THE ART INSTITUTE OF FORT LAUDERDALE, INC.

AUDIT OF COMPLIANCE FOR EACH MAJOR STATE PROJECT IN ACCORDANCE WITH CHAPTER 10.650, RULES OF THE AUDITOR GENERAL

Year Ended June 30, 2014

FOGLE & ASSOCIATES, LLC
Certified Public Accountants

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Fogle & Associates, LLC
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR STATE PROJECT AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY CHAPTER 10.650, RULES OF THE AUDITOR GENERAL

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

Report on Compliance for Each Major State Project

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, 2014. 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.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its State projects.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of The Art Institute of Fort Lauderdale, Inc.'s major State projects based on our audit of the types of compliance requirements referred to above.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and 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 on compliance for each major State project. However, our audit does not provide a legal determination of The Art Institute of Fort Lauderdale, Inc.'s compliance.

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Opinion on Each Major State Project

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, 2014.

Report on 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 the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered The Art Institute of Fort Lauderdale, Inc.'s internal control over compliance with the types of requirements that could have a direct and material effect on each major State project to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major State project 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. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a State project that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of Chapter 10.650, *Rules of the Auditor General*. Accordingly, this report is not suitable for any other purpose.

Fogle & Associates, LLC

February 9, 2015

THE ART INSTITUTE OF FORT LAUDERDALE, INC.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - STATE PROJECTS

Year Ended June 30, 2014

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 3, 2014 expressed an unmodified opinion.

2. One material weakness disclosed during the audit of the financial statements of The Art Institute of Fort Lauderdale, Inc. was reported by another independent registered public accounting firm in its "Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*" dated November 3, 2014.

3. The financial statements of The Art Institute of Fort Lauderdale, Inc. were audited by another independent registered public accounting firm whose "Report of Independent Auditors on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*" dated November 3, 2014 identified no instances of noncompliance material to the financial statements and no findings related to the financial statements which would be required to be reported in accordance with *Government Auditing Standards*.

4. The independent auditor's report on compliance for each major State project for The Art Institute of Fort Lauderdale, Inc. expresses an unmodified opinion.

5. The audit of the major state projects of The Art Institute of Fort Lauderdale, Inc. disclosed no findings or questioned costs required to be reported under Chapter 10.650, *Rules of the Auditor General*.

6. 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 was $235,200 for major State projects.

8. No management letter is required because there were no matters related to major State projects 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 10.650, *Rules of the Auditor General*.

Financial Statements and Supplemental Information

The Art Institute of Ft. Lauderdale, Inc.
Fiscal Years Ended June 30, 2014 and 2013
With Report of Independent Auditors

The Art Institute of Ft. Lauderdale, Inc.

Financial Statements and
Supplemental Information

Fiscal Years Ended June 30, 2014 and 2013

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Building a better working world

Report of Independent Auditors

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

Report on the Financial Statements

We have audited the accompanying financial statements of The Art Institute of Ft. Lauderdale, Inc., which comprise the balance sheets as of June 30, 2014 and 2013, and the related statements of operations, shareholder's equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

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.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Art Institute of Ft. Lauderdale, Inc. at June 30, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying Supplemental Schedules of Expenditures of State Financial Assistance and Supplemental Schedule of 90/10 Ratios and Composite Scores are presented for purposes of additional analysis and are 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with Government Auditing Standards, we have also issued our report dated November 3, 2014 on our consideration of The Art Institute of Ft. Lauderdale, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards in considering The Art Institute of Ft. Lauderdale, Inc.'s internal control over financial reporting and compliance.

Ernst + Young LLP

November 3, 2014

The Art Institute of Ft. Lauderdale, Inc.
Balance Sheets
(In thousands)

	June 30, 2014	June 30, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 1,513	$ 5,531
Restricted cash	759	166
Student accounts receivable, net of allowance of $1,361 and $1,728	1,563	1,696
Notes, advances, and other receivables	300	106
Deferred income taxes	244	820
Other current assets	282	131
Total current assets	4,661	8,450
Property and equipment, net	5,644	6,913
Deferred income taxes	1,018	2,253
Other long-term assets	899	526
Total assets	$ 12,222	$ 18,142
Liabilities and shareholder's equity		
Current liabilities:		
Current portion of financing obligation on sale-leaseback transaction	$ —	$ 3,621
Accounts payable	330	267
Accrued liabilities	621	891
Advance payments	1,155	1,355
Total current liabilities	2,106	6,134
Other long term liabilities	292	464
Shareholder's equity:		
Net investment of EDMC (Note 2)	(111,897)	(110,394)
Retained earnings	121,721	121,938
Total shareholder's equity	9,824	11,544
Total liabilities and shareholder's equity	$ 12,222	$ 18,142

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

The Art Institute of Ft. Lauderdale, Inc.
Statements of Operations
(In thousands)

	For the Fiscal Year Ended June 30,	
	2014	**2013**
Net revenues	$ 37,415	$ 43,511
Costs and expenses:		
Educational services	21,889	23,670
General and administrative	9,859	11,026
Long-lived asset impairment	—	1,022
Depreciation and amortization	1,963	2,040
Total costs and expenses	33,711	37,758
Income before interest and income taxes	3,704	5,753
Interest expense	403	444
Income before income taxes	3,301	5,309
Income tax expense	3,518	1,772
Net (loss) income	$ (217)	$ 3,537

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

The Art Institute of Ft. Lauderdale, Inc.
Statements of Shareholder's Equity
(In thousands)

	Net Investment of EDMC	Retained Earnings	Total Shareholder's Equity
Balance, June 30, 2012	$ (104,720)	$ 118,401	$ 13,681
Decrease in net investment of EDMC	(5,674)	—	(5,674)
Net income	—	3,537	3,537
Balance, June 30, 2013	(110,394)	121,938	11,544
Decrease in net investment of EDMC	(1,503)	—	(1,503)
Net loss	—	(217)	(217)
Balance, June 30, 2014	$ (111,897)	$ 121,721	$ 9,824

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

The Art Institute of Ft. Lauderdale, Inc.
Statements of Cash Flows
(In thousands)

	For the Fiscal Year Ended June 30, 2014	2013
Cash flows from operating activities:		
Net (loss) income	$ (217)	$ 3,537
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	1,963	2,040
Bad debt expense	1,150	1,386
Long-lived asset impairment	—	1,022
Deferred income taxes	2,114	(155)
Changes in assets and liabilities:		
Restricted cash	(593)	1,045
Receivables	(1,156)	(1,187)
Other assets	(862)	216
Accounts payable	177	(205)
Accrued liabilities	(558)	(259)
Advance payments	(200)	(306)
Total adjustments	2,035	3,597
Net cash flows provided by operating activities	1,818	7,134
Cash flows from investing activities:		
Expenditures for long-lived assets	(4,333)	(611)
Net cash flows used in investing activities	(4,333)	(611)
Cash flows from financing activities:		
Proceeds from the sale-leaseback of fixed assets	—	3,621
Decrease in net investment of EDMC	(1,503)	(5,674)
Net cash flows used in financing activities	(1,503)	(2,053)
Net (decrease) increase in cash and cash equivalents	(4,018)	4,470
Cash and cash equivalents, beginning of year	5,531	1,061
Cash and cash equivalents, end of year	$ 1,513	$ 5,531

	As of June 30, 2014	2013
Supplemental disclosure of cash flow information		
Capital expenditures in current liabilities	$ 547	$ 849

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

1. OWNERSHIP, OPERATIONS AND GOVERNANCE

The Art Institute of Ft. Lauderdale, Inc. or the “School” is wholly-owned by Education Management Corporation (“EDMC”). The School focuses on applied arts in creative professions. The principal degree programs offered by the School include Culinary Arts, Graphic Design, Fashion Design, Media Arts & Animation, Video Production, Photography, Fashion Merchandising, Interior Design, Baking and Pastry, Industrial Design, Illustration & Design and Website Development. 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 campus-based and online education. These programs typically are completed in 18 to 48 months.

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 was not allocated to the School's financial statements. The School's assets and liabilities, where applicable, continue to be recognized on a historical basis.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation (Including EDMC Debt Restructuring)

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

EDMC has experienced deteriorating results from operations over the last several fiscal years, which coupled with the use of cash, created uncertainty as to EDMC's ability to continue as a going concern. EDMC has entered into the following agreements and taken the following actions to mitigate these risks:

- an amendment agreement dated September 5, 2014 (the "Amendment Agreement"), with the holders of in excess of 98% of the term loan facilities and 100% of the revolving credit facility (collectively, the "Consenting Lenders") pursuant to which, among other things, (i) the maturity on the revolving credit facility was extended from June 1, 2015 to July 2, 2015, (ii) the Consenting Lenders under the revolving credit facility agreed to accept payment of interest in kind rather than cash through June 30, 2015, (iii) the Consenting Lenders holding term loans agreed that no amortization payments will be payable through June 30, 2015 and to accept the payment of interest in kind rather than cash through June 30, 2015, (iv) EDMC became a guarantor and granted a lien on substantially all of its assets to secure the obligations under the agreement, (v) compliance with the financial covenants was waived through June 30, 2015, and (vi) the security agreement governing the credit facility was amended such that the collateral proceeds “waterfall” set forth therein now provides that obligations owing to any lenders that are not Consenting Lenders shall be paid only after satisfaction in full of obligations owing to Consenting Lenders and swap counterparties who have executed the RSA (as defined below);

- a supplemental indenture dated September 5, 2014 (the "Supplemental Indenture"), pursuant to which the Indenture governing the cash pay/PIK notes due 2018 (the "Cash Pay/PIK Notes") was amended (i) to require EDMC to offer all holders of the Cash Pay/PIK Notes the opportunity to receive the same consideration in the Debt Restructuring (as defined below) as holders of the Interim Notes (as defined below), (ii) to provide for (a) the release of EDMC's guarantee and (b) the termination of certain covenants and certain events of default, in each case upon the completion of the exchange of Cash Pay/PIK Notes and Interim Notes contemplated by the Debt Restructuring and (iii) to provide that if Education Management LLC is no longer subject to the reporting requirements of Section 13 or Section 15(d) of the Securities Exchange Act of 1934, it will not be required to file reports with the Securities and Exchange Commission but instead will be required to distribute annual, quarterly and current reports to the trustee under the Indenture and hold a conference call within 20 business days of furnishing required annual and quarterly reports;
- an exchange agreement dated September 5, 2014 (the "Exchange Agreement"), pursuant to which the holders of 86% of the outstanding Cash Pay/PIK Notes exchanged their Cash Pay/PIK Notes for a like principal amount of new Senior PIK Toggle Notes due 2018 (the "Interim Notes" and together with the Cash Pay/PIK Notes, the "Notes"), whose terms are substantially similar to those of the Cash Pay/PIK Notes, except that their interest is payable entirely in kind for the two interest periods ending September 30, 2014 and March 30, 2015;
- a new indenture dated September 5, 2014 (the "New Indenture"), pursuant to which the Interim Notes were issued; and
- a Restructuring Support Agreement dated September 4, 2014 (the "RSA"), pursuant to which the Consenting Lenders, holders of in excess of 65% of the outstanding Notes (the "Consenting Noteholders"), certain of EDMC's swap counter-parties and holders of in excess of 72% of EDMC's outstanding common stock (the "Consenting Shareholders") agreed to support a comprehensive debt restructuring ("Debt Restructuring") as described below.

Pursuant to the Debt Restructuring:

- $150 million of revolving loans under the existing revolving credit facility will be repaid in cash at par, with such amount available for re-borrowing under a new revolving credit facility;
- the remaining portion of EDMC's $1.5 billion of outstanding indebtedness, including the Interim Notes, will be exchanged for two first lien senior secured term loans due July 2, 2020 in the aggregate principal amount of $400 million, mandatorily convertible preferred stock, optionally convertible preferred stock and warrants for common stock; and
- EDMC's current shareholders will retain their outstanding common stock, which in aggregate will equal 4% of EDMC's outstanding common stock after giving effect to the conversion of all of the preferred stock described above and subject to further dilution by a management incentive plan (the "MIP") and warrants (including those described in the next sentence) to be awarded pursuant to the Debt Restructuring. In addition, current shareholders will receive warrants for 5% of EDMC's common stock (subject to dilution by the MIP).

In connection with the RSA, EDMC commenced an exchange offer for the outstanding Notes on October 1, 2014 pursuant to which the Notes would be exchanged for a combination of mandatory convertible preferred stock of EDMC and warrants to purchase common stock of EDMC. On October 29, 2014, EDMC announced an extension of the termination date of the exchange offer until November 24, 2014 due to a lawsuit filed by holders of approximately $20 million of the Notes seeking to enjoin EDMC from engaging in an intercompany sale transaction which EDMC has stated it plans to use in the event that less than 100% of holders of Notes participate in the exchange offer.

In addition to these actions, management has developed a plan to reduce cash outflows in fiscal 2015 in order to maintain sufficient liquidity to allow EDMC to meet its obligations as they become due. While no assurance can be given that management's plan will be fully implemented in fiscal 2015, based on the agreements executed and management's projected cash flows for fiscal 2015, management believes that cash flow from operations and available cash on hand, supplemented from time to time with borrowings under the revolving credit facility, will provide adequate funds for ongoing operations, required debt service and other obligations as they become due during the next twelve months.

The accompanying financial statements have been prepared on the assumption that EDMC and the School will continue to operate as a going concern and do not include any adjustments that might result from EDMC and the School not being able to continue as a going concern. Accordingly, assets and liabilities of the School are recorded on the basis that the School will be able to realize its assets and discharge its liabilities in the normal course of business.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management bases these estimates on assumptions that it believes to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

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 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 sheets 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, except as noted in footnote two to the table below. This transfer generally occurs for the period of the academic term for which such funds were authorized, with no term being more than 16 weeks in length.

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

	2014	2013
Cash secured letters of credit (1)	$ 300	$ —
Title IV funds in excess of charges applied (2)	459	166
Total restricted cash	$ 759	$ 166

(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. Such cash is not available for any purpose other than to reimburse drawings under the letters of credit or to pay related fees and obligations. Refer to Note 3, "Governmental Regulations," 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. In addition, some states have similar requirements. Such funds received for courses that have not yet begun are recorded as restricted cash due to legal restrictions on the use of the funds and as advance payments on the School's balance sheets. 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.

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. The School derived approximately 89% and 91% of its net revenues from tuition and fees in the fiscal years ended June 30, 2014 and 2013, respectively.

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 are generally refundable and relate to payments received for future academic periods and are recorded as a current liability in the accompanying balance sheets.

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 Southern Association of Colleges and Schools Commission on Colleges (“SACSCOC”) and the School's institutional policies (collectively, “Refund Policies”). In the vast majority of situations, if a student withdrew from school after attending classes for at least approximately 50% of a term of instruction, he or she would not be eligible for any reduction in tuition under the School's Refund Policies. Accordingly, the student would have to pay the School the balance of tuition and fees that has not been received already either in the form of financial aid or payments from the student. However, if a student withdraws from school prior to attending classes for at least approximately 50% of a term of instruction, the School may reduce the amount of a student's obligation for tuition and fees based on a tiered approach under which, in general, 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's reported net revenues are net of any reduction in the student's obligation to the School that results from any applicable Refund Policy.

Based on the application of its Refund Policies, the School may be entitled to incremental revenue on the day the student withdraws from one of its schools. Prior to fiscal 2014, the School recorded this incremental revenue, related student receivable and an estimate of the amount it did not expect to collect as bad debt expense during the fiscal quarter a student withdrew. Effective in fiscal 2014, the School reassesses collectability when a student withdraws from the institution (i.e., is no longer enrolled) and records this incremental revenue as it receives the related cash. This correction in policy had the effect of reducing net revenues and student receivables by $0.4 million and bad debt expense and the corresponding allowance for doubtful accounts by $0.3 million, which resulted in a decrease to earnings before taxes of less than $0.1 million in the fiscal year ended June 30, 2014. Prior year amounts were not corrected because the effects were not material.

Student Receivables

The School records student receivables at cost less an estimated allowance for doubtful accounts, which is determined on a quarterly basis based on the likelihood of collection considering students' enrollment status and historical payment experience. Historical collection experience is analyzed by disaggregating the student receivable balances based on predominant risk characteristics, such as whether the student is currently in-school, recently withdrew from school, or has not made a payment for a longer period of time. This level of disaggregation of student receivables results in individual pools of receivables which management believes appropriately differentiates credit risk in the portfolio and provides a reasonable basis to compute the estimate of loss. 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 a collection agency. Student accounts that have been placed with a collection agency are almost fully reserved and are written off after collection attempts have been unsuccessful.

During fiscal 2013, the School reduced the number of days since a student last paid after which accounts placed with a collection agency are written off. This change had no impact on the statement of operations or net student receivables as the applicable accounts were already fully reserved. Refer to Note 5, "Student Receivables," for more information.

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 contain escalation clauses under which, if fixed and determinable, rent expense is recognized on a straight-line basis over the lives of the leases, which generally range from ten to 11 years with one or more renewal options. For leases with renewal options, the School records rent expense over the original lease term, exclusive of the renewal period. When a renewal occurs, the School records rent expense over the new lease term.

Property and Equipment

Property and equipment is recorded at cost less accumulated depreciation. The School's property and equipment is depreciated over estimated useful lives ranging from three to 11 years using the straight-line method, depending on the asset. Leasehold improvements are amortized using the straight-line method over the shorter of the remaining lease term, exclusive of any renewal periods, or their estimated useful lives. 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. Refer to Note 4, "Property and Equipment," for more information.

Net Investment of EDMC

The School participates in a cash management program operated by EDMC that allows EDMC to consolidate most cash from all its locations in order to maximize investment income. In addition, 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 member's equity as part of the net investment of EDMC in the balance sheets as there is no formal repayment schedule related to this amount. The net investment of EDMC balance also includes contributed capital.

Costs and Expenses

Educational services expense consists primarily of costs related to the development, delivery and administration of the School's education programs. Major cost components are faculty compensation, administrative salaries, facility occupancy costs, bad debt expense, costs of educational materials, information systems costs and support services provided by The Center as described in Note 7, "Related-Party Transactions."

General and administrative expense 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, which are expensed as incurred and classified as general and administrative expense in the statements of operations, were $3.2 million in each of the fiscal years ended June 30, 2014 and 2013.

Contingencies

The School accrues for contingent obligations when it is probable that a liability has been incurred and the amount is reasonably estimable. As facts concerning contingencies become known, management reassesses its position and makes appropriate adjustments to its financial statements.

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 (including the measurement of any necessary valuation allowance) in the accompanying statements of operations is calculated on a carve-out 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 not deductible for tax purposes. State taxes are accrued and reported to the states where the School provides services.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers." The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is not permitted. The School is currently evaluating the impact that the standard will have on its financial condition, results of operations, and disclosures.

Subsequent Events

The School has evaluated subsequent events through November 3, 2014, the date through which these financial statements were available to be issued.

3. GOVERNMENTAL REGULATIONS

Most of the students at the School rely, at least in part, on financial assistance to pay for the cost of their education. In the United States, the largest sources of such support are the federal student aid programs under Title IV of the Higher Education Act of 1965, as amended ("HEA"). Additional sources of funds include other federal grant programs, state grant and loan programs, private loan programs and institutional grants and scholarships. To provide students access to financial assistance resources available through Title IV programs, a school must be (i) authorized to offer its programs of instruction by the relevant agency of the states in which it is physically located and comply with applicable state requirements regarding fully-online programs, (ii) institutionally accredited by an agency recognized by the U.S. Department of Education, and (iii) certified as an eligible institution by the U.S. Department of Education. In addition, the school must ensure that Title IV program funds are properly accounted for and disbursed in the correct amounts to eligible students and remain in compliance generally with the Title IV program regulations. Most of the U.S. Department of Education's requirements, such as the financial responsibility standards and the 90/10 Rule, which are described in greater detail below, are applied on an institutional basis, with an institution defined as a main campus and its additional locations, if any.

Financial Responsibility Standards. Education institutions participating in Title IV programs must satisfy a series of specific standards of financial responsibility. The U.S. Department of Education has adopted standards to determine an institution's financial responsibility to participate in Title IV programs. The regulations establish three ratios: (i) the equity ratio, intended to measure an institution's capital resources, ability to borrow and financial viability; (ii) the primary reserve ratio, intended to measure an institution's ability to support current operations from expendable resources; and (iii) the net income ratio, intended to measure an institution's profitability. Each ratio is calculated separately, based on the figures in the institution's most recent annual audited financial statements, and then weighted and combined to arrive at a single composite score. The composite score must be at least 1.5 in order for the institution to be deemed financially responsible without conditions or additional oversight. If an institution fails to meet any of these requirements, the U.S. Department of Education may set restrictions on the institution's eligibility to participate in Title IV programs. Institutions are evaluated for compliance with these requirements as part of the U.S. Department of Education's renewal of certification process and also annually as each institution submits its audited financial statements to the U.S. Department of Education. As of June 30, 2014 and 2013, the School satisfied the financial responsibility standards.

As of June 30, 2014, EDMC did not meet the required quantitative measures of financial responsibility on a consolidated basis due to the amount of indebtedness incurred and goodwill it recorded in connection with the Transaction. Accordingly, EDMC is required by the U.S. Department of Education to post a letter of credit and is subject to provisional certification and additional financial and cash monitoring of its disbursements of Title IV funds. The amount of this letter of credit was $302.2 million at June 30, 2014, which equals 15% of the total Title IV aid received by students attending EDMC's institutions during the fiscal year ended June 30, 2013.

The "90/10 Rule." Under a provision of the HEA commonly referred to as the "90/10 Rule," an institution will cease to be eligible to participate in Title IV programs if, on a cash accounting basis, more than 90% of its revenues for each of two consecutive fiscal years were derived from Title IV programs as calculated under the applicable regulations. If an institution loses its Title IV eligibility under the 90/10 Rule, it may not reapply for eligibility until the end of two fiscal years. Institutions that fail to satisfy the 90/10 Rule for one fiscal year are placed on provisional certification. The School was in compliance with the 90/10 Rule for the fiscal years ended June 30, 2014 and 2013.

4. PROPERTY AND EQUIPMENT

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

Asset Class	2014	2013
Land	$ —	$ 2,017
Buildings and improvements	—	4,892
Leasehold improvements	10,490	10,605
Technology and other equipment	7,147	7,438
Furniture and equipment	2,782	2,549
Library books	959	971
Construction in progress	3,800	729
Total	25,178	29,201
Accumulated depreciation	(19,534)	(22,288)
Property and equipment, net	$ 5,644	$ 6,913

The School's depreciation and amortization expense was $2.0 million in each of the fiscal years ended June 30, 2014 and 2013.

The School completed a sale-leaseback transaction with an unrelated third party in fiscal 2013 for net proceeds of $3.6 million classified as a financing activity in the statement of cash flows. EDMC guaranteed the lease, which is considered a form of continuing involvement that precludes sale-leaseback accounting; as a result, the sale was accounted for as a secured financing transaction. This resulted in the land and building fixed assets remaining on the School's balance sheet with the proceeds treated as a financing liability. Rent payments are treated as an interest expense and were $0.4 million and $0.3 million in the fiscal years ended June 30, 2014 and 2013, respectively. Because the net proceeds were lower than the $4.6 million net book value of the land and building fixed assets, the School recorded an impairment charge of $1.0 million during fiscal 2013 at the time of the transaction. The transaction qualified as a sale upon the expiration of the lease in June 2014, which resulted in the derecognition of the land and building fixed assets and financing obligation, yielding a gain of $0.3 million recorded in educational services expense in the fiscal 2014 statement of operations.

5. STUDENT RECEIVABLES

The School offers three types of financial arrangements to its students to assist with the obligation associated with tuition and fees, which helps students fund the difference between total tuition and fees and the amount covered by various sources of financial aid, including amounts awarded under Title IV programs, private loans and cash payments: due and payable amounts; a tuition payment plan; and lines of credit. Due and payable amounts are short-term extensions of credit for typically small balances which are repayable upon demand by the School. Tuition payment plans are short-term credit extensions for 12 months or less. Lines of credit are extensions of credit which include a monthly minimum payment amount and permit students to repay amounts borrowed over a period of up to 42 months after graduation. During fiscal 2013, the School extended the repayment period for financing made available to students from a maximum of 36 months beyond graduation to a maximum of 42 months beyond graduation. Student receivables include $0.2 million (net of $0.2 million allowance) and $0.2 million (net of $0.3 million allowance) at June 30, 2014 and 2013, respectively, recorded in other long-term assets on the accompanying balance sheets related to lines of credit to students for amounts due beyond one year.

The School monitors its student receivables based on enrollment status. Receivables from out-of-school students are reserved for at a higher rate than receivables from students that are in-school. Receivables from out-of-school students include balances in collections, which are reserved for at a higher rate than balances not in collections. The gross current and non-current student receivables by student status were as follows at June 30 (in thousands):

	2014	2013
In-school	$ 1,424	$ 1,656
Out-of-school	1,871	2,271
Gross student receivables	$ 3,295	$ 3,927

A roll forward of the School's total allowance for doubtful accounts from June 30, 2012 to June 30, 2014 is as follows (in thousands):

Balance June 30, 2012	$	2,945
Bad debt expense		1,386
Amounts written off		(2,328)
Balance June 30, 2013		2,003
Bad debt expense		1,150
Amounts written off		(1,594)
Balance June 30, 2014	$	1,559

The amounts set forth above are recorded within student receivables, net and other long-term assets on the balance sheets. Recoveries of amounts previously written off were not significant in any period presented. Refer to Note 2, "Summary of Significant Accounting Policies," for more information.

EDMC allocated loan fees expense to the School of $0.4 million, which is included in educational services expense in the statement of operations, in the fiscal year ended June 30, 2014 for students participating in a lending program under which EDMC purchases loans awarded and disbursed to its students from a private lender. Loan fees expense was not material in fiscal 2013.

6. ACCRUED LIABILITIES

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

	2014		2013	
Employee compensation	$	261	$	352
Capital expenditures		248		436
Other		112		103
Total accrued liabilities	$	621	$	891

7. 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 enrollment, which estimate the amount that the School would pay an unaffiliated entity for these services. In addition, during fiscal 2014, EDMC created "The Center," which provides support services to all of its campuses through the centralization and automation of certain non-student facing activities, including financial aid packaging, the qualification and transfer of prospective students to school admissions teams, student billing services, certain registrar services, support call center services for students and employees, and remote student advising services. The Center allocates costs to each campus based primarily on the level of transaction volume.

Total costs allocated by The Center and EDMC to the School were approximately $4.0 million and $4.3 million in the fiscal years ended June 30, 2014 and 2013, respectively, which are included in general and administrative expense and educational services expense in the statements of operations.

Building

The School owned its building throughout fiscal 2013 prior to the sale-leaseback transaction described in Note 4, "Property and Equipment." As a result, EDMC allocated $0.2 million of interest expense from its consolidated debt to the School during the fiscal year ended June 30, 2013.

Leases

EDMC guarantees all of the School's lease agreements, under which EDMC assumes all obligations, liabilities, and duties of the School in the event of default. The guarantees are in place through the full terms of the leases, including any extensions or renewals. Refer to Note 9, "Commitments and Contingencies," for the School's remaining lease obligations.

Cash Management

Refer to Note 2, "Summary of Significant Accounting Policies," under "Net Investment of EDMC" for information regarding the School's cash management program.

8. INCOME TAXES

Income tax expense includes current and deferred taxes, as reflected below (in thousands):

	2014	2013
Current taxes:		
Federal	$ 1,427	$ 1,867
State	(23)	60
Total current tax provision	1,404	1,927
Deferred tax (benefit) expense	2,114	(155)
Income tax expense	$ 3,518	$ 1,772

As result of the EDMC consolidated group being in a historical cumulative loss position, it was concluded that the group may not fully recognize the benefit of its deferred tax assets. As such, valuation allowances were recorded against certain federal and state deferred tax assets of the EDMC consolidated group. The deferred tax assets presented in accompanying balance sheets reflect the impact of the recording of such valuation allowances against the School's deferred tax assets.

Deferred income taxes are presented in the balance sheets for all significant temporary differences between tax and financial reporting, which consist primarily of property and equipment, the allowance for doubtful accounts, deferred rent and start-up costs. Net deferred income tax assets and liabilities consisted of the following at June 30 (in thousands):

	2014	2013
Gross current deferred tax assets	$ 890	$ 820
Valuation allowance	(646)	—
Total current deferred tax assets	$ 244	$ 820
Total noncurrent deferred tax assets	$ 3,576	$ 2,276
Valuation allowance	(2,405)	—
Total noncurrent deferred tax assets	1,171	2,276
Noncurrent deferred tax liabilities	153	23
Total net noncurrent deferred tax assets	$ 1,018	$ 2,253

9. 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 case, which is pending in federal district court in the Western District of Pennsylvania, relates to whether EDMC's 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 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, which included both quantitative and qualitative factors, violated the incentive compensation rule and allowing common law claims and the allegations that the plan as implemented violated the rule to continue to discovery. On May 8, 2014, the Court denied EDMC's motion for summary judgment based on a statistical analysis of the salary adjustments for admissions representatives under the compensation plan. EDMC believes the case to be without merit and intends to vigorously defend itself. From time to time,EDMC engages in settlement discussions with respect to this case. At this time,EDMC is unable to estimate the amount of any reasonably possible loss related to this matter because of the status of current settlement negotiations and the fact that EDMC is only willing to settle the case if a settlement can be negotiated in an amount that EDMC believes is reasonable. There can be no assurance that the settlement conversations will lead to a settlement acceptable to all parties and approved by all parties. There can also be no assurance that any settlement will be within amounts currently accrued or be covered by insurance or not be material to EDMC.

In July 2014, our excess insurer filed a declaratory judgment action in federal district court in the Western District of Pennsylvania seeking a ruling that it has no liability to provide coverage to us in connection with the Washington and other qui tam litigation matters. Because of the many questions of fact and law that may arise, the outcome of this legal proceeding is uncertain at this point.

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 federal district court 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.

In August 2013, the parties to the action, along with the U.S. Department of Justice, participated in a private mediation in which the relator and defendants reached an agreement in principle regarding the financial terms of a potential settlement. The agreement between the parties remains subject to approval by the U.S. Department of Justice. Significant terms remain to be negotiated, and there is no certainty that a final agreement will be reached. The settlement amount agreed to by the parties under the terms of the agreement in principle would be paid by EDMC's insurer and EDMC would pay an immaterial amount of attorneys' fees incurred by the relator. The ultimate dismissal of the action, should a final settlement be reached, is subject to the Court's approval.

In the course of settlement discussions regarding the *Sobek* matter, the U.S. Department of Justice informed EDMC that it is the subject of an investigation related to a claim under the federal false claims act by the U.S. Attorney’s Office for the Middle District of Tennessee. Additionally, in March 2014 the U.S. Department of Justice informed EDMC that it is the subject of an investigation related to a claim under the federal false claims act by the U.S. Attorney's Office for the Western District of Pennsylvania. EDMC plans to cooperate with the U.S. Department of Justice with regard to these matters. However, EDMC cannot predict the eventual scope, duration or outcome of the investigations at this time nor can it estimate any amount of a reasonably possible loss related to these investigations because of their status.

Shareholder Derivative Lawsuits

On May 21, 2012, a shareholder derivative class action captioned *Oklahoma Law Enforcement Retirement System v. Todd S. Nelson, et al.* was filed against the directors of EDMC in state court located in Pittsburgh, PA. EDMC is named as a nominal defendant in the case. The complaint alleges that the defendants violated their fiduciary obligations to EDMC's shareholders due to EDMC's violation of the U.S. Department of Education's prohibition on paying incentive compensation to admissions representatives, engaging in improper recruiting tactics in violation of Title IV of the HEA and accrediting agency standards, improper classification of job placement data for graduates of its schools and failure to satisfy the U.S. Department of Education's financial responsibility standards. EDMC previously received two demand letters from the plaintiff which were investigated by a Special Litigation Committee of the EDMC Board of Directors and found to be without merit.

EDMC and the director defendants filed a motion to dismiss the case with prejudice on August 13, 2012. In response, the plaintiffs filed an amended complaint making substantially the same allegations as the initial complaint on September 27, 2012. EDMC and the director defendants filed a motion to dismiss the amended complaint on October 17, 2012. On July 16, 2013, the Court dismissed the claims that EDMC engaged in improper recruiting tactics and mismanaged EDMC's financial well-being with prejudice and found that the Special Litigation Committee could conduct a supplemental investigation of the plaintiff's claims related to incentive compensation paid to admissions representatives and graduate placement statistics. The Special Litigation Committee filed supplemental reports on October 15, 2013, January 9, 2014 and February 28, 2014, finding no support for the incentive compensation and graduate placement statistic claims. The Court held a hearing on the defendants' supplemental motion to dismiss the case on January 29, 2014 and granted the plaintiff’s request for limited discovery on June 11, 2014.

On August 3, 2012, a shareholder derivative class action captioned *Stephen Bushansky v. Todd S. Nelson, et al.* was filed against certain of the directors of EDMC in federal district court in the Western District of Pennsylvania. EDMC is named as a nominal defendant in the case. The complaint alleges that the defendants violated their fiduciary obligations to EDMC's shareholders due to EDMC's use of improper recruiting, enrollment admission and financial aid practices and violation of the U.S. Department of Education's prohibition on the payment of incentive compensation to admissions representatives. EDMC previously received a demand letter from the plaintiff which was investigated by a Special Litigation Committee of the EDMC Board of Directors and found to be without merit. EDMC believes that the claims set forth in the complaint are without merit and intends to vigorously defend itself.

EDMC and the named director defendants filed a motion to stay the litigation pending the resolution of the *Oklahoma Law Enforcement Retirement System* shareholder derivative case or, alternatively, dismiss the case on October 19, 2012. On August 5, 2013, the Court granted EDMC's motion to stay the case in light of the ruling on the defendants' motion to dismiss the *Oklahoma Law Enforcement Retirement System* case.

Because of the many questions of fact and law that may arise, the outcome of these legal proceedings is uncertain at this point. Based on the information presently available, EDMC cannot reasonably estimate a range of loss for these actions and, accordingly, has not accrued any liability associated with these actions.

Securities Class Action

On September 19, 2014, a securities class action complaint captioned *Robb v. Education Management Corporation*, et. al was filed against EDMC and certain of its executive officers. The complaint alleges violations of Sections 10(b) and 20(a) of the Exchange Act of 1934 and rule 10b-5 promulgated thereunder due to allegedly materially false and misleading statements made by EDMC during the period of August 8, 2012 through September 16, 2014 in connection with EDMC's filings with the SEC, press releases and other statements and documents. Because of the many questions of fact and law that may arise, the outcome of this legal proceeding is uncertain at this point. Based on the information available to us at present, we cannot reasonably estimate a range of loss for this action and, accordingly, we have not accrued any liability associated with this action.

State Attorneys General Investigations

In October 2010, Argosy University 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

EDMC is a defendant in certain other legal proceedings arising out of the conduct of its business. Additionally, EDMC is subject to compliance reviews by various state and federal agencies which provide student financial aid programs, with respect to which noncompliance may result in liability for educational benefits paid as well as fines and other corrective action. In the opinion of management, based upon an investigation of these matters and discussion with legal counsel, the ultimate outcome of such other legal proceedings and compliance reviews, individually and in the aggregate, is not expected to have a material adverse effect on EDMC's consolidated financial position, results of operations or liquidity. At June 30, 2014, 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.

Lease Commitments

The School leases its facilities under various operating leases that expire on various dates through 2024. Rent expense under these leases was approximately $3.7 million and $4.1 million in the fiscal years ended June 30, 2014 and 2013, respectively.

The minimum future cash commitments for the fiscal years ending June 30 under the School's noncancelable, long-term operating leases, which include the lease entered into in connection with the sale-leaseback transaction described in Note 4, "Property and Equipment," are as follows at June 30, 2014 (in thousands):

Fiscal Year:	
2015	$ 3,264
2016	2,487
2017	2,535
2018	2,479
2019	2,675
Thereafter	14,039

10. EMPLOYEE BENEFIT PLANS

At June 30, 2014, EDMC sponsors a 401(k) plan that covers substantially all employees under which EDMC matches employee contributions to the retirement plan dollar for dollar up to 6%. All participants in the plan vest in EDMC’s matching contributions immediately. The School's expense relating to this plan was $0.4 million in each of the fiscal years ended June 30, 2014 and 2013, which is presented in educational services expense in the statements of operations. Effective September 20, 2014, EDMC suspended its matching program indefinitely.

Supplemental Information

The Art Institute of Ft. Lauderdale, Inc.

Supplemental Schedule of 90/10 Ratios and Composite Scores

(Dollars in thousands)

For the Fiscal Years Ended June 30, 2014 and 2013

	Fiscal 2014	Fiscal 2013
90/10 Ratio:		
Numerator	$ 24,902	$ 29,336
Denominator	$ 34,745	$ 41,042
90/10 Ratio	71.7%	71.5%
Composite Score	2.8	3.0

Refer to Note 3, "Governmental Regulations," of the accompanying financial statements for a definition of the 90/10 Rule and a description of how the composite score is calculated.

The Art Institute of Ft. Lauderdale, Inc.

Supplemental Schedule of Expenditures of State Financial Assistance

For the Fiscal Year Ended June 30, 2014

	CSFA No.	Grant No.	Expenditures	Transfers to Subrecipients
FLORIDA DEPARTMENT OF EDUCATION				
Direct Projects:				
Florida Student Assistance Grant	48.054		$ 722,426	$ —
Florida Children and Spouses of Deceased or Disabled Veterans and Service Members Scholarship	48.055		9,556	—
Florida Bright Futures Scholarship	48.059		52,017	—
TOTAL DIRECT PROJECTS			$ 783,999	$ —
Indirect Projects:			$ —	$ —
Passed Through:			$ —	$ —
TOTAL FLORIDA DEPARTMENT OF EDUCATION			$ 783,999	$ —
TOTAL EXPENDITURES OF STATE FINANCIAL ASSISTANCE			$ 783,999	$ —

NOTE 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 69I-5, Rules of the Florida Department of Financial Services, Florida Administrative Code, *Schedule of Expenditures of State Financial Assistance.*

The Art Institute of Ft. Lauderdale, Inc.

Supplemental Schedule of Expenditures of State Financial Assistance

For the Fiscal Year Ended June 30, 2013

	CSFA No.	Grant No.	Expenditures	Transfers to Subrecipients
FLORIDA DEPARTMENT OF EDUCATION				
Direct Projects:				
Florida Student Assistance Grant	48.054		$ 738,287	$ —
Florida Children and Spouses of Deceased or Disabled Veterans and Service Members Scholarship	48.055		9,948	—
Florida Bright Futures Scholarship	48.059		77,895	—
TOTAL DIRECT PROJECTS			$ 826,130	$ —
Indirect Projects:			$ —	$ —
Passed Through:			$ —	$ —
TOTAL FLORIDA DEPARTMENT OF EDUCATION			$ 826,130	$ —
TOTAL EXPENDITURES OF STATE FINANCIAL ASSISTANCE			$ 826,130	$ —

NOTE 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 69I-5, Rules of the Florida Department of Financial Services, Florida Administrative Code, *Schedule of Expenditures of State Financial Assistance.*

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Building a better working world

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

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

We have audited, 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, the financial statements of The Art Institute of Ft. Lauderdale, Inc., which comprise the balance sheets as of June 30, 2014 and 2013, and the related statements of operations, shareholder's equity, and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated November 3, 2014.

Internal Control Over Financial Reporting

In planning and performing our audits of the financial statements, we considered The Art Institute of Ft. Lauderdale, Inc.'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of The Art Institute of Ft. Lauderdale, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of The Art Institute of Ft. Lauderdale, Inc.'s internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Responses, we identified a deficiency in internal control that we consider to be a material weakness.

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. We consider the deficiency described in the accompanying Schedule of Findings and Responses to be a material weakness.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention to those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether The Art Institute of Ft. Lauderdale, Inc.'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*.

The Art Institute of Ft. Lauderdale, Inc.'s Response to Findings

The Art Institute of Ft. Lauderdale, Inc.'s response to the findings identified in our audit is described in the accompanying Schedule of Findings and Responses. The Art Institute of Ft. Lauderdale, Inc.'s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

November 3, 2014

The Art Institute of Ft. Lauderdale, Inc.

Schedule of Findings and Responses

Year Ended June 30, 2014

Criteria:	The Art Institute of Ft. Lauderdale Inc.'s (the “School”) financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP").
Condition:	The School did not maintain effective controls to ensure the proper selection of its revenue recognition policy. Personnel with the appropriate level of accounting knowledge, experience and training commensurate with the financial reporting requirements did not analyze certain accounting issues at the level of detail required to ensure proper application of GAAP in certain circumstances. Specifically, the process for analyzing the collectibility criterion for revenue recognition was not designed to assess collectibility, on a student-by-student basis, throughout the period revenue was recognized by the School.
Cause:	The School’s lack of adequate internal controls over the selection of the revenue recognition policy did not appropriately reflect revenue recorded upon a student’s withdrawal from school during a term of instruction.
Effect:	The lack of adequately designed controls over the proper selection of its revenue recognition policy could result in errors within the School’s financial statements that could be material.
Recommendation:	We recommend that the School implement controls over the selection of the revenue recognition policy to appropriately assess collectibility, on a student-by-student basis, throughout the period revenue was recognized by the School.
Views of responsible officials planned corrective actions:	Management is committed to remediating the control deficiency that constitutes the material weakness by implementing changes to its internal control over financial reporting. Management is responsible for implementing changes and improvements in the internal control over financial reporting and for remediating the control deficiency that gave rise to the material weakness. Management plans to achieve this primarily through instituting additional controls within the revenue recognition process. Management also plans to undertake additional review processes to ensure the related significant accounting policies are implemented and applied properly on a consistent basis throughout the School. Management believes these measures will remediate the control deficiency. However, to date, management has not completed the corrective actions that it believes are necessary. As management continues to evaluate and work to remediate the control deficiency that gave rise to the material weakness, it may determine to take additional measures to address the control deficiency.