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INDEPENDENT MANAGEMENT REPORT

International American Education Federation, Inc.
International Leadership of Texas

<u>$111,040,000 CLIFTON HIGHER EDUCATION FINANCE CORPORATION</u>

$105,680,000 Education Revenue Bonds, Series 2015A
$5,360,000 Education Revenue Bonds, Series 2015B (Taxable)

Dynamic Support Solutions
November 7, 2018

On October 17, 2018 the Board of Directors governing International Leadership of Texas (ILTexas, the Company) approved the Company's Annual Financial Report (AFR) for the 10-month period ended June 30, 2018. At this time the Company determined it did not meet the covenants contained in the Company's 2015 bond obligations. In accordance with the bond documents, the Company immediately engaged Dynamic Support Solutions (DSS), an independent Management Consultant, to review and analyze the operations and administration of the Company, inspect the facilities, and perform such other review and analysis as necessary to make recommendations to bring the company within compliance.

COMPANY BACKGROUND

International Leadership of Texas is a public school serving students in grades K-12 in Texas. The school received its charter from the state of Texas in 2013 and opened two schools for the 2013-2014 academic year as the largest start-up charter school in Texas history. The school has continued aggressive expansion, reaching 18,500 students for the 2018-2019 school year. In (insert month) 2018, the Texas Education Agency approved a ten-year renewal of the charter to (insert month) 2028.

For the 2017-2018 school year, the district did not receive an academic rating under the State's A-F academic accountability system due to the impact of a hurricane on the South-Texas coast. Of the 26 campuses operated that year, 2 campuses were impacted by the hurricane, 21 campuses were rated Met Standard, and 3 campuses were rated Improvement Required. The school received an "A" under the state's A-F financial accountability system based on financial data as of August 30, 2017.

For the 2018-2019 academic school year, the school now operates 33 campuses at 19 locations. Among the locations, 6 are owned (12 campuses), 11 are permanent locations under long-term leases (19 campuses), and 2 are leased temporary facilities.

CALCULATIONS

The bond covenants provide two financial metrics discussed in this report; a Debt Service Coverage measurement, and a Liquidity measurement.

Debt Service Coverage Ratio

As calculated and described in the following pages, ILT improved the Debt Service Coverage Ratio from 0.77x for the 12 months ended August 31, 2017 to 1.48x for the 10 months ended June 30, 2018.

Liquidity Requirement

As of August 2017, ILTexas exceeded Required Liquidity under the debt agreements with approximately 44.8 days (35 days required). However, at June 30, 2018 the Company closed the fiscal year with 7.6 days liquidity (40 days required).

The 2018 Liquidity measurement was adversely impacted by certain controllable events and our independent interpretation of the loan documents. If each of these were managed differently, ILTexas could have met the Liquidity Requirement of 40 days. Favorable treatment of the following would have produced 44.8 days liquidity (see pro-forma):

a. The audit identifies $3,258,525 of Debt Service Reserves as "Restricted Cash" (see Audit footnote 3). These funds are restricted by the Company's internal operating policies and not by obligation.
b. To reduce debt expense, the Company declined to pursue or borrow against available credit lines. The company established a credit line of $10,000,000 which it drew on during July and August and repaid in September.
c. The 10-month fiscal year required accelerated recognition of certain salary expenses totaling $13,768,066 which would have normally been recognized over a 12-month period.
d. In accordance with the debt agreement, Liquidity is calculated with *actual expenses* which are not defined and understood as Total Operating Expenses shown on the financial statements. Where the bond documents excludes depreciation and amortization from its liquidity calculation, our independent interpretation of the document includes depreciation in *actual expenses*. The company recorded $9,959,725 in depreciation and amortization for the 10-month period ended June 30, 2018.

Combined, a pro-forma calculation of the Liquidity Requirement yields 44.8 days.

The Company further asserts the correct calculation for Required Liquidity should use *Expenses* as defined in the loan documents where the liquidity covenant refers to *actual expenses*. If this is an error in the Loan Agreement, then *Expenses* would exclude depreciation, amortization and interest expense, further improving the Liquidity calculation. The audit identifies cash paid for interest of $15,469,374.

RECOMMENDED ACTION

Following prior recommendations of DSS and others, the Company purchased two leased campuses through a new bond issuance and is actively moving to purchase several more. The new and proposed future debt is structured to improve future cash flows and liquidity. These transactions by themselves, exchanging monthly lease payments for semi-annual debt payments, will bring additional liquidity to ILTexas and is expected to bring the Company into compliance with the Liquidity Requirement.

REVIEW OF PRIOR RECOMMENDATIONS

Dynamic Support Solutions issued a prior report on May 16, 2018. That report was required to address the Company's failure to meet the Debt Service Coverage Ratio at the end of the prior fiscal year. Many recommendations included in that report appear to have been adopted by management. From our prior report:

A. Manage Growth: Enrollment at existing schools has increased and ILTexas is utilizing a larger portion of school capacity, reducing facility costs per student. New schools have been opened in temporary facilities to reduce start-up costs.

B. Personnel Changes: ILTexas made several changes in leadership, appointing Dr. Alan Seay, CEO, and dividing the responsibilities of the executive team for better efficiencies. Administrative staffing reductions begun during the 2017-2018 school year have been maintained, growing overall salary costs at a rate lower than student and revenue growth.

C. Revenue, Expense and Cash Management: While the effect of these changes are not yet measurable, Management has developed new sources of state revenue and 3rd party donations. Financial reporting to the board and CEO has improved and management is reviewing detailed vendor expense reports on a regular basis. As forecast in the report, the company concluded FY 2018 with approximately 9 to 12 (7.6) days operating cash and is working to improve liquidity.

D. Accounting Changes: ILTexas successfully completed the FY2018 audit with a new auditor and changed its fiscal year to better align with the school's business cycle. The school adopted FASB revised lease accounting standards (ASC 842) and improved management reporting.

   Thorough implementation of revised accounting policies, controls and practices takes significantly more time than the period since our last report. We encourage the Company's accounting group to continue to make improvements and suggest moving to a single accounting system as soon as possible.

E. Review Debt Structures: Consistent with DSS recommendations, the Company is refinancing leased assets and utilized available cash to purchase expansion furniture and equipment.

F. New Revenue Opportunities: The Company is capturing new revenue from the state in the form of Replication Grants, New Instructional Facilities Allotments and Charter School facility funding.

SUMMARY

Dynamic Support Solutions met with management of International Leadership of Texas, reviewed the financial and operational representations of management, and analyzed available internal and public information. We did not deem it necessary to visit or inspect the company's campuses and we believe our interviews with management and working with its finance team provided valuable insight into the Company's operations. We determined the company continues to make significant efforts to improve the financial health of the organization and, in addition to current and ongoing accomplishments, we believe there is a great deal of work to be done to improve the company's administration and operations. We believe the recent progress is indicative of management's strong commitment to the organization.

Debt Service Coverage Ratio	**12 months ended August 31, 2017**	**10 months ended June 30, 2018**
Change in Net Assets	(7,304,416)	4,657,843
Add depreciation expenses	5,230,322	9,875,606
Add amortization expenses	-	84,163
Add lease payments	8,140,100	15,469,374
Add interest expenses	6,121,275	8,417,167
Available Revenue for Debt Service	**12,187,281**	**38,504,153**
Debt service		
Interest payments	6,121,275	15,469,374
Facility lease payment	8,140,100	8,417,167
Principal payments	1,569,647	2,174,407
Total Debt Service	**15,831,022**	**26,060,948**
Debt service coverage ratio	**0.77x**	**1.48x**

	12 months ended August 31, 2017	10 months ended June 30, 2018
LIQUIDITY		
Actual expenses	$ 106,821,704	$ 135,269,561
Calendar days	365	303
Daily expenses	**$ 292,662**	**$ 446,434**
Cash	21,007,669	14,714,466
Cash - restricted (per audit)	(7,931,275)	(11,315,422)
	$ 13,076,394	$ 3,399,044
Days liquidity	**44.7**	**7.6**
Add: Cash restricted by internal policy		3,258,525
Total available cash for operations		$ 6,657,569
Adjusted days liquidity		**14.9**

	Liquidity pro-forma 10 months ended June 30, 2018
Actual expenses	$ 135,269,561
Less: Accelerated expense recognition	(13,768,066)
Less: Depreciation & amortization	(9,959,725)
	$ 111,541,249
Calendar days	303
Daily expenses	**$ 368,125**
Cash	14,714,466
Cash - restricted (per audit)	(11,315,422)
	$ 3,399,044
Add: Cash restricted by internal policy	3,258,525
Add: Pro-forma borrowing	10,000,000
Total pro-forma cash available for operations	$ 16,657,569
Pro-forma adjusted days liquidity	**44.8**

SUPPLEMENTAL INFORMATION

Section 5.9 Liquidity. (a) For so long as the Bonds are Outstanding, the Company shall maintain operating reserves in an amount equal to at least thirty (30) days of actual expenses for the Fiscal Year ending August 31, 2016, thirty-five (35) days for the Fiscal Year ending August 31, 2017, forty (40) days for the Fiscal Year ending August 31, 2018, forty-five (45) days for the Fiscal Year ending August 31, 2019 and each Fiscal Year thereafter (in each case, the "Liquidity Requirement") as evidenced by the Company's audited financial statements for each such Fiscal Year. Such operating reserves shall not be funded with Bond proceeds. Such balance shall be tested every year, commencing August 31, 2016. Funds held in satisfaction of the Liquidity Requirement may be used for any lawful purpose. The foregoing is subject to the qualification that if applicable State or federal laws or regulations, or the rules and regulations of agencies having jurisdiction, shall not permit the Company to maintain such balance, then the Company shall, in conformity with the then prevailing laws, rules or regulations, maintain a balance equal to the maximum permissible level.

Section 409. Debt Service Coverage Ratio. Available Revenues for each Fiscal Year must be equal to at least 1.10x the Annual Debt Service Requirements of the Company as of the end of each Fiscal Year. If the Company does not maintain Available Revenues for any Fiscal Year ending on or after August 31, 2016, of at least 1.10x the Annual Debt Service Requirements during such Fiscal Year, the Company will, at its sole expense, promptly employ (within 30 days of the date a certificate describing such circumstances was required to be submitted) an independent Management Consultant to review and analyze the operations and administration of the Company, inspect the facilities, and perform such other review and analysis as necessary. The independent Management Consultant shall deliver its report within forty-five (45) days of its retention to the Company and Master Trustee, and such report shall make such recommendations as to the operation and administration of the Company as such independent Management Consultant deems appropriate, including any recommendation as to a revision of the methods of operation thereof. The Company agrees to consider any recommendations by the independent Management Consultant and, to the fullest extent practicable, to adopt and carry out such recommendations. Notwithstanding the preceding sentence, if the debt service coverage ratio falls below 1.0x the Annual Debt Service Requirements of the Company, it shall constitute a default hereunder.

"***Annual Debt Service Requirements***" of any specified Person means, for any Fiscal Year, the principal of (and premium, if any) and interest and other debt service charges (which include for purposes hereof, any fees or premiums for any letter of credit, surety bond, policy of insurance, bond purchase agreement, or any similar credit or liquidity support secured in connection therewith) on all Long-Term Debt of such Person coming due at Maturity or Stated Maturity, and, for such purposes, any one or more of the following rules shall apply:

"***Adjusted Revenues***" means, for any period of calculation, the total of all operating and nonoperating revenues of the Company, including but not limited to State Revenues, federal and local funds for school lunches and other food programs, special education, and transportation, including accounts receivable and rights to receive the same plus investment and other income or loss of the Company for such period; provided, however, that no determination thereof shall take into account (a) income derived from Defeasance Obligations that are irrevocably deposited in escrow to pay the principal of or interest on Debt or Related Bonds, (b) any gains or losses resulting from the early extinguishment of Debt, the sale, exchange or other disposition of property not in the ordinary course of business, or the reappraisal, reevaluation or write-up of assets, or any other extraordinary gains or losses, (c) any gains or losses from the sale, lease, license, exchange, or other disposition of educational software or curriculum created by the Company, (d) gifts, grants (excluding grants from the State), bequests or donations and income thereon restricted as to use by the donor or grantor for a purpose inconsistent with the payment of debt service on Debt or Related Bonds or Notes (i.e., unrelated to the purposes for which such obligations were issued), (e) net unrealized gain (losses) on investments and Financial Products Agreements and (f) proceeds of borrowing. Notwithstanding any provision herein to the contrary, State Revenues received by each of the Company's campuses will be used in accordance with Section 12.107(a), Texas Education Code.

"***Available Revenues***" means, for any period of determination thereof, the amount of excess (deficit) of Adjusted Revenues over Expenses for such period, plus any gifts, grants, requests or donations and income thereon restricted as to use by the donor or grantor for the sole purpose of paying Expenses of the Company, but less: (a) unrealized pledges for such period to make a donation, gift, or other charitable contribution to the extent encumbered, as permitted herein to secure the payment of Debt that is not Long-Term Debt, and (b) insurance (other than business interruption) and condemnation proceeds.

"***Eliminated Expenses***" means any Expenses that they Company certifies will be eliminated as a result of the issuance or incurrence of any additional Debt.

"***Expenses***" means, for any period of time for which calculated, the total of all operating and non-operating expenses incurred during such period by the Company for which such calculation is made, determined in accordance with generally accepted accounting principles, other than (a) interest expense, (b) depreciation and amortization, (c) extraordinary losses resulting from the early extinguishment of debt, the sale or other disposition of assets not in the ordinary course of business or any reappraisal, revaluation or write-down of assets, and any other extraordinary losses or expenses, (d) expenditures that are customarily capitalized pursuant to generally accepted accounting principles and (e) Eliminated Expenses.

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Dynamic Support Solutions Key Team Members:

Bill Mays, Chief Consulting Officer

Bill retired from serving as the Chief Financial Officer of Uplift Education since 2007. As Chief Financial Officer, Bill was responsible for all aspects of Uplift's financial operations, including budget development, monitoring, analysis, cash management, accounting compliance and payroll processing. Bill has over 30 years of experience primarily in the financial management area in high tech industries, including the gas turbines and telecommunications industries. For most of his career Bill was involved in international business; one of his assignments included a three year posting as the CFO for the Japanese subsidiary of a North American Telecom company in Tokyo. During his tenure with Uplift Education, Bill led 5 public bond issuing and raised more than $278 million funds to expend Uplift School Network. In 2009 and 2013, Bill was a finalist for the Dallas Business Journal's CFO of the year. Bill received his bachelor's degree in mathematics from Colgate University. He lives in Farmers Branch, TX with his wife Susan.

Gene Zhu, Managing Director

Gene is a well-seasoned accounting and finance professional. He has been serving in various capacities in financial operation for non-profit organizations and public charter schools for the past 15 years. He has served senior roles in accounting and finance operations with public charter schools for 12 years and most recently served as Senior Director of Accounting and Finance for Uplift Education, a charter school network serving over 17,000 students on 19 campuses in the Dallas-Fort Worth region. Gene started his school business office consulting firm in 2010 and currently serving more than 12 charter schools and ten non-for-profit organizations in Greater Dallas-Fort Worth, Austin and Waco. Gene graduated from Dallas Baptist University with Master Degrees in Finance and Management Information System. He lives in Las Colinas in Irving, TX with his wife and four children.

James Dworkin, CPA

James entered the not-for-profit sector as CFO of Trinity Basin Preparatory in 2015. His background is in private and public corporations where he served in varying roles including CFO, Controller and VP Finance. A graduate of the University of Chicago (MBA, 1998) and DePaul University (BS, 1993), James is a CPA with over 20 years' experience and is also a certified Charter School Business Officer and United States Navy veteran. James continues to serve as CFO of Trinity Basin Preparatory and joins DSS on special projects to support charter school organizations.

Besides our leadership members, we also have a full time CPA, six full-time and five part-time accountants and two part-time IT professionals serve on our team.

Dynamic Support Solutions Service Summary:

Charter School Service Department:
We at Dynamic Support Solutions partner with K-12 school districts and charter schools to manage school business office operations more effectively using Texas Education Agency (TEA) compliant financial accounting management software includes TxEIS, Skyward, AptaFund from Harris Computer, TEAMS from Prologic and WebSmart from JR3 Education. Working closely with the school, we conduct a detailed business process analysis of all aspects of business office operations. Based on the results, a master set of optimized processes is created, and the ERP system is configured with TEA standards to implement those processes.

We work with client's management team to manage certain business office functions: Financial reporting, Accounts Payable, Payroll and monthly and quarterly tax filings, PEIMS, TRAQS and Financial Audits. In some case, the client outsources the entire business office to us. We also facilitate and support school bond financing.

Non-for-profit Support Department:
We evaluate, develop and provide scalable and effective solutions to assist primarily small and medium-sized non for-profit organizations in the financial, accounting, IT and HR operations. We serve organizations in various capacities: Bookkeeper, Accountant, Business Manager, IT helpdesk, Internal Auditor and CFO. Our professionals have extensive experiences with non-for-profit and governmental financial and accounting standards and fund accounting management. We implement and interact with a wide range of EPR software: QuickBooks, Sage 50 (formerly Peachtree), Mas 90, MAS 500, Abila MIP Fund Accounting (formerly Sage MIP), Microsoft Dynamic Great Plains, and other customized ERP software.

Depending on the size or needs of our clients, we can provide skilled professionals on-site or we handle the responsibilities remotely.

Gene Zhu, Managing Director

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