

SPARTAN EDUCATION, LLC AND SUBSIDIARY
(A Wholly-Owned Subsidiary of Spartan Education Group, LLC)

OPE ID No. 00767800

Consolidated Financial Statements

For the Year Ended December 31, 2017

with

Independent Auditors' Report

SPARTAN EDUCATION, LLC AND SUBSIDIARY
(A Wholly-Owned Subsidiary of Spartan Education Group, LLC)

Table of Contents

	<u>Page</u>
Independent Auditors' Report on the Consolidated Financial Statements and Other Information	1
Consolidated Balance Sheet as of December 31, 2017	3
Consolidated Statement of Income and Member's Equity for the Year Ended December 31, 2017	4
Consolidated Statement of Cash Flows for the Year Ended December 31, 2017	5
Notes to Consolidated Financial Statements	6
Supplementary Information (Information Required by the U.S. Department of Education)	16
Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Consolidated Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	19
Schedule of Findings and Questioned Costs	21

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INDEPENDENT AUDITORS' REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS AND OTHER INFORMATION

To the Board of Directors and
Member of Spartan Education, LLC:

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Spartan Education, LLC (a Delaware limited liability company) and Subsidiary, which comprise the consolidated balance sheet as of December 31, 2017, and the related consolidated statements of income and member's equity and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated 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 the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated 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 Spartan Education, LLC and Subsidiary'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 consolidated 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 Spartan Education, LLC and Subsidiary as of December 31, 2017, and the results of their operations and their cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Report on Required Supplementary Information and Other Regulatory Requirements

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying supplementary information beginning on page 16 on Spartan Education, LLC and Subsidiary's calculation of their Title IV 90/10 revenue test and on related party transactions is required by the U.S. Department of Education and is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 10, 2018, on our consideration of Spartan Education, LLC and Subsidiary's internal control over financial reporting and on our tests of their 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 Spartan Education, LLC and Subsidiary's internal control over financial reporting and compliance.



Lake Forest, California
May 10, 2018

SPARTAN EDUCATION, LLC AND SUBSIDIARY
(A Wholly-Owned Subsidiary of Spartan Education Group, LLC)
Consolidated Balance Sheet
December 31, 2017

Assets

Current assets:

Cash	\$ 255,207
Accounts and notes receivable, net of allowance for doubtful accounts of \$1,053,327	2,424,466
Other receivables	365,636
Current portion of note receivable	64,919
Prepaid expenses and other	587,714
Inventories	1,186,354
Total current assets	4,884,296
Restricted cash	500,459
Due from affiliates	8,207,636
Accounts and notes receivable, net of current portion and allowance for doubtful accounts of \$11,327	92,766
Note receivable, net of current portion	201,057
Property, equipment and improvements, net of accumulated depreciation and amortization of \$5,239,884	9,666,970
Curriculum, net of accumulated amortization of \$315,000	252,662
Other intangible assets, net of accumulated amortization of \$4,800,000	5,000,000
Deposits	23,375
Goodwill	2,473,915
	<u>\$ 31,303,136</u>

Liabilities and Member's Equity

Current liabilities:

Accounts payable	\$ 1,086,953
Accrued expenses	758,796
Unearned tuition	5,440,794
Current portion of long-term debt	536,259
Total current liabilities	7,822,802
Deferred rent	46,050
Long-term debt, net of current portion	12,100,905
Total liabilities	19,969,757
Member's equity	11,333,379
	<u>\$ 31,303,136</u>

See notes to consolidated financial statements

SPARTAN EDUCATION, LLC AND SUBSIDIARY
(A Wholly-Owned Subsidiary of Spartan Education Group, LLC)
Consolidated Statement of Income and Member's Equity
For the Year Ended December 31, 2017

Revenues:	
Tuition	\$ 28,961,393
Housing	1,331,492
Total revenues	<u>30,292,885</u>
Costs and expenses:	
Student instruction and training	12,878,300
Marketing and admissions	3,966,196
General and administrative, housing and support services	8,146,950
Facilities	1,472,552
Depreciation and amortization	2,575,308
Total costs and expenses	<u>29,039,306</u>
Income from operations	<u>1,253,579</u>
Other income (expenses):	
Interest expense	(1,000,783)
Other income	40,555
Total other income (expenses)	<u>(960,228)</u>
Income before income taxes	293,351
Provision for income taxes	-
Net income	293,351
Capital contributed by member	500,000
Member's equity, beginning of year	<u>10,540,028</u>
Member's equity, end of year	<u><u>\$ 11,333,379</u></u>

See notes to consolidated financial statements

SPARTAN EDUCATION, LLC AND SUBSIDIARY
(A Wholly-Owned Subsidiary of Spartan Education Group, LLC)
Consolidated Statement of Cash Flows
For the Year Ended December 31, 2017

Cash flows from operating activities:	
Net income	\$ 293,351
Adjustments to reconcile net income to net cash provided by operating activities -	
Depreciation and amortization	2,575,308
Amortization of deferred loan fees	123,025
Changes in operating assets and liabilities -	
Accounts and notes receivable, net	(805,921)
Other receivables	(195,919)
Prepaid expenses and other	(232,582)
Inventories	(77,511)
Deposits	(23,375)
Accounts payable	12,723
Accrued expenses	(56,052)
Unearned tuition	3,474,562
Deferred rent	46,050
Net cash provided by operating activities	<u>5,133,659</u>
Cash flows from investing activities:	
Purchases of property, equipment and improvements	<u>(1,672,868)</u>
Net cash used by investing activities	<u>(1,672,868)</u>
Cash flows from financing activities:	
Increase in due from affiliates	(2,770,614)
Decrease in note receivable	54,507
Increase in restricted cash	(500,459)
Borrowing on long-term debt	715,676
Principal repayments on long-term debt	(2,437,120)
Capital contributed by member	500,000
Net cash used by financing activities	<u>(4,438,010)</u>
Decrease in cash	(977,219)
Cash, beginning of year	<u>1,232,426</u>
Cash, end of year	<u><u>\$ 255,207</u></u>
Supplemental cash flows information:	
Cash paid for -	
Interest	<u><u>\$ 887,253</u></u>
Income taxes	<u><u>\$ -</u></u>

See notes to consolidated financial statements

SPARTAN EDUCATION, LLC AND SUBSIDIARY
(A Wholly-Owned Subsidiary of Spartan Education Group, LLC)
Notes to Consolidated Financial Statements
December 31, 2017

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

Organization and Basis of Presentation

Spartan Education, LLC (Spartan) is a Delaware limited liability company formed during 2009 whose duration is perpetual. Spartan is a wholly-owned subsidiary of Spartan Education Group, LLC (SEG) which is also a Delaware limited liability company formed during 2009. Effective December 28, 2012, Spartan acquired certain net assets of Spartan Aviation Industries, Inc., an Oklahoma corporation, and Spartan Residence Hall, LLC, an Oklahoma limited liability company (collectively, the Seller), pursuant to the terms of an Asset Purchase Agreement (the Agreement). Spartan provides career training in the fields of aviation flight, maintenance, electronics and instruments. Spartan operates both a technical school and flight school in Tulsa, Oklahoma.

Spartan Landing Holdings, LLC (Spartan Landing, a wholly-owned subsidiary of Spartan) is a Delaware limited liability company formed during 2013. Effective February 24, 2014, Spartan Landing acquired, from an unrelated third party, apartments previously leased by Spartan for student housing for \$850,000; this amount is reflected within property, equipment and improvements in the accompanying consolidated balance sheet.

SEG provides certain general and administrative as well as marketing services to Spartan and other educational institutions owned by SEG. These costs are incurred by SEG and are not allocated to Spartan or SEG's other subsidiaries.

The accompanying consolidated financial statements include the accounts of Spartan and Spartan Landing. All intercompany amounts and transactions have been eliminated in consolidation. Spartan and Spartan Landing are hereafter referred to collectively as the Company.

Revenue Recognition

Revenues are derived primarily from courses taught at the Company and student housing charges. Revenues are recognized on a straight-line basis over the term of instruction taking into consideration expected refunds. Unearned tuition represents tuition payments received but not earned as of the consolidated balance sheet date.

During the year ended December 31, 2017, management refined its estimates related to revenue recognition for training contracts with foreign entities. The revisions to the estimates were based upon facts and circumstances which arose during 2017, and principally related to the timely rendering of training under those contracts. The analysis resulted in a decrease in revenue of approximately \$4,820,000 for the year ended December 31, 2017, as compared to what would have been recognized under the estimates used in the prior year.

Accounts and Notes Receivable

Accounts and notes receivable are recorded at the net realizable value expected to be received from students or third-party payors and are not collateralized. Accounts receivable include tuition amounts earned less payments received and an allowance for doubtful accounts. The allowance for doubtful accounts is management's best estimate based upon historical experience. Management continually monitors and adjusts its allowance associated with the Company's receivables to address any known credit risks associated with the accounts receivable. When uncertainty exists as to the collection of receivables, the Company records an allowance for doubtful accounts and a corresponding charge to bad debt expense.

During the year ended December 31, 2017, management refined its estimates related to bad debts and the allowance for doubtful accounts based upon an analysis of historical collection experience and change in the composition of its student population, as well as a change in the Company's collection practices. The analysis resulted in a decrease in bad debt expense of approximately \$195,000 for the year ended December 31, 2017, as compared to what would have been recognized under the estimates used in the prior year.

Restricted cash

The Company maintains a certificate of deposit account with a bank as security for a letter of credit in favor of Sallie Mae Bank which is reflected as restricted cash on the accompanying consolidated balance sheet. The letter of credit was required in order to continue participating in Sallie Mae Bank's smart option student loan program. The letter of credit is for \$500,000 and is set to expire March 31, 2019.

Inventories

Inventories are comprised primarily of aircraft maintenance supplies, textbooks, gasoline and school supplies and are stated at the lower of cost or market using the first-in, first-out method.

Property, Equipment and Improvements

Property and equipment are recorded at cost and are being depreciated over their estimated useful lives ranging from 3 to 25 years utilizing the straight-line method. Leasehold improvements are recorded at cost and are being amortized over the shorter of their estimated useful lives or the term of the lease utilizing the straight-line method. Maintenance, repairs, and minor renewals and betterments are expensed as incurred.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When such factors indicate that assets should be evaluated for possible impairment, management would prepare an analysis comparing the carrying value of the assets to future undiscounted cash flows of the underlying assets. The net book value of the underlying assets is adjusted to fair value if the sum of the expected undiscounted future cash flows is less than book value. To date, management has not identified any such factors pertaining to the Company's long-lived assets.

Goodwill

Goodwill consists of the cost in excess of fair value of identifiable net assets acquired in a purchase business combination. Goodwill is not amortized, but evaluated for impairment annually, in the fourth quarter of each fiscal year, or whenever events or circumstances indicate that the carrying amount may not be recoverable. Impairment exists when the carrying amount of goodwill exceeds its implied fair value. The implied fair value of goodwill is determined by deducting the estimated fair value of all tangible and identifiable intangible net assets of the reporting unit from the estimated fair value of the reporting unit. If the recorded value of goodwill exceeds its implied value, an impairment charge is recorded for the excess. The Company tests for goodwill impairment at the reporting unit level. The Company consists of a single reporting unit. As a result of market, regulatory and financial conditions, the Company recorded goodwill impairment charges of \$26,755,592 during the year ended December 31, 2016. The Company's annual impairment testing did not result in additional impairment of goodwill as of December 31, 2017.

Determining the fair value of a reporting unit is judgmental in nature and involves the use of significant estimates and assumptions. These estimates and assumptions include, among others, future economic and market conditions and determination of appropriate market comparables. Such estimates are unpredictable and inherently uncertain; actual future results may differ from the estimates. The Company may also assess qualitative factors to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying amount.

Curriculum

Curriculum represents amounts paid to an unrelated third-party to develop online program curriculum; the related online program commenced in January 2016. Curriculum is being amortized on a straight-line basis over its estimated useful life of 3 years. Amortization expense related to curriculum for the year ended December 31, 2017 was \$180,000 and is included within depreciation and amortization expense on the accompanying consolidated statement of income and member's equity.

Deferred Loan Fees

Deferred loan fees represented the fees and costs incurred by the Company with respect to obtaining its debt financing in connection with the acquisition. Deferred loan fees were being amortized over the term of the related debt and were fully amortized as of December 31, 2017. Deferred loan fees amortization for the year ended December 31, 2017 was \$123,025, and is included within interest expense on the accompanying consolidated statement of income and member's equity.

Income Taxes

The Company operates as a limited liability company. As such, revenues and expenses of the Company are passed through to the member. As a limited liability company, the Company is not required to pay federal or state income taxes but may be subject to certain state fees.

Fair Value Measurements

The carrying value of the Company's financial instruments approximates fair value due to the relative short-term nature of these instruments.

The Company uses a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted market prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either observable directly or indirectly through market corroboration, for substantially the full term of the financial instruments; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. The Company has no financial instruments utilizing Level 2 or Level 3 inputs.

Advertising

Advertising costs are expensed as incurred.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers*, which establishes a comprehensive revenue recognition standard for virtually all industries in U.S. GAAP, including those that previously followed industry-specific guidance. This *ASU* will become effective for the Company for the year ending December 31, 2019. The Company is currently evaluating the effect the provisions of *ASU 2014-09* will have on the consolidated financial statements.

In February 2016, FASB issued *ASU No. 2016-02, Leases*. The guidance in this *ASU* supersedes the leasing guidance in *Topic 840, Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the consolidated balance sheet for all leases with terms longer than twelve months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the consolidated statement of income and member's equity. This *ASU* will become effective for the Company for the year ending December 31, 2020. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the consolidated financial statements, with certain practical expedients available. The Company is currently evaluating the effect the provisions of *ASU 2016-02* will have on the consolidated financial statements.

Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Subsequent Events

The Company has evaluated subsequent events through the date of the auditors' report, May 10, 2018, which is the date the accompanying consolidated financial statements were available to be issued.

NOTE 2 – PROPERTY, EQUIPMENT AND IMPROVEMENTS

Property, equipment and improvements consisted of the following as of December 31, 2017:

Buildings and improvements	\$ 2,263,790
Furniture, fixtures, and equipment	4,003,173
Aircraft	8,509,317
Automobiles	130,574
	<hr/>
	14,906,854
Less: accumulated depreciation and amortization	(5,239,884)
	<hr/>
	\$ 9,666,970

Depreciation and amortization expense related to property, equipment and improvements for the year ended December 31, 2017 was \$1,495,308 and is included within depreciation and amortization expense on the accompanying consolidated statement of income and member's equity.

NOTE 3 – OTHER INTANGIBLE ASSETS

The Company has identified certain intangible assets related to the December 28, 2012 acquisition. Such intangible assets consisted of the following as of December 31, 2017:

	Estimated Useful Life	Gross Amount	Accumulated Amortization
Title IV funding	15	\$ 5,000,000	\$ 1,666,666
Trade name	15	2,500,000	833,334
Flight contracts	5	2,000,000	2,000,000
Student relationships	1	300,000	300,000
		<u>\$ 9,800,000</u>	<u>\$ 4,800,000</u>

Amortization expense related to these intangible assets is recognized on a straight-line basis over the estimated useful lives of the assets. Amortization expense related to these intangible assets for the year ended December 31, 2017 was \$900,000 and is included within depreciation and amortization expense on the accompanying consolidated statement of income and member's equity. The total remaining weighted-average amortization period for intangible assets subject to amortization as of December 31, 2017, is approximately 10 years. Intangible assets are evaluated for impairment annually. Management does not believe that there is any impairment associated with these assets.

As of December 31, 2017, estimated future amortization of other intangible assets is as follows:

<u>Year Ending December 31,</u>	
2018	\$ 500,000
2019	500,000
2020	500,000
2021	500,000
2022	500,000
Thereafter	<u>2,500,000</u>
	<u>\$ 5,000,000</u>

NOTE 4 – LONG-TERM DEBT

Credit Agreement

To finance a portion of the acquisition price, the Company entered into a Credit and Guaranty Agreement (the Credit Agreement) which provides term loans in an aggregate amount of \$15,000,000. The Company may elect that all or any part of the term loans be Base Rate Loans or Eurodollar Loans, as defined in the Credit Agreement. Prior to July 26, 2017, Base Rate Loans bore interest at the Base Rate, as defined, plus a margin of 4.9% per annum; Eurodollar Loans bore interest at Adjusted LIBOR, as defined, plus a margin of 3.9% per annum. On July 26, 2017, the Credit Agreement was amended; among other things, the margin for Base Rate Loans and Eurodollar Loans was increased to 7.25% and 6.25%, respectively. As of December 31, 2017, the term loans were Eurodollar Loans with a 7.94% interest rate. Interest on Base Rate Loans is payable monthly. Interest on Eurodollar Loans is payable on the last day of the Interest Period, as defined, and at maturity, and, if the applicable Interest Period is longer than three

months, on each day occurring every three months after the commencement of such Interest Period. Quarterly payments of principal were due beginning March 31, 2013, however the quarterly payments previously due each quarter from June 30, 2017 to December 31, 2018 have been deferred to maturity on January 31, 2021; the total amount of these deferred payments is included within the noncurrent portion of long-term debt on the accompanying consolidated balance sheet. The term loans may be prepaid without premium or penalty. Concurrent with the July 26, 2017 amendment, the Company repaid \$1,900,000 of the then outstanding balance. As of December 31, 2017, the outstanding balance under this credit agreement was \$9,987,500. The Company made a prepayment of \$200,000 in January 2018 which is reflected as a current liability on the accompanying consolidated balance sheet. The term loans are collateralized by substantially all assets and member's equity of the Company and SEG.

Notes Payable

On October 3, 2014, the Company entered into a \$2,669,626 note payable with a bank to finance the purchase of three aircraft. During the year ended December 31, 2017, the note was amended to provide for additional borrowings of \$466,565. The note bears interest at 5.0% and is collateralized by the aircraft. The note requires a monthly principal and interest payment of \$34,508 through maturity on October 3, 2024. As of December 31, 2017, the outstanding balance under this note payable was \$2,424,423.

The Company has another note payable with the same bank for aircraft which bears interest at 5.0% and is collateralized by the aircraft. The note requires a monthly principal and interest payment of \$3,313 and matures on May 10, 2024. As of December 31, 2017, the outstanding balance under this note payable was \$217,847.

The Company has another note payable with the same bank for equipment which bears interest at 4.50% and is collateralized by the equipment. The note requires a monthly principal and interest payment of \$756 and matures in September 2018. As of December 31, 2017, the outstanding balance under this note payable was \$7,394.

Future maturities of long-term debt as of December 31, 2017, were as follows:

<u>Year Ending December 31,</u>	
2018	\$ 536,259
2019	2,151,964
2020	2,164,174
2021	6,570,307
2022	402,392
Thereafter	<u>812,068</u>
	12,637,164
Less: current portion	<u>(536,259)</u>
	<u><u>\$ 12,100,905</u></u>

The debt agreements described above have certain defined financial covenants with which the Company must comply. As of December 31, 2017, the Company was in compliance with the covenants.

NOTE 5 - MEMBER'S EQUITY

The Company has authorized three classes of membership units: Preferred Class A Units, Preferred Class B Units, and Senior Units. Senior Units are non-voting. The Company shall make distributions to the unit holders as determined by the Board of Directors in its sole discretion in an order of priority as defined in the Amended and Restated Limited Liability Company Agreement of the Company (LLC Agreement).

As of December 31, 2017, the issued membership units of the Company were as follows:

	<u>Issued</u>	<u>Amount</u>
Preferred Class A Units	29,189.74	\$ 29,189,745
Preferred Class B Units	-	-
Senior Units	-	-

Preferred Units

The Preferred Class A Units and Preferred Class B Units are designated as Preferred Units. If the Company's Board of Directors determines to issue Additional Securities, each member holding Preferred Units shall have the right to purchase up to such member's pro rata share of all or any part of the Additional Securities, as defined in the LLC Agreement.

Senior Units

The Company has the right to repurchase all or any portion of the Senior Units, as defined in the LLC Agreement. At any time after December 28, 2018, the holders of the Senior Units have the right to require the Company to purchase all, but not less than all, of the Senior Units then outstanding, as defined in the LLC Agreement. Senior Units holders are entitled to a Senior Preferred Return of 2% per annum, as defined in the LLC Agreement.

NOTE 6 – COMMITMENTS AND CONTINGENCIES

Lease Commitments

The Company leases its operating facilities under the terms of noncancellable lease agreements that expire at various dates through October 31, 2037. The leases require the Company to pay certain operating expenses in addition to base monthly rental payments. The leases also have various options to renew up to four additional five-year periods.

Facility rent expense for the year ended December 31, 2017 was approximately \$200,000, and is included within facilities expense on the accompanying consolidated statement of income and member's equity.

The Company also rents equipment under the term of noncancellable operating leases expiring through May 2021. The equipment rent expense for the year ended December 31, 2017 was approximately \$421,000, and is reflected within various expense categories on the accompanying consolidated statement of income and member's equity.

Future minimum lease payments under the terms of noncancellable lease agreements as of December 31, 2017 were as follows:

<u>Year Ending December 31,</u>	<u>Facility Leases</u>	<u>Equipment Leases</u>	<u>Total</u>
2018	\$ 145,004	\$ 1,269,774	\$ 1,414,778
2019	103,561	93,774	197,335
2020	110,487	51,000	161,487
2021	115,104	21,250	136,354
2022	102,839	-	102,839
Thereafter	494,717	-	494,717
	<u>\$ 1,071,712</u>	<u>\$ 1,435,798</u>	<u>\$ 2,507,510</u>

Estimated Recourse Purchase Obligation

During the year ended December 31, 2014, Spartan entered into a Tuition Loan Program Agreement (the ASFG Agreement) with American Student Financial Group, Inc. (ASFG), an unrelated Delaware corporation, under which ASFG purchased student loans originated by the students with a financial institution in which Spartan received the proceeds. Spartan paid ASFG a program subsidy equal to 40% of the loan proceeds received. Spartan did not sell any receivables to ASFG under the ASFG Agreement during the year ended December 31, 2017. As of December 31, 2017, the program subsidy paid to ASFG totaled \$333,234, of which \$67,258 had been repaid by ASFG; the outstanding balance has been recorded as notes receivable on the accompanying consolidated balance sheet. The student loans have full recourse to Spartan and must be repurchased upon default, as defined. During the year ended December 31, 2017, \$41,376 was paid to ASFG for loan repurchases. As of December 31, 2017, Spartan reduced its estimated repurchase obligation by \$116,000 to zero as management believes that the remaining student loans will be collected by ASFG and any repurchases for recourse will be immaterial. Management will monitor the collection experience of the accounts covered by the ASFG Agreement and revise the estimate used in the calculation of the estimated recourse purchase obligation on a prospective basis. It is at least reasonably possible that a change in estimate will occur in the near-term and the effect could be material. The ASFG Agreement also requires Spartan to pay certain fees to ASFG which are expensed as incurred.

Contingencies

The Company is subject to various claims and lawsuits in the ordinary course of business. In the opinion of management, such claims and lawsuits are without merit. Management does not believe the outcome of any of the claims and lawsuits will have a material adverse effect upon the consolidated financial condition of the Company.

NOTE 7 – RELATED PARTY TRANSACTIONS

Due from Affiliates

The Company advances and receives funds with SEG and educational institutions owned by SEG. Such amounts are unsecured, non-interest bearing and have no stipulated repayment provisions. Amounts advanced as of December 31, 2017 were \$8,207,636.

Guarantee of Long-term Liability

The Company guarantees a long-term liability of SEG payable to one of the stockholders of the Seller for purchase consideration related to the Agreement described in Note 1. The liability is payable \$200,000 a year through January 2019. As of December 31, 2017, the balance of this long-term liability was \$368,179.

Guarantee of Debt

The Company serves as a guarantor on \$28,403,389 of SEG's debt.

NOTE 8 – EMPLOYEE BENEFIT PLAN

The Company maintains a defined contribution 401(k) savings plan covering substantially all of the Company's employees. Employer contributions are equal to 100% of the first 2% of employee 401(k) elective deferrals, then 25% on the next 4% of employee 401(k) elective deferrals. Employer contributions vest after 3 years of service with a minimum of 1,000 hours of service in each year. During the year ended December 31, 2017, employer contributions of approximately \$42,000 were made by the Company.

NOTE 9 – REGULATORY MATTERS

In connection with the acquisition, the U.S. Department of Education (ED) required a letter of credit which was posted by the Company and guaranteed by the majority member of SEG. The letter of credit also covers another educational institution owned by SEG and amounted to \$1,859,951 in total. During the year ended December 31, 2017, ED required an increase in the amount of the letter of credit to \$2,806,109. The letter of credit is scheduled to expire on December 31, 2018.

The Company is subject to extensive regulation by federal and state governmental agencies and accrediting bodies. In particular, the Higher Education Act of 1965 (the Act) and the regulations promulgated thereunder by ED subject the Company to significant regulatory scrutiny on the basis of numerous standards that schools must satisfy in order to participate in the various federal student financial assistance programs under Title IV of the Act. These standards include, among others, financial responsibility, student default rates, and the "90/10" rule. Ineligibility to participate in the Title IV programs would have a material adverse effect on the Company's enrollments, revenue and results of operations.

Institutions participating in Title IV programs are required by ED to demonstrate financial responsibility. ED determines an institution's financial responsibility through the calculation of a composite score based upon certain financial ratios as defined in regulations. Institutions receiving a composite score of 1.5 or greater are considered fully financially responsible. Institutions receiving a composite score between 1.0 and 1.4 are subject to additional monitoring. Institutions receiving a composite score below 1.0 are required to submit financial guarantees in order to continue participation in the Title IV programs. As of and for the year ended December 31, 2017, the Company's composite score was (0.3).

For each federal fiscal year, ED calculates a rate of student defaults for each educational institution known as a "cohort default rate". Under certain defined circumstances, an institution may lose its eligibility to participate in some or all Title IV programs. As of December 31, 2017, management believes that the Company was in compliance with ED's requirements concerning cohort default rates.

Substantial portions of the Company's revenue and collection of accounts receivable are dependent upon its continued participation in the Title IV programs of the Act. To continue to participate in the Title IV programs, the Company must comply with certain regulations of ED. ED regulations restrict the proportion of cash receipts for tuition and fees from eligible programs to not more than 90 percent from the Title IV programs. The failure of an institution to meet the 90 percent limitation could result in the loss of an institution's ability to participate in Title IV programs. For the years ended December 31, 2017 and 2016, the Company was in compliance with the 90/10 rule. ED requires an institution to provide additional disclosures with respect to the 90/10 rule, which are included in the accompanying supplementary information beginning on page 16.

As a result of operating in a highly regulated industry, the Company may be subject from time to time to audits, investigations, claims of noncompliance or lawsuits by governmental agencies, regulatory bodies, or other third parties. While there can be no assurance that such matters will not occur and if they do occur will not have a material adverse effect on the Company's business, results of operations or financial condition, management believes that the Company has complied with all regulatory requirements.

On October 30, 2014, ED released its final rule concerning gainful employment which was formally published in the Federal Register October 31, 2014 and became effective July 1, 2015. The final rule applies to all gainful employment programs, which include all non-degree programs at public and private non-profit institutions, and all programs offered at for-profit institutions. The final rule assesses continued eligibility of gainful employment programs by their performance against specific defined debt-to-earnings measures. Gainful employment programs that fail in two out of any three consecutive years or are in the zone for four consecutive years will be ineligible. In addition, institutions are required to certify that each of their gainful employment programs meet state and federal licensure, certification, and accreditation requirements, as well as make public disclosures regarding performance and outcomes of their gainful employment programs, such as costs, earnings, debt and completion rates. In January 2017, ED released its final debt-to earnings rates and underlying data applicable for the first measurement year. The Company had one program that was determined to be in the zone and no programs that were determined to fail. ED's future enforcement of the gainful employment rule is currently uncertain.

NOTE 10 – CONCENTRATION OF CREDIT RISK

As of December 31, 2017, the Company maintained cash balances with a bank in excess of the federally insured limit.

For the year ended December 31, 2017, approximately 22% of the Company's revenues were generated from training contracts with foreign entities.

SPARTAN EDUCATION, LLC AND SUBSIDIARY
(A Wholly-Owned Subsidiary of Spartan Education Group, LLC)
Supplementary Information
(Information Required by the U.S. Department of Education)
December 31, 2017

Institution's Calculation of 90/10 Revenue Test

Spartan Education, LLC (the Institution) and Subsidiary derives a substantial portion of its revenues from Student Financial Aid (SFA) received by its students under the Title IV programs administered by the U.S. Department of Education pursuant to the Higher Education Act of 1965, as amended (HEA). To continue to participate in the SFA programs the Institution must comply with the regulations promulgated under HEA. The regulations restrict the proportion of cash receipts for tuition and fees from eligible programs to not more than 90 percent from the Title IV programs. In July 2008, modifications to the regulations were made with respect to amounts to be included in the 90 percent calculations including allowing for the inclusion of funds received for certain qualifying non-Title IV programs. In addition, the modifications included provisions for institutions that do not comply with the 90 percent rule for a single fiscal year, whereby such institutions would be placed on provisional certification status for a period of two years. Institutions that do not comply with the 90 percent rule for two consecutive fiscal years are subject to the loss of their ability to participate in the SFA programs. For the year ended December 31, 2016, the Institution complied with the 90/10 revenue test percentage.

For the year ended December 31, 2017, the Institution's 90/10 revenue test percentage was computed as follows:

Revenue by Fund Source

	Amount Disbursed	Adjusted Amount
Student Title IV Revenue		
Subsidized Loan	\$ 4,046,785	\$ 4,046,785
Unsubsidized Loan	4,991,150	4,991,150
Federal Pell Grant	3,429,944	3,429,944
FSEOG (subject to matching reduction)	120,438	90,329
Federal Work Study applied to tuition and fees (subject to matching reduction)	-	-
Federal Direct PLUS Loan	5,884,982	5,884,982
All Other Title IV Loans and Grants	-	-
Student Title IV Revenue	\$ 18,473,299	\$ 18,443,190
Revenue Adjustment		
If the amount of funds applied first plus Student Title IV revenue is more than tuition and fees, then reduce Title IV revenue by the amount over tuition and fees		(847,783)
Title IV funds returned for a student under 34 C.F.R § 668.22 (withdrawal), reduce Student Title IV Revenue		(1,483,419)
Adjusted Student Title IV Revenue		\$ 16,111,988

Revenue by Fund Source

	Amount Disbursed	Adjusted Amount	
Student Non-Title IV Revenue			
Grant funds for the student from non-Federal public agencies or private sources independent of the institution	\$ 526,748		
Funds provided for the student under a contractual arrangement with a Federal, State, or local government agency for the purpose of providing job training to low income individuals	-		
Funds used by a student from savings plans for educational expenses established by, or on behalf of, the student that qualify for special tax treatment under the Internal Revenue Code	-		
Institutional scholarships disbursed to the student	-		
Student payments on current charges	7,866,451		
Student Non-Title IV Revenue	\$ 8,393,199		
Revenue from Other Sources			
Activities conducted by the institution that are necessary for education and training (34 C.F.R § 668.28(a)(3)(ii))	\$ -		
Funds paid by a student, or on behalf of a student, by a party other than the school for an education or training program that is not eligible (34 C.F.R. § 668.28(a)(3)(iii))	4,847,905		
Allowable student payments plus allowable amounts from account receivable or institutional loan sales minus any required payments under a recourse agreement	-		
Total Revenue from Other Sources	\$ 4,847,905		
Adjusted Title IV Revenue		\$ 16,111,988	
Adjusted Title IV Revenue + Adjusted Student Non-Title IV Revenue + Total Revenue from Other Sources		\$ 29,353,092	54.89%

This information is required by the U.S. Department of Education and is presented for purposes of additional analysis and is not a required part of the consolidated financial statements.

Related Party Transactions

The Institution participates in Student Financial Aid under the Title IV programs administered by the U.S. Department of Education pursuant to the Higher Education Act of 1965, as amended (HEA). The Institution must comply with the regulations promulgated under HEA. Those regulations require that all related party transactions be disclosed, regardless of their materiality to the consolidated financial statements.

Organization

Spartan Education, LLC (the Institution) is a Delaware limited liability company formed during 2009 whose duration is perpetual. The Institution is a wholly-owned subsidiary of Spartan Education Group, LLC (SEG) which is also a Delaware limited liability company formed during 2009. Effective December 28, 2012, the Institution acquired certain net assets of Spartan Aviation Industries, Inc., an Oklahoma corporation, and Spartan Residence Hall, LLC, an Oklahoma limited liability company, pursuant to the terms of an Asset Purchase Agreement. The Institution provides career training in the fields of aviation flight, maintenance, electronics and instruments. The Institution operates both a technical school and flight school in Tulsa, Oklahoma.

Spartan Landing Holdings, LLC (Spartan Landing, a wholly-owned subsidiary of Spartan) is a Delaware limited liability company formed during 2013. Effective February 24, 2014, Spartan Landing acquired, from an unrelated third party, apartments previously leased by the Institution for student housing for \$850,000.

Due from Affiliates

The Institution advances and receives funds with SEG and an educational institution owned by SEG. Such amounts are unsecured, non-interest bearing and have no stipulated repayment provisions. Amounts advanced as of December 31, 2017 were \$8,207,636.

Contributions from Member

During the year ended December 31, 2017, SEG contributed equity capital of \$500,000 to the Institution.

Guarantee of Long-term Liability

The Institution guarantees a long-term liability of SEG payable to one of the stockholders of the Seller for purchase consideration related to the Agreement described in Note 1. The liability is payable \$200,000 a year through January 2019. As of December 31, 2017, the balance of this long-term liability was \$368,179.

Guarantee of Debt

The Institution serves as guarantor on \$28,403,389 of SEG's debt.

This information is required by the U.S. Department of Education and is presented for purposes of additional analysis and is not a required part of the consolidated financial statements.

ALMICH & ASSOCIATES

AN ACCOUNTANCY CORPORATION

• Certified Public Accounting and Business Services •

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

To the Board of Directors and
Member of Spartan Education, LLC:

We have audited, 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, the consolidated financial statements of Spartan Education, LLC (a Delaware limited liability company) and Subsidiary (collectively, the Company) which comprise the consolidated balance sheet as of December 31, 2017, and the related consolidated statements of income and member's equity and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated May 10, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Company'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 the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company'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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity'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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a deficiency in internal control, described in the accompanying schedule of findings and questioned costs as Finding No. 2017-001, that we consider to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's consolidated financial statements are free from material misstatement, we performed tests of their compliance with certain provisions of laws, regulations, contracts, and grant agreements, non-compliance with which could have a direct and material effect on the determination of consolidated financial statement amounts. Such tests included compliance tests as set forth in the *Guide for Audits of Proprietary Schools and for Compliance Attestation Engagements of Third-Party Servicers Administering Title IV Programs*, issued by the U.S. Department of Education, Office of Inspector General (the Guide) including those relating to related parties and percentage of revenue derived from Title IV programs. 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 non-compliance that are required to be reported under *Government Auditing Standards* or the Guide.

Entity's Response to Finding

Spartan Education, LLC and Subsidiary's response to the finding identified in our audit are described in the accompanying schedule of findings and questioned costs. Spartan Education, LLC and Subsidiary's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on it.

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 the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Lake Forest, California
May 10, 2018

SPARTAN EDUCATION, LLC AND SUBSIDIARY
(A Wholly-Owned Subsidiary of Spartan Education Group, LLC)
Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2017

FINDING NO. 2017-001

Statement of Condition

Company personnel did not consistently perform timely, accurate and complete reconciliations and analysis of subsidiary ledgers. The most significant areas pertained to cash, accrued expenses, accounts receivable and unearned tuition. Numerous post-closing adjustments were necessary to properly state the consolidated financial statements.

Criteria

Management is responsible for performing timely, accurate and complete reconciliations and analysis of subsidiary ledgers. Internal controls in place should be adequate to prevent, or detect and correct misstatements in the financial statements on a timely basis. We noted instances where accounts were not reconciled and reviewed.

Effect

The lack of timely reconciliations and reviews creates the risk that errors or discrepancies will go unnoticed for extended periods of time. It also creates the opportunity for fraud if there is inadequate oversight of the general ledger accounts on a timely basis.

Cause

Timely, accurate and complete reconciliations were not performed due to high turnover in financial personnel.

Recommendation

Management should ensure that timely, accurate and complete reconciliations and analysis of subsidiary ledgers are performed.

Views of Responsible Officials

During 2017, the Company experienced significant turnover in the finance and accounting functions. This turnover left a lack of historical knowledge and experience for the monthly tasks and reconciliations. In late 2017, the Company transitioned to an updated accounting system. In early 2018, the Company instituted a detailed monthly checklist of monthly closing processes and tasks to ensure all accounts are reconciled on a timely basis.