified as low-risk auditee?	<u>No</u>

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

**FINANCIAL STATEMENT FINDINGS**  
**FOR THE YEAR ENDED JUNE 30, 2016**

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None reported.

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

**FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2016**

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None reported.

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

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**  
**FOR THE YEAR ENDED JUNE 30, 2016**

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



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, 2016, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

However, during our audit we noted matters that are opportunities for strengthening internal controls and operating efficiency. The following items represent conditions noted by our audit that we consider important enough to bring to your attention. This letter does not affect our report dated December 12, 2016 on the financial statements of MERF.

### **MSA 1 - Payroll**

#### *Observation*

It was noted that an "employee" (Teacher) of the Charter School was paid outside of the payroll process as an "independent contractor" for a "home visit".

#### *Recommendation*

The Charter School should take the necessary steps to implement procedures to prevent this type of situation from occurring in the future. The determination of an "independent contractor" versus an "employee" should be reviewed with all staff involved in consultant contracts to ensure the staff is aware of the IRS regulations.

#### *Corrective Action Plan*

Accounting staff are aware that employees need to be paid through the payroll process and not through the disbursements process.

### **MSA 3 - Cash Collections**

#### *Observation*

Teachers collecting funds at the Charter School do not use triplicate, pre-numbered receipt logs, tally sheets or any sort of adequate cash collection backup.

*Recommendation*

It is recommended that the Charter School use triplicate, pre-numbered, receipt books. Tally sheets may also be used as the cash receipt control procedure. Two people should be involved: one person to make a mark on the tally sheet when an item is sold and issue the goods and another person to collect the cash. When it is not practical to use pre-numbered receipts due to high volume of collections for small amounts of cash collected, it is recommended that the individual collecting funds use a class roster or a log in lieu of triplicate, pre-numbered receipts. Documents mentioned are to be provided to the front office along with funds receipted.

*Corrective Action Plans*

The school sites are responsible for keeping proper supporting documentation for the collection of money. MERF will be reviewing procedures with all principals to enhance the verification of deposits and will be tested periodically to double-check the collections.

**MSA 3 - Cash Disbursements**

*Observation*

It was noted that an "employee" of the charter school was paid outside of the payroll process as an "independent contractor" for "referee services".

*Recommendation*

The Charter School should take the necessary steps to implement procedures to prevent this type of situation from occurring in the future. The determination of an "independent contractor" versus an "employee" should be reviewed with all staff involved in consultation contracts to ensure the staff is aware of the IRS regulations. In addition, the charter school should perform a review of the procedures for determining who receives a Form 1099 to ensure all 1099's are properly issued.

*Corrective Action Plan*

Accounting staff is aware that employees are to be paid through the payroll process and not through the disbursements process.

**MSA 4 - Cash Collections**

*Observation*

Cash collections are not all being receipted or logged at the time collection.

*Recommendation*

To strengthen the procedures over cash collections, all cash should be verified and receipted at the time of or very soon after the money is collected. This procedure prevents and avoids any dispute over the amount of cash submitted by the person turning in the funds to the office. The immediate receipting process is also a tool to reconcile the cash awaiting deposit to the receipts issued since the last deposit. The current system would not disclose that funds have been misplaced or stolen since the cash on hand at the date of the deposit would be the only funds receipted.

*Corrective Action Plan*

The school sites are responsible for keeping proper supporting documentation for the collection of money. MERF will be reviewing procedures with all principals to enhance the verification of deposits and will be tested periodically to double-check the collections.

**MSA Bell - Cash Collections**

*Observation*

Teachers collecting funds at the Charter School do not use triplicate, pre-numbered receipts, logs, tally sheets or any sort of adequate cash collection backup. Additionally, cash count sheets are not consistently being signed by a reviewer.

*Recommendation*

It is recommended that the Charter School use triplicate, pre-numbered, receipt books. Tally sheets may also be used as the cash receipt control procedure, two people should be involved: one person to make a mark on the tally sheet when an item is sold and issue the goods and another person to collect the cash. When it is not practical to use pre-numbered receipts due to high volume of collections for small amounts of cash collected, it is recommended that the individual collecting funds use a class roster or a log in lieu of triplicate, pre-numbered receipts. Documents mentioned are provided to the front office along with funds receipted.

*Corrective Action Plans*

The school sites are responsible for keeping proper supporting documentation for the collection of money. MERF will be reviewing procedures with all principals to enhance the verification of deposits and will be tested periodically to double-check the collections.

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

*Varrink, Tim, Day & Co., LLP*

Rancho Cucamonga, California  
December 12, 2016