

**THE ART INSTITUTE OF FORT LAUDERDALE, INC.**

**FLORIDA SINGLE AUDIT REPORTS**

**YEAR ENDED JUNE 30, 2011**

**FOGLE & ASSOCIATES, LLC**  
Certified Public Accountants

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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS THAT  
COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR STATE PROJECT  
AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH THE  
EXECUTIVE OFFICE OF THE GOVERNOR'S STATE PROJECTS COMPLIANCE  
SUPPLEMENT**

To the Board of Directors  
The Art Institute of Fort Lauderdale, Inc.

Compliance

We have audited The Art Institute of Fort Lauderdale, Inc.'s compliance with the types of compliance requirements described in the Executive Office of the Florida Governor's *State Projects Compliance Supplement* that could have a direct and material effect on each of its major State projects for the year ended June 30, 2011. The Art Institute of Fort Lauderdale, Inc.'s major State projects are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs relating to state financial assistance. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major State projects is the responsibility of The Art Institute of Fort Lauderdale, Inc.'s management. Our responsibility is to express an opinion on The Art Institute of Fort Lauderdale, Inc.'s compliance based on our audit.

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 Chapter 10.650, *Rules of the Florida Auditor General*. Those standards and Chapter 10.650, *Rules of the Florida Auditor General* 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 State project occurred. An audit includes examining, on a test basis, evidence about The Art Institute of Fort Lauderdale, Inc.'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. Our audit does not provide a legal determination of The Art Institute of Fort Lauderdale, Inc.'s compliance with those requirements.

In our opinion, The Art Institute of Fort Lauderdale, Inc. complied, in all material respects, with the requirements referred to above that are applicable to each of its major State projects for the year ended June 30, 2011.

### Internal Control Over Compliance

The management of The Art Institute of Fort Lauderdale, Inc. is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to State projects. In planning and performing our audit, we considered The Art Institute of Fort Lauderdale, Inc.'s internal control over compliance with the requirements that could have a direct and material effect on a major State project in order to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with Chapter 10.650, *Rules of the Florida Auditor General* 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 The Art Institute of Fort Lauderdale, Inc.'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 State project 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 State project will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

*Fogle & Associates, LLC*  
March 5, 2012

THE ART INSTITUTE OF FORT LAUDERDALE, INC.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS RELATING TO  
STATE FINANCIAL ASSISTANCE  
Year Ended June 30, 2011

A. SUMMARY OF AUDITORS' RESULTS

1. The financial statements of The Art Institute of Fort Lauderdale, Inc. were audited by another independent registered public accounting firm whose report dated December 22, 2011 expressed an unqualified opinion.
2. The financial statements of The Art Institute of Fort Lauderdale, Inc. were audited by another independent registered public accounting firm whose report dated December 22, 2011 disclosed no instances of noncompliance material to the financial statements and no findings related to the financial statements required to be reported under *Government Auditing Standards*.
3. The independent auditor's report on compliance with requirements that could have a direct and material effect on each major State project for The Art Institute of Fort Lauderdale, Inc. expresses an unqualified opinion.
4. The audit of the major state projects disclosed no findings or questioned costs required to be reported under Chapter 10.656, *Rules of the Florida Auditor General*.
5. The programs tested as major state projects included:  
  
Florida Department of Education Student Financial Assistance Programs:
  - a. Florida Student Assistance Grant - CSFA #48.054
7. The dollar threshold for distinguishing between Type A and Type B projects as described in Chapter 27D-1, Rules of the Executive Office of the Governor, Florida Administrative Code, *Florida Single Audit Act* was \$275,638.
8. No management letter is required because there were no findings related to State financial assistance required to be reported in the management letter.
9. No Summary Schedule of Prior Audit Findings is required because there were no prior audit findings related to major State projects.
10. No Corrective Action Plan is required because there were no findings required to be reported under the *Florida Single Audit Act*.



FINANCIAL STATEMENTS AND  
SUPPLEMENTAL INFORMATION

The Art Institute of Fort Lauderdale, Inc.  
Fiscal Years Ended June 30, 2011 and 2010  
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

The Art Institute of Fort Lauderdale, Inc.

Financial Statements  
and Supplemental Information

Years Ended June 30, 2011 and 2010

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## Report of Independent Auditors

The Shareholder and Board of Trustees of  
The Art Institute of Fort Lauderdale, Inc.

We have audited the accompanying balance sheets of The Art Institute of Fort Lauderdale, Inc. (the “School”) as of June 30, 2011 and 2010, and the related statements of income, shareholder’s equity, and cash flows for the years then ended. These financial statements are the responsibility of the School’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States 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 of material misstatement. We were not engaged to perform an audit of the School’s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the School’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Art Institute of Fort Lauderdale, Inc. as of June 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 22, 2011 on our consideration of the School’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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Supplemental Information section, containing supplemental schedules of related-party transactions and of expenditures of state financial assistance, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic consolidated financial statements taken as a whole.

*Ernst + Young LLP*

December 22, 2011

The Art Institute of Fort Lauderdale, Inc.

Balance Sheets  
(In Thousands)

	June 30,	
	2011	2010
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,294	\$ 4,104
Restricted cash	88	68
Student accounts receivable, net of allowance of \$2,990 and \$2,181	2,000	2,583
Notes, advances, and other receivables	37	126
Inventory	159	260
Deferred income taxes	1,207	995
Other current assets	87	—
Total current assets	<u>4,872</u>	<u>8,136</u>
Property and equipment, net	9,796	11,366
Other long-term assets	466	466
Deferred income taxes	1,492	3,077
Total assets	<u>\$ 16,626</u>	<u>\$ 23,045</u>
<b>Liabilities and shareholder's equity</b>		
Current liabilities:		
Accounts payable	\$ 19	\$ 445
Accrued liabilities	465	1,464
Advance payments	1,453	2,443
Total current liabilities	<u>1,937</u>	<u>4,352</u>
Other long-term liabilities	915	1,057
Shareholder's equity:		
Additional paid-in capital	1	1
Receivable from EDMC	(98,410)	(87,072)
Retained earnings	112,183	104,707
Total shareholder's equity	<u>13,774</u>	<u>17,636</u>
Total liabilities and shareholder's equity	<u>\$ 16,626</u>	<u>\$ 23,045</u>

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

The Art Institute of Fort Lauderdale, Inc.

Statements of Income

(In Thousands)

	Fiscal Years Ended June 30,	
	2011	2010
Net revenues	\$ 57,505	\$ 59,367
Costs and expenses:		
Educational services	28,841	28,902
General and administrative	12,067	11,766
Depreciation and amortization	2,220	2,326
Total costs and expenses:	<u>43,128</u>	<u>42,994</u>
Income before interest and income taxes	14,377	16,373
Interest expense	183	218
Income before income taxes	<u>14,194</u>	<u>16,155</u>
Provision for income taxes	6,718	4,501
Net income	<u>\$ 7,476</u>	<u>\$ 11,654</u>

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

The Art Institute of Fort Lauderdale, Inc.

Statements of Shareholder's Equity  
(In Thousands)

	<b>Additional Paid-in Capital</b>	<b>Receivable from EDMC</b>	<b>Retained Earnings</b>	<b>Total Shareholder's Equity</b>
Balance, June 30, 2009	\$ 1	\$ (77,021)	\$ 93,053	\$ 16,033
Increase in receivable from EDMC	-	(10,051)	-	(10,051)
Net income	-	-	11,654	11,654
Balance, June 30, 2010	1	(87,072)	104,707	17,636
Increase in receivable from EDMC	-	(11,338)	-	(11,338)
Net income	-	-	7,476	7,476
Balance, June 30, 2011	<u>\$ 1</u>	<u>\$ (98,410)</u>	<u>\$ 112,183</u>	<u>\$ 13,774</u>

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

The Art Institute of Fort Lauderdale, Inc.

Statements of Cash Flows

(In Thousands)

	<b>Fiscal Year Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 7,476	\$ 11,654
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,220	2,326
Bad debt expense	1,768	1,288
Non-cash adjustments related to deferred rent	(136)	(109)
Deferred tax provision	1,372	(2,016)
Changes in assets and liabilities:		
Restricted cash	(20)	(54)
Receivables	(1,185)	(2,094)
Inventory	101	(80)
Other assets	3	232
Accounts payable	(202)	50
Accrued liabilities	(957)	96
Advance payments	(990)	22
Total adjustments	<u>1,974</u>	<u>(339)</u>
Net cash flows provided by operating activities	<u>9,450</u>	<u>11,315</u>
<b>Cash flows from investing activities</b>		
Expenditures for long-lived assets	(916)	(1,319)
Net cash flows used in investing activities	<u>(916)</u>	<u>(1,319)</u>
<b>Cash flows from financing activities</b>		
Payments to EDMC	(11,338)	(10,051)
Other	(6)	(120)
Net cash flows used in financing activities	<u>(11,344)</u>	<u>(10,171)</u>
Net decrease in cash and cash equivalents	(2,810)	(175)
Cash and cash equivalents, beginning of year	4,104	4,279
Cash and cash equivalents, end of year	<u>\$ 1,294</u>	<u>\$ 4,104</u>
	<b>As of June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Supplemental disclosure of cash flow information</b>		
Capital expenditures in current liabilities	\$ 8	\$ 273

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

# The Art Institute of Fort Lauderdale, Inc.

## Notes to Financial Statements

June 30, 2011

### **1. Ownership, Operations, and Governance**

The Art Institute of Fort Lauderdale, Inc. (the “School”) is an indirect wholly owned subsidiary of Education Management Corporation (“EDMC”). The School focuses on applied arts in creative professions such as graphic design, interior design, web design and interactive media, digital filmmaking, media arts and animation, game art and design, fashion design, marketing and culinary arts. The School offers Associate’s, Bachelor’s and Master’s degree programs, as well as selective non-degree diploma programs. Students pursue their degrees through a local campus and blended formats, which combine on-campus and online education. These programs typically are completed in 18 to 48 months.

EDMC operates other postsecondary institutions similar to the School. Each of EDMC’s institutions is directed by its own Board of Trustees or Directors that has fiduciary and operational authority. The Board of Directors of EDMC is responsible for the overall establishment of the financial goals of the School and monitors the setting of standards and policies to ensure quality and integrity among all EDMC-owned institutions.

#### **Change in Ownership of EDMC and Initial Public Offering**

On June 1, 2006, EDMC was acquired by a consortium of private equity investment funds led by Providence Equity Partners, Goldman Sachs Capital Partners and Leeds Equity Partners (collectively, the “Sponsors”). The acquisition was accomplished through the merger of an acquisition company into EDMC, with EDMC surviving the merger (the “Transaction”).

The Transaction was accounted for as a purchase; however, the impact of the purchase accounting related to the Transaction is not allocated to the School’s financial statements. The School’s assets and liabilities, where applicable, continue to be recognized on a historical basis.

EDMC completed an initial public offering of its common stock on October 7, 2009 in which 23.0 million shares of common stock were sold for \$18.00 per share. Net proceeds from the initial public offering were used by EDMC to repay indebtedness and pay a termination fee under a management agreement with the Sponsors.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies**

**Basis of Presentation**

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States. Unless otherwise specified, any reference to a “year” is to a fiscal year ended June 30.

**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 revenue and expenses during the reporting period. Management bases its estimates on assumptions that management believes to be reasonable under the circumstances, the results of which form a basis for making judgments about the carrying value of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates under different assumptions or conditions. However, management believes that its estimates are reasonable.

**Cash and Cash Equivalents and Restricted Cash**

The School holds funds from the United States government under various student aid grants and loan programs in separate bank accounts. The School also serves as trustee for the U.S. Department of Education or respective lender, guaranty agency or student borrower, as applicable. The funds held in these bank accounts are not shown as cash or restricted cash on the balance sheet until the authorization and disbursement process has occurred. Once the authorization and disbursement process to the student has been completed, the funds are transferred to unrestricted accounts and become available for use in current operations.

U.S. Department of Education regulations require Title IV Program funds received by the School in excess of the charges applied to the relevant students at that time to be, with these students’ permission, maintained and classified as restricted. Funds transferred through electronic funds transfer programs are held in a separate cash account and released when certain conditions are satisfied. These restrictions have not significantly affected the School’s ability to fund daily operations.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Student Receivables**

The School records student receivables at cost less an estimated allowance for doubtful accounts. The School determines its allowance for doubtful accounts by categorizing gross receivables based upon the enrollment status of the student. The reserve is established based on the likelihood of collection considering the School's historical experience, which is updated on a frequent basis. The reserve methodology results in a higher reserve rate for out-of-school students compared to in-school students. Student accounts are monitored through an aging process whereby past-due accounts are pursued. When certain criteria are met, which is generally when receivables age past the due date by more than four months, and internal collection measures have been taken without success, the accounts of former students are placed with an outside collection agency. Student accounts that are in collection are reserved for at a high rate and are written off after repeated collection attempts have been unsuccessful.

**Inventory**

Inventory consists mainly of textbooks and supplies held for sale to students enrolled in the School's educational programs. Cost is determined using the average cost method, and inventory is valued at the lower of cost or market.

**Leases**

The School leases certain classroom, dormitory and office space as well as equipment under operating leases. Before entering into a lease, an analysis is performed to determine whether a lease should be classified as a capital lease or an operating lease.

Certain of the School's lease agreements include rent escalation clauses, which if fixed and determinable, are recognized on a straight-line basis over the life of the lease, which generally range from five to 20 years with one or more renewal options. For leases with renewal options, the School records rent expense and amortizes the leasehold improvements on a straight-line basis over the original lease term, exclusive of the renewal period. When a renewal occurs, the School records rent expense over the new lease term.



The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Property and Equipment**

Property and equipment is recorded at cost less accumulated depreciation. The School's building is depreciated over an estimated useful life of 30 years using the straight-line method. Leasehold improvements are amortized using the straight-line method over estimated useful lives ranging from five to 20 years. The remainder of the School's property and equipment is depreciated over estimated useful lives ranging from 3 to 10 years using the straight-line method, depending on the asset. Accelerated depreciation methods are generally used for income tax purposes. The School evaluates the recoverability of property and equipment whenever events or changes in circumstances indicate the carrying amount of such assets may not be fully recoverable. No impairments were recorded in fiscal 2011 and 2010.

**Revenue Recognition**

The School's net revenues consist primarily of tuition and fees, student housing fees, bookstore sales, restaurant sales in connection with culinary programs, workshop fees, and sales of related study materials. Net revenues are reduced for student refunds and scholarships.

Tuition revenue varies based on the average tuition charge per credit hour, type of program, specific curriculum, average student population and number of credit hours taken. The School derived 91% of its net revenues from tuition and fees in both fiscal 2011 and 2010. The School bills tuition and housing revenues at the beginning of an academic term and recognizes the revenue on a pro rata basis over the term of instruction or occupancy. Advance payments represent that portion of payments received but not earned and are recorded as a current liability in the accompanying balance sheets. These payments are typically related to future academic periods and generally are refundable.

If a student withdraws from the School, a student's obligation for tuition and fees is limited depending on when a student withdraws during an academic term. Student refunds are regulated by the standards of the U.S. Department of Education, the state of Florida, the Accrediting Council of Independent Colleges and Schools ("ACICS") and the School's institutional policies (collectively, "Refund Policies"). The limitations imposed by the Refund Policies are generally based on the portion of the academic term that has elapsed at the time the student withdraws. The greater the portion of the academic term that has elapsed at the time the student withdraws, the greater the student's obligation is to the school for the tuition and fees related to that academic term. The School records revenue net of any refunds that result from any applicable Refund Policy.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Costs and Expenses**

Educational services expense consists primarily of costs related to the development, delivery and administration of the School's educational programs. Major cost components are faculty compensation, administrative salaries, costs of educational materials, facility occupancy costs, information system costs and bad debt expense.

General and administrative expense primarily consists of marketing and student admissions expenses and certain central staff costs such as executive management, finance and accounting, legal, corporate development and other departments that do not provide direct services to the School's education programs.

Marketing costs are expensed in the fiscal year incurred and are classified as general and administrative expense in the accompanying statements of income. The School's marketing expense was approximately \$3.7 million and \$3.3 million for the fiscal years ended June 30, 2011 and 2010, respectively.

**Income Taxes**

The School accounts for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities result from (i) temporary differences in the recognition of income and expense for financial and income tax reporting requirements, and (ii) differences between the recorded value of assets acquired in business combinations accounted for as purchases for financial reporting purposes and their corresponding tax bases. Deferred income tax assets are reduced by a valuation allowance if it is more-likely-than-not that some portion of the deferred income tax asset will not be realized.

The School is included in the consolidated tax return filed by EDMC. The School and EDMC do not have a formal tax-sharing agreement. The provision for income taxes in the accompanying statements of income is calculated on a separate-entity basis, giving recognition to the impact of filing in a consolidated group. The effective tax rate differs from the combined federal and state statutory rates primarily due to expenses that are non-deductible for tax purposes. State taxes are accrued and reported to the states where the School provides services.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Subsequent Events**

The School has evaluated subsequent events through December 22, 2011, the date through which these financial statements were available to be issued.

**3. Government Regulations**

The School participates in various federal student financial aid programs (“Title IV Programs”) under Title IV of the Higher Education Act of 1965, as amended (“HEA”). The School is required to comply with certain federal regulations established by the U.S. Department of Education, including financial responsibility regulations. These requirements include specific financial responsibility measures relating to expendable resources, shareholder’s equity, and net income, as well as the 90/10 Rule. As described in Note 2, the School is also required to classify as restricted certain Title IV Program funds in excess of charges currently applicable to students’ accounts.

The School had less than \$0.1 million of such amounts for fiscal years ended June 30, 2011 and 2010, which were recorded as restricted cash in the balance sheets. Student refunds of approximately \$1.5 million and \$1.6 million were recorded for the fiscal years ended June 30, 2011 and 2010, respectively, and are presented within net revenues in the statements of income. There was approximately \$0.1 million accrued for student refunds as of June 30, 2011 and 2010, respectively, which was recorded in accrued liabilities in the balance sheets.

The School is required to administer Title IV Program funds in accordance with the HEA and U.S. Department of Education regulations and must use due diligence in approving and disbursing funds. In the event the School does not comply with federal requirements or if student loan default rates are at a level considered excessive by the federal government, the School could lose its eligibility to participate in Title IV Programs or could be required to repay funds determined to have been improperly disbursed. If the School loses or suffers limited access to Title IV Program funds, that loss could have a materially adverse effect on the results of operations.

The School has historically made contributions to the Federal Perkins Loan Program. At June 30, 2011 and 2010, the contributions were approximately \$0.6 million and are included within other long-term assets, net of an allowance, in the accompanying balance sheets.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**3. Government Regulations (continued)**

Under the 90/10 Rule, a for-profit institution will become immediately ineligible to participate in Title IV Programs if, on a cash accounting basis, more than 90% of its revenues for two consecutive fiscal years were derived from Title IV Programs. If the 90/10 Rule is violated for two consecutive fiscal years, the School immediately becomes ineligible to participate in Title IV Programs and is unable to apply to regain eligibility until the end of the following two fiscal years. The School's 90/10 ratio was 72.7% during fiscal 2011.

Pursuant to the Title IV regulations, as revised, each eligible higher education institution must satisfy the minimum standard of financial responsibility established for three tests which assess the financial condition of the institution at the end of its fiscal year. The tests provide three individual scores which must then satisfy a composite score standard. The maximum composite score is 3.0. If the institution achieves a composite score of at least 1.5, it is considered financially responsible. A composite score from 1.0 to 1.4 is considered financially responsible, subject to additional monitoring, and the institution may continue to participate as a financially responsible institution for up to three years. An institution that does not achieve a satisfactory composite score will fall under alternative standards. The School's composite score was 2.64 as of June 30, 2011 and 2.97 as of June 30, 2010.

The U.S. Department of Education ("DoE") requires EDMC to maintain a letter of credit due to EDMC's failure to satisfy certain regulatory financial ratios after giving effect to the Transaction. The amount of this letter of credit was \$361.5 million at June 30, 2011, which is 15% of the total Title IV aid received by students attending EDMC's institutions during fiscal 2010. On June 1, 2012, the capacity on EDMC's revolving credit facility, which is permitted to be used for letters of credit, will decrease to \$328.3 million. As a result, Education Management LLC, a wholly owned subsidiary of EDMC, entered into a separate \$150.0 million letter of credit facility with a private lender in November 2011 to help meet DoE requirements in the future.

*Program Integrity Regulations*

In November 2009, the U.S. Department of Education convened two negotiated rulemaking teams primarily related to Title IV program integrity issues. The resulting program integrity rules promulgated in October 2010 and June 2011 address numerous topics. The U.S. Department of

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**3. Government Regulations (continued)**

Education published the final program integrity regulations on October 29, 2010, with most of the final rules effective July 1, 2011. On June 13, 2011, the U.S. Department of Education published final regulations on metrics for gainful employment programs effective July 1, 2012.

**4. Property and Equipment**

Property and equipment consisted of the following as of June 30, 2011 and 2010 (in thousands):

Asset Class	2011	2010
Buildings and improvements	\$ 6,908	\$ 6,901
Leasehold improvements	10,581	10,169
Technology and other equipment	6,957	6,682
Furniture and equipment	2,426	2,366
Other	902	1,481
Total	27,774	27,599
Accumulated depreciation	(17,978)	(16,233)
Property and equipment, net	\$ 9,796	\$ 11,366

The School's depreciation and amortization expense was approximately \$2.2 million and \$2.3 million for the fiscal years ended June 30, 2011 and 2010, respectively.

**5. Accrued Liabilities**

Accrued liabilities consisted of the following as of June 30, 2011 and 2010 (in thousands):

	2011	2010
Employee compensation	\$ 428	\$ 1,154
Other	37	310
Total accrued liabilities	\$ 465	\$ 1,464

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**6. Related-Party Transactions**

**Coordinating and Support Services**

The School receives coordinating and support services from EDMC, such as legal, insurance, and information technology-related services. EDMC allocates costs to the School based upon certain factors, including the School's revenue and student body, which estimate the amount that the School would pay for these services to an unaffiliated entity. Allocated costs of approximately \$4.3 million and \$4.5 million are included in general and administrative expense in the accompanying statements of income for the fiscal years ended June 30, 2011 and 2010, respectively.

**Cash Management**

The School participates in a cash management program operated by EDMC. This program allows EDMC to consolidate most cash for investment purposes from all its locations in order to maximize investment income. EDMC funds checks written on the School's disbursement bank account as they clear the disbursing bank. The difference between the cash provided to EDMC by the School and the day-to-day funding provided by EDMC to the School has been classified in shareholder's equity as a receivable from EDMC in the balance sheets as there is no formal repayment schedule related to this amount.

**Employee Scholarships**

The School records revenues and expenses related to its internal tuition grant policy on a gross basis. The School received approximately \$0.1 million in each of the fiscal years ended June 30, 2011 and 2010, relating to employees of other EDMC-owned entities attending the School. In addition, the School paid \$0.6 million and \$0.3 million in fiscal years 2011 and 2010, respectively, to other EDMC-owned entities relating to its employees attending another EDMC-owned institution.

**Building**

Most EDMC schools rent their teaching space through operating leases. However, the School owns one of its buildings; as a result, EDMC allocates a portion of the interest expense from its consolidated debt to the School. Approximately \$0.2 million of allocated interest from EDMC is included in interest expense, net in the accompanying statements of income for the years ended June 30, 2011 and 2010.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**7. Income Taxes**

The components of the income tax provision reflected in the statements of income for the years ended June 30 were as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Current taxes:		
Federal	\$ 4,912	\$ 6,054
State	434	463
Total current tax provision	<u>5,346</u>	6,517
Deferred tax provision (benefit)	<u>1,372</u>	(2,016)
Total provision for income taxes	<u>\$ 6,718</u>	<u>\$ 4,501</u>

Net deferred income tax assets and liabilities consisted of the following at June 30, 2011 and 2010 (in thousands):

	<u>2011</u>	<u>2010</u>
Current deferred tax assets:		
Allowance for doubtful accounts	\$ 1,180	\$ 869
Other	27	126
Total current deferred tax assets	<u>\$ 1,207</u>	<u>\$ 995</u>
Noncurrent deferred tax assets:		
Property and equipment	\$ 1,206	\$ 2,722
Deferred rent	261	-
Other	115	456
Total noncurrent deferred tax assets	<u>1,582</u>	<u>3,178</u>
Noncurrent deferred tax liabilities:		
Intangible assets	88	93
Other	2	8
Total noncurrent deferred tax liabilities	<u>90</u>	<u>101</u>
Total net noncurrent deferred tax assets	<u>\$ 1,492</u>	<u>\$ 3,077</u>

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**8. Commitments and Contingencies**

**Incentive Compensation Matters**

On May 3, 2011, a qui tam action captioned United States of America, and the States of California, Florida, Illinois, Indiana, Massachusetts, Minnesota, Montana, New Jersey, New Mexico, New York and Tennessee, and the District of Columbia, each ex rel., Lynntoya Washington and Michael T. Mahoney v. Education Management Corporation, et. al (“Washington”) filed under the federal False Claims Act in April 2007 was unsealed due to the U.S. Department of Justice’s decision to intervene in the case under the federal False Claims Act. Five of the states listed on the case caption and the District of Columbia have joined the case based on qui tam actions filed under their respective False Claims Acts. The State of Kentucky, which does not have a False Claims Act, filed a motion to intervene in the case under its consumer protection laws which was denied by the Court. The case, which is pending in the Western District of Pennsylvania, relates to whether the defendants’ compensation plans for admission representatives violated the HEA, and U.S. Department of Education regulations prohibiting an institution participating in Title IV programs from providing any commission, bonus or other incentive payment based directly or indirectly on success in securing enrollments to any person or entity engaged in any student recruitment or admissions activity. On October 5, 2011, EDMC filed a motion to dismiss the case with prejudice due to its failure to state a claim upon which relief can be granted. EDMC believes the claims to be without merit and intends to vigorously defend itself.

**State Attorney General Investigation**

In October 2010, Argosy University, wholly owned by EDMC, received a subpoena from the Florida Attorney General’s office seeking a wide range of documents related to EDMC’s institutions, including the School and eight other institutions located in Florida, from January 2, 2006 to the present. The Florida Attorney General has announced that it is investigating potential misrepresentations in recruitment, financial aid and other areas. EDMC is cooperating with the investigation, but has also filed a suit to quash or limit the subpoena and to protect information sought that constitutes proprietary or trade secret information. EDMC cannot predict the eventual scope, duration or outcome of the investigation at this time.



The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

**8. Commitments and Contingencies (continued)**

From time to time, the School could be subject to certain legal proceedings arising out of the conduct of its businesses. When these proceedings arise, management will make a determination, based upon its investigation of these claims and discussion with legal counsel, the possible adverse material effect on the financial position, results of operations, or liquidity of the School. At June 30, 2011, the School was not subject to any legal proceedings that are expected to have a material adverse effect on its financial position, results of operations, or liquidity of the School.

**Lease Commitments**

The School leases its facilities under various operating leases that expire on various dates through 2014. Rent expense under these leases was approximately \$4.0 million and \$4.1 million for the fiscal years ended June 30, 2011 and 2010, respectively.

The minimum future commitments for the fiscal years ending June 30 under the School's non-cancelable, long-term operating leases are as follows at June 30, 2011 (in thousands):

2012	\$	3,579
2013		3,608
2014		3,638

**9. Employee Benefit Plans**

EDMC sponsors a 401(k) plan that covers substantially all employees. In January 2011, EDMC changed its policy and now matches dollar for dollar up to 6% of employee contributions to the retirement plan. This change also allows all participants in the plan to vest in EDMC's matching contributions immediately. The School's expense relating to this plan was \$0.4 million for the fiscal years ended June 30, 2011 and 2010.

# Supplemental Information

Report on Internal Control Over Financial Reporting and on Compliance  
and Other Matters Based on an Audit of the  
Financial Statements Performed in Accordance  
With *Government Auditing Standards*

The Shareholder and Board of Trustees of  
The Art Institute of Fort Lauderdale, Inc.

We have audited the financial statements of The Art Institute of Fort Lauderdale, Inc. (the “School”) as of and for the years ended June 30, 2011 and 2010, and have issued our report thereon dated December 22, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the School’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School’s internal control over financial reporting.

*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 financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting 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 deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the School's financial statements are free of material misstatement, we performed tests of its 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 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*.

This report is intended solely for the information and use of the Board of Trustees, management, accrediting agencies, and the Department of Education and is not intended to be, and should not be, used by anyone other than these specified parties.

*Ernst + Young LLP*

December 22, 2011

## The Art Institute of Fort Lauderdale, Inc.

### Supplemental Schedule of Related-Party Transactions

June 30, 2011

The Art Institute of Fort Lauderdale, Inc. (the “School”) 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 School must comply with the regulations promulgated under the HEA. Those regulations require that all related party transactions be disclosed, regardless of their materiality to the financial statements.

#### **Coordinating and Support Services**

The School receives coordinating and support services from EDMC, such as legal, insurance, and information technology-related services. EDMC allocates costs to the School based upon certain factors, including the School’s revenue and student body, which estimate the amount that the School would pay for these services to an unaffiliated entity. Allocated costs of approximately \$4.3 million and \$4.5 million are included in general and administrative expense in the accompanying statements of income for the fiscal years ended June 30, 2011 and 2010, respectively.

#### **Cash Management**

The School participates in a cash management program operated by EDMC. This program allows EDMC to consolidate most cash for investment purposes from all its locations in order to maximize investment income. EDMC funds checks written on the School’s disbursement bank account as they clear the disbursing bank. The difference between the cash provided to EDMC by the School and the day-to-day funding provided by EDMC to the School has been classified in shareholder’s equity as a receivable from EDMC in the balance sheets as there is no formal repayment schedule related to this amount.

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The Art Institute of Fort Lauderdale, Inc.

Supplemental Schedule of Related-Party Transactions (continued)

**Building**

The debt associated with a building the School owns is held by EDMC. As a result, EDMC allocates interest expense to the School. Approximately \$0.2 million is included in interest expense in the accompanying statements of income for the fiscal years ended June 30, 2011 and 2010.

The Art Institute of Fort Lauderdale, Inc.

Supplemental Schedule of Expenditures of State Financial Assistance

For the Year Ended June 30, 2011

	<b>CSFA No.</b>	<b>Grant No.</b>	<b>Expenditures</b>	<b>Transfers to Subrecipients</b>
<b>FLORIDA DEPARTMENT OF EDUCATION</b>				
Direct Projects:				
Florida Student Assistance Grant	48.054	N/A	\$ 724,854	\$ -
Florida Bright Futures Scholarship	48.059	NA	193,940	-
<b>TOTAL DIRECT PROJECTS</b>			<b>\$ 918,794</b>	<b>\$ -</b>
Indirect Projects:			\$ -	\$ -
Passed Through:			\$ -	\$ -
<b>TOTAL FLORIDA DEPARTMENT OF EDUCATION</b>			<b>\$ 918,794</b>	<b>\$ -</b>
<b>TOTAL EXPENDITURES OF STATE FINANCIAL ASSISTANCE</b>			<b>\$ 918,794</b>	<b>\$ -</b>

NOTES TO SCHEDULE OF EXPENDITURES OF STATE FINANCIAL ASSISTANCE

**BASIS OF PRESENTATION**

The information in this schedule is prepared on the accrual basis of accounting and is presented in accordance with Chapter 691-5, Rules of the Florida Department of Financial Services. Florida Administrative Code, *Schedule of Expenditures of State Financial Assistance*.

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