

THE ART INSTITUTE OF FORT LAUDERDALE, INC.

FLORIDA SINGLE AUDIT REPORTS

YEAR ENDED JUNE 30, 2012

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 CHAPTER
10.650, RULES OF THE AUDITOR GENERAL**

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 Department of Financial Services' *State Projects Compliance Supplement* that could have a direct and material effect on each of The Art Institute of Fort Lauderdale, Inc.'s major State projects for the year ended June 30, 2012. 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. 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 Auditor General*. Those standards and Chapter 10.650, *Rules of the 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 could have a direct and material effect on each of its major State projects for the year ended June 30, 2012.

Internal Control Over Compliance

Management of The Art Institute of Fort Lauderdale, Inc. is responsible for establishing and maintaining effective internal control over compliance with 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 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 Auditor General* but not for the purpose of expressing an opinion on the effectiveness of The Art Institute of Fort Lauderdale, Inc.'s 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 was not designed to 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.

The purpose of this report is solely to describe the scope of our testing of compliance with the types of compliance requirements applicable to each of The Art Institute of Fort Lauderdale, Inc.'s major State projects and our testing of internal control over compliance and the results of our testing, and to provide an opinion on The Art Institute of Fort Lauderdale, Inc.'s compliance but not to provide an opinion on the effectiveness of The Art Institute of Fort Lauderdale, Inc.'s internal control over compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering The Art Institute of Fort Lauderdale, Inc.'s compliance with requirements applicable to each major State project and its internal control over compliance. Accordingly, this report is not suitable for any other purpose.

Jogle & Associate, LLC

February 5, 2013

THE ART INSTITUTE OF FORT LAUDERDALE, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS -
STATE PROJECTS

Year Ended June 30, 2012

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 November 29, 2012 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 November 29, 2012 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 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
 - b. Florida Bright Futures Scholarship - CSFA #48.059
7. The dollar threshold for distinguishing between Type A and Type B projects was \$263,752 for major State projects.
8. No management letter is required because there were no findings 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 Chapter 10.656, *Rules of the Auditor General*.



FINANCIAL STATEMENTS AND
SUPPLEMENTAL INFORMATION

The Art Institute of Fort Lauderdale, Inc.
Fiscal Years Ended June 30, 2012 and 2011
With Report of Independent Auditors

Ernst & Young LLP



The Art Institute of Fort Lauderdale, Inc.
Financial Statements and Supplemental Information
Fiscal Years Ended June 30, 2012 and 2011

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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, 2012 and 2011, 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. at June 30, 2012 and 2011, 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 November 29, 2012 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 conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying Supplemental Information section containing supplemental schedules of related-party transactions and expenditures of state financial assistance is presented for purposes of additional analysis and is not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Ernst & Young LLP

November 29, 2012

The Art Institute of Fort Lauderdale, Inc.

Balance Sheets
(In Thousands)

	June 30,	
	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,061	\$ 1,294
Restricted cash	1,211	88
Student accounts receivable, net of allowance of \$2,842 and \$2,990	1,837	2,000
Notes, advances, and other receivables	87	37
Inventory	110	159
Deferred income taxes	1,205	1,207
Other current assets	—	87
Total current assets	<u>5,511</u>	<u>4,872</u>
Property and equipment, net	8,533	9,796
Other long-term assets	840	466
Deferred income taxes	1,714	1,492
Total assets	<u>\$ 16,598</u>	<u>\$ 16,626</u>
Liabilities and shareholder's equity		
Current liabilities:		
Accounts payable	\$ 78	\$ 19
Accrued liabilities	420	465
Advance payments	1,661	1,453
Total current liabilities	<u>2,159</u>	<u>1,937</u>
Deferred rent	758	915
Shareholder's equity:		
Additional paid-in capital	1	1
Receivable from EDMC	(104,721)	(98,410)
Retained earnings	118,401	112,183
Total shareholder's equity	<u>13,681</u>	<u>13,774</u>
Total liabilities and shareholder's equity	<u>\$ 16,598</u>	<u>\$ 16,626</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 Year Ended June 30,	
	2012	2011
Net revenues	\$ 49,732	\$ 57,505
Educational services	26,465	28,841
General and administrative	11,331	12,067
Depreciation and amortization	2,083	2,220
Total costs and expenses	<u>39,879</u>	<u>43,128</u>
Income before interest and income taxes	9,853	14,377
Interest expense	181	183
Income before income taxes	<u>9,672</u>	<u>14,194</u>
Income tax expense	3,454	6,718
Net income	<u>\$ 6,218</u>	<u>\$ 7,476</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)

	Additional Paid-in Capital	Receivable from EDMC	Retained Earnings	Total Shareholder's Equity
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	1	(98,410)	112,183	13,774
Increase in receivable from EDMC	—	(6,311)	—	(6,311)
Net income	—	—	6,218	6,218
Balance, June 30, 2012	\$ 1	\$ (104,721)	\$ 118,401	\$ 13,681

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

The Art Institute of Fort Lauderdale, Inc.

Statements of Cash Flows
(In Thousands)

	Fiscal Year Ended June 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 6,218	\$ 7,476
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,083	2,220
Bad debt expense	1,544	1,768
Non-cash adjustments related to deferred rent	(157)	(136)
Deferred tax provision	(220)	1,372
Changes in assets and liabilities:		
Restricted cash	(1,123)	(20)
Receivables	(1,381)	(1,185)
Inventory	49	101
Other assets	(337)	3
Accounts payable	49	(202)
Accrued liabilities	(46)	(957)
Advance payments	208	(990)
Total adjustments	669	1,974
Net cash flows provided by operating activities	6,887	9,450
Cash flows from investing activities:		
Expenditures for long-lived assets	(809)	(916)
Net cash flows used in investing activities	(809)	(916)
Cash flows from financing activities:		
Payments to EDMC	(6,311)	(11,338)
Other	—	(6)
Net cash flows used in financing activities	(6,311)	(11,344)
Net decrease in cash and cash equivalents	(233)	(2,810)
Cash and cash equivalents, beginning of year	1,294	4,104
Cash and cash equivalents, end of year	\$ 1,061	\$ 1,294
	As of June 30,	
	2012	2011
Supplemental disclosure of cash flow information		
Capital expenditures in current liabilities	\$ 18	\$ 8

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

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements

Fiscal Years Ended June 30, 2012 and 2011

1. OWNERSHIP, OPERATIONS, AND GOVERNANCE

The Art Institute of Fort Lauderdale, Inc. (the "School") is an indirect wholly owned subsidiary by 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.

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.

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.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. These investments are stated at cost, which, based upon the scheduled maturities, approximates fair value.

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 cash accounts and become available for use in current operations.

Restricted cash was as follows at June 30 (in thousands):

	<u>2012</u>	<u>2011</u>
Cash secured letters of credit ⁽¹⁾	\$ 800	\$ —
Title IV funds in excess of charges applied ⁽²⁾	411	88
Total restricted cash	<u>\$ 1,211</u>	<u>\$ 88</u>

(1) Includes amounts related to two cash secured letter of credit facilities entered into by EDMC pursuant to which the lenders agreed to issue letters of credit to the U.S. Department of Education. Refer to Note 3 for more details.

(2) 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 cash. 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 or an operating lease.

Certain of the School's lease agreements include tenant improvement allowances. Once the lease agreement is signed, these tenant improvement allowances are recorded as other current assets with the offset to deferred rent liabilities on the balance sheet. As spending occurs, the School records increases to leasehold improvement assets in property and equipment. Other current assets are reduced once the landlord reimburses the School. The deferred rent liabilities related to tenant improvements are amortized over the term of the lease as a reduction to rent expense upon possession of the lease space.

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. Lease terms range from ten to 25 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 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. Leasehold improvements are amortized using the straight-line method over estimated useful lives ranging from ten to 25 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 2012 and 2011.

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 91.2% and 91.0% of its net revenues from tuition and fees in fiscal 2012 and 2011, respectively. Bookstore and housing revenues are largely a function of the average student population.

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 sheet. 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 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 departmental costs such as executive management, finance and accounting, legal, corporate development and other departments that do not provide direct services to the School's students.

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 in each of the fiscal years ended June 30, 2012 and 2011.

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 valuation allowances and expenses that are non-deductible for tax purposes. State taxes are accrued and reported in the state of Florida where the School is located.

Fair Value

The fair value of the School's cash and cash equivalents, restricted cash, student receivables, notes receivable, accounts payable and accrued expenses approximate their carrying values.

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 November 29, 2012, the date through which these financial statements were available to be issued.

In October 2012, the School completed a sale-leaseback transaction on one of its student housing facilities with an unrelated third party for total proceeds of \$3.6 million. The School signed a lease for this facility through June 2014.

3. GOVERNMENTAL 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”). As such, 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 \$0.4 million of such funds at June 30, 2012 which are reported as restricted cash in the balance sheet. Student refunds of approximately \$1.1 million and \$1.5 million were recorded for the fiscal years ended June 30, 2012 and 2011, respectively, and are presented within net revenues in the statements of income. There was less than \$0.1 million accrued for student refunds as of June 30, 2012 and 2011, which were 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. The contributions since the inception of the program at June 30, 2012 and 2011, were approximately \$0.6 million and are included within other long-term assets, net of an allowance, in the balance sheet.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

3. GOVERNMENTAL 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 72.6% during fiscal 2012.

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. As of June 30, 2012, the School's composite score was 2.85.

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 \$414.5 million at June 30, 2012, which is 15% of the total Title IV aid received by students attending EDMC's institutions during fiscal 2011. On June 1, 2012, the capacity on EDMC's revolving credit facility, which is permitted to be used for letters of credit, decreased to \$328.3 million. As a result, Education Management LLC, a wholly owned subsidiary of EDMC, entered into two cash secured letter of credit facilities that provide up to \$200.0 million of capacity. Amounts utilized under these facilities are required to be reflected as restricted cash.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

4. PROPERTY AND EQUIPMENT

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

<u>Asset Class</u>	<u>2012</u>	<u>2011</u>
Land	\$ 2,017	\$ 2,017
Buildings and improvements	4,891	4,891
Leasehold improvements	10,558	10,581
Technology and other equipment	7,550	6,957
Furniture and equipment	2,437	2,426
Other	1,043	902
Total	28,496	27,774
Accumulated depreciation	(19,963)	(17,978)
Property and equipment, net	\$ 8,533	\$ 9,796

The School's depreciation and amortization expense was \$2.1 million and \$2.2 million in the fiscal years ended June 30, 2012 and 2011, respectively.

5. ACCRUED LIABILITIES

Accrued liabilities consisted of the following as of June 30 (in thousands):

	<u>2012</u>	<u>2011</u>
Employee compensation	\$ 408	\$ 428
Other	12	37
Total accrued liabilities	\$ 420	\$ 465

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 revenues and student body, which approximate the amount that the School would pay for these services to an unaffiliated entity. Allocated costs of approximately \$4.2 million and \$4.3 million were included in general and administrative expense in the statements of income in the fiscal years ended June 30, 2012 and 2011, respectively.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

6. RELATED-PARTY TRANSACTIONS (continued)

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, 2012 and 2011 relating to employees of other EDMC-owned entities attending the School. In addition, the School paid \$0.4 million and \$0.6 million in fiscal 2012 and 2011, 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 the interest expense, net in the accompanying statements of income for each of the fiscal years ended June 30, 2012 and 2011.

7. INCOME TAXES

The provision for income taxes includes current and deferred taxes, as reflected below for the fiscal years ended June 30 (in thousands):

	<u>2012</u>	<u>2011</u>
Current taxes:		
Federal	\$ 3,367	\$ 4,912
State	307	434
Current tax expense	<u>3,674</u>	<u>5,346</u>
Deferred tax (benefit) expense	(220)	1,372
Total income tax expense	<u>\$ 3,454</u>	<u>\$ 6,718</u>

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

7. INCOME TAXES (continued)

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

	<u>2012</u>	<u>2011</u>
Current deferred tax assets:		
Allowance for doubtful accounts	\$ 1,155	\$ 1,180
Other	50	27
Total current deferred tax assets	<u>\$ 1,205</u>	<u>\$ 1,207</u>
Noncurrent deferred tax assets:		
Property and equipment	\$ 1,391	\$ 1,206
Deferred rent	197	261
Other	140	115
Total noncurrent deferred tax assets	<u>1,728</u>	<u>1,582</u>
Noncurrent deferred tax liabilities:		
Intangible assets	14	88
Other	—	2
Total noncurrent deferred tax liabilities	<u>14</u>	<u>90</u>
Total net noncurrent deferred tax assets	<u>\$ 1,714</u>	<u>\$ 1,492</u>

8. COMMITMENTS AND CONTINGENCIES

Qui Tam Matters

Washington v. Education Management Corporation. 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. Five of the states listed on the case caption joined the case based on *qui tam* actions filed under their respective False Claims Acts. The Court granted EDMC’s motion to dismiss the District of Columbia from the case and denied the Commonwealth of Kentucky’s motion to intervene in the case under its consumer protection laws.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

8. COMMITMENTS AND CONTINGENCIES (continued)

The case, which is pending in federal district court in the Western District of Pennsylvania, relates to whether our compensation plans for admission representatives violated the Higher Education Act, as amended (“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 during the period of July 1, 2003 through June 30, 2011. The complaint was initially filed by a former admissions representative at The Art Institute of Pittsburgh Online Division and a former director of training at EDMC Online Higher Education and asserts the relators are entitled to recover treble the amount of actual damages allegedly sustained by the federal government as a result of the alleged activity, plus civil monetary penalties. The complaint does not specify the amount of damages sought but claims that EDMC and/or students attending EDMC’s schools received over \$11 billion in funds from participation in Title IV programs and state financial aid programs during the period of alleged wrongdoing.

On May 11, 2012, the Court ruled on EDMC’s motion to dismiss the case for failure to state a claim upon which relief can be granted, dismissing the claims that the design of EDMC’s compensation plan for admissions representatives violated the incentive compensation rule and allowing the allegations that the plan as implemented violated the rule and common law claims to continue to discovery.

EDMC believes the case to be without merit and intends to vigorously defend itself.

Sobek v. Education Management Corporation. On March 13, 2012, a *qui tam* action captioned *United States of America, ex rel. Jason Sobek v. Education Management Corporation, et al.* filed under the federal False Claims Act on January 28, 2010 was unsealed after the U.S. Department of Justice declined to intervene in the case. The case, which is pending in the Western District of Pennsylvania, alleges that the defendants violated the U.S. Department of Education’s regulation prohibiting institutions from making substantial misrepresentations to prospective students, did not adequately track student academic progress and violated the U.S. Department of Education’s prohibition on the payment of incentive compensation to admissions representatives. The complaint was filed by a former project associate director of admissions at EDMC Online Higher Education who worked for South University and asserts the relator is entitled to recover treble the amount of actual damages allegedly sustained by the federal government as a result of the alleged activity, plus civil monetary penalties. The complaint does not specify the amount of damages sought but claims that EDMC’s institutions were ineligible to participate in Title IV programs during the period of alleged wrongdoing.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

8. COMMITMENTS AND CONTINGENCIES (continued)

On May 29, 2012, EDMC filed a motion to dismiss the case with prejudice for failure to state a claim upon which relief can be granted. In response, the relators withdrew the allegations in the complaint related to violations of the incentive compensation rule. EDMC believes the remaining claims in the case to be without merit and intends to vigorously defend itself. On October 22, 2012, the Magistrate Judge assigned to the case issued a Report and Recommendation on EDMC's motion to dismiss, which recommends that the Court dismiss with prejudice claims related to incentive compensation, program costs and the withholding of amounts due to the government and allow claims related to satisfactory academic progress, job placement statistics and programmatic accreditation to continue. EDMC filed objections to the Report and Recommendation with the Court on November 9, 2012.

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 nine 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.

Other Matters

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, 2012, 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 2015. Rent expense under these leases was approximately \$4.0 million in each of the years ended June 30, 2012 and 2011.

The Art Institute of Fort Lauderdale, Inc.

Notes to Financial Statements (continued)

8. COMMITMENTS AND CONTINGENCIES (continued)

The minimum future cash commitments for the fiscal years ending June 30 under the School's noncancelable, long-term operating leases are as follows at June 30, 2012 (in thousands):

Fiscal Year:	
2013	\$ 3,689
2014	3,647
2015	2

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 \$0.5 million and \$0.4 million in the fiscal years ended June 30, 2012 and 2011, respectively.

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 accompanying financial statements of The Art Institute of Fort Lauderdale, Inc. (the “School”) as of and for the years ended June 30, 2012 and 2011, and have issued our report thereon dated November 29, 2012. 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.

Internal Control Over Financial Reporting

Management of the School is responsible for establishing and maintaining effective 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.

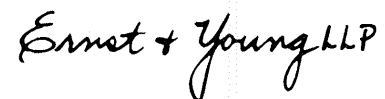
A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination 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.



November 29, 2012

Supplemental Information

The Art Institute of Fort Lauderdale, Inc.

Supplemental Schedule of Related-Party Transactions

The Art Institute of Fort Lauderdale, Inc. (the “School”) is wholly owned by Education Management Corporation (“EDMC”). EDMC was acquired in 2006 by a consortium of private equity investment funds led by Providence Equity Partners (together with its affiliated investment funds, “Providence”), Goldman Sachs Capital Partners (together with its affiliated investment funds, “Goldman”) and Leeds Equity Partners (together with its affiliated investment funds, “Leeds” and, together with Providence and Goldman, the “Sponsors”).

During its fiscal years ended June 30, 2012 and 2011, EDMC engaged in the related-party transactions described below, which involved one or more of the Sponsors or other entities in which the Sponsors have invested. Although the School does not directly pay these related parties, it benefits from the majority of these transactions.

- EDMC licenses student information system software from Campus Management Corp. (“CMC”), which since February 2008 has been owned by Leeds. EDMC paid licensing, maintenance and consulting fees to CMC of approximately \$2.1 million and \$3.5 million in the fiscal years ended June 30, 2012 and 2011, respectively.
- EDMC uses PeopleScout, Inc., d/b/a StudentScout, for contact management services when processing some of its inquiries from prospective students. StudentScout is owned by investment funds associated with Leeds. During fiscal 2012 and 2011, EDMC paid servicing fees to StudentScout of approximately \$1.8 million and \$2.8 million, respectively.
- EDMC uses Ex Libris Group, which is owned by Leeds, for IT maintenance services. EDMC paid Ex Libris \$0.3 million and \$0.5 million in fiscal 2012 and 2011, respectively.
- EDMC purchases personal computers and related equipments from CDW Corporation, which is owned by Providence, and its affiliates (“CDW”). During fiscal 2012 and 2011, EDMC paid approximately \$0.3 million and \$1.8 million, respectively, in equipment from CDW.
- EDMC paid Nextag, Inc., which is affiliated with Providence, approximately \$38,000 for marketing lead services during fiscal 2011.
- EDMC paid Assessment Technologies Institute, LLC, which is affiliated with Providence, approximately \$0.5 million and \$0.6 million in fiscal 2012 and 2011, respectively, for skills testing software.
- EDMC purchased products from Jones & Bartlett Learning, which is affiliated with Providence, for approximately \$0.1 million in each of fiscal 2012 and 2011.
- EDMC has engaged Kroll Ontrack for litigation management and electronic discovery document retention services for which it paid approximately \$0.4 million and \$1.0 million in fiscal 2012 and 2011, respectively. Kroll is affiliated with Providence.
- EDMC paid \$2.7 million during fiscal 2012 for security services at several of its schools from United States Securities Associates, which is owned in part by Goldman.

The Art Institute of Fort Lauderdale, Inc.

Supplemental Schedule of Related-Party Transactions (continued)

Finally, EDMC is party to employment agreements with certain of its executive officers and senior managers. The agreements, which were designed to retain executives and provide continuity of management in the event of an actual or threatened changes in control, address a number of compensation issues, including salary, bonus potential, benefit eligibility, and severance and other payments to which the executive may be entitled in the event of his or her separation from EDMC, and generally include non-competition, non-solicitation and confidentiality provisions that are customary to agreements of this type.

In addition to the foregoing transactions, the School engaged in the following 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 revenues and student body, which approximate the amount that the School would pay for these services to an unaffiliated entity. Allocated costs of approximately \$4.2 million and \$4.3 million were included in general and administrative expense in the statements of income in the fiscal years ended June 30, 2012 and 2011, respectively.

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The Art Institute of Fort Lauderdale, Inc.

Supplemental Schedule of Related-Party Transactions (continued)

Building

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The Art Institute of Fort Lauderdale, Inc.

Supplemental Schedule of Expenditures of State Financial Assistance

Fiscal Year Ended June 30, 2012

	CSFA No.	Grant No.	Expenditures	Transfers to Subrecipients
FLORIDA DEPARTMENT OF EDUCATION				
Direct Projects:				
Florida Student Assistance Grant	48.054	N/A	\$ 751,174	\$ —
Florida Children and Spouses of Deceased or Disabled Veterans and Service Members Scholarship	48.055	N/A	4,425	—
Florida Bright Futures Scholarship	48.059	N/A	<u>123,573</u>	<u>—</u>
TOTAL DIRECT PROJECTS			<u>\$ 879,172</u>	<u>\$ —</u>
Indirect Projects:			<u>\$ —</u>	<u>\$ —</u>
Passed Through:			<u>\$ —</u>	<u>\$ —</u>
TOTAL FLORIDA DEPARTMENT OF EDUCATION			<u>\$ 879,172</u>	<u>\$ —</u>
TOTAL EXPENDITURES OF STATE FINANCIAL ASSISTANCE			<u>\$ 879,172</u>	<u>\$ —</u>

Notes to Supplemental 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*.

The Art Institute of Fort Lauderdale, Inc.

Supplemental Schedule of Expenditures of State Financial Assistance

Fiscal Year Ended June 30, 2011

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

Notes to Supplemental 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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