

Ai MIAMI INTERNATIONAL UNIVERSITY OF ART & DESIGN

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

Year Ended June 30, 2017

R.D. HOAG & ASSOCIATES, LLC
Certified Public Accountants

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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR 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
Ai Miami International University of Art & Design

Report on Compliance for Each Major State Project

We have audited Ai Miami International University of Art & Design'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 Ai Miami International University of Art & Design's major State projects for the year ended June 30, 2017. Ai Miami International University of Art & Design'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 State statutes, regulations, and the terms and conditions applicable to its State projects.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Ai Miami International University of Art & Design'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 Ai Miami International University of Art & Design'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 Ai Miami International University of Art & Design's compliance.



Opinion on Each Major State Project

In our opinion, Ai Miami International University of Art & Design 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, 2017.

Report on Internal Control Over Compliance

Management of Ai Miami International University of Art & Design 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 Ai Miami International University of Art & Design'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 Ai Miami International University of Art & Design's internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Ai Miami International University of Art & Design'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.

R J / Kay + Associates, LLC

March 23, 2018

Ai MIAMI INTERNATIONAL UNIVERSITY OF ART & DESIGN

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS -
STATE PROJECTS**

Year Ended June 30, 2017

A. SUMMARY OF AUDITORS' RESULTS

1. The combined financial statements of Ai Miami International University of Art & Design were audited by another independent registered public accounting firm whose report dated October 27, 2017 expressed an unmodified opinion.
2. The combined financial statements of Ai Miami International University of Art & Design were audited by another independent registered public accounting firm whose "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*" dated October 27, 2017 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*.
3. The independent auditor's report on compliance for each major State project for Ai Miami International University of Art & Design expresses an unmodified opinion.
4. The audit of the major state projects of Ai Miami International University of Art & Design disclosed no findings or questioned costs required to be reported under Chapter 10.650, *Rules of the Auditor General*.
5. The programs tested as major state projects included:

Florida Department of Education Student Financial Assistance Programs:
 - a. Florida Access to Better Learning and Education Grant - CSFA #48.017
 - b. Florida Student Assistance Grant - CSFA #48.054
6. The dollar threshold for distinguishing between Type A and Type B projects was \$300,000 for major State projects.
7. No management letter is required because there were no matters related to major State projects required to be reported in the management letter.
8. No Summary Schedule of Prior Audit Findings is required because there were no prior audit findings related to major State projects.
9. No Corrective Action Plan is required because there were no findings required to be reported under Chapter 10.650, *Rules of the Auditor General*.

COMBINED FINANCIAL STATEMENTS AND
SUPPLEMENTAL INFORMATION

Miami International University of Art & Design (Combined)
Fiscal Years Ended June 30, 2017 and 2016
With Report of Independent Auditors

Miami International University of Art & Design (Combined)
Combined Financial Statements and Supplemental Information
Fiscal Years Ended June 30, 2017 and 2016

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Report of Independent Auditors

The Member and Board of Trustees of
Miami International University of Art & Design (Combined)

We have audited the accompanying combined financial statements of Miami International University of Art & Design (Combined), which comprise the combined balance sheets as of June 30, 2017 and 2016, and the related combined statements of operations, shareholder's equity and cash flows for the years then ended, and the related notes to the combined 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 combined financial position of Miami International University of Art & Design (Combined) at June 30, 2017 and 2016, and the combined results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Miami International University of Art & Design (Combined) Ability to Continue as a Going Concern

The accompanying combined financial statements have been prepared assuming that the Miami International University of Art & Design (Combined) will continue as a going concern. As discussed in Note 2 to the combined financial statements, the Miami International University of Art & Design (Combined) relies on its parent company, Education Management Corporation and Subsidiaries (EDMC), for cash management and coordinating and support services. EDMC has experienced deteriorating results from operations, which combined with its current liquidity position, raises substantial doubt about Miami International University of Art & Design's (Combined) ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The combined financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the combined financial statements as a whole. The accompanying combining financial statement schedules, 90/10 ratios and composite scores, and supplemental schedule of expenditures of state financial assistance are presented for purposes of additional analysis and are not a required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined 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 combined 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 October 27, 2017 on our consideration of Miami International University of Art & Design (Combined)'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 Miami International University of Art & Design (Combined)'s internal control over financial reporting and compliance.



October 27, 2017

Miami International University of Art & Design (Combined)
 Combined Balance Sheets
 (In thousands)

	June 30,	
	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 21,893	\$ 35,453
Restricted cash	3,750	10,521
Student accounts receivable, net of allowance of \$5,999 and \$9,070	5,413	7,356
Notes, advances, and other receivables	165	126
Other current assets	207	378
Total current assets	31,428	53,834
Property and equipment, net	2,932	4,811
Other long-term assets	1,500	1,999
Intangible assets, net	79	145
Goodwill	8,353	8,353
Total assets	\$ 44,292	\$ 69,142
Liabilities and shareholder's equity		
Current liabilities:		
Accounts payable	\$ 364	\$ 332
Accrued liabilities	1,823	2,688
Advance payments	2,950	3,043
Unearned tuition	5,513	6,361
Total current liabilities	10,650	12,424
Deferred income taxes	2,924	2,924
Deferred rent	7,494	8,136
Shareholder's equity:		
Net investment of EDMC (Note 2)	(97,367)	(77,279)
Retained earnings	120,591	122,937
Total shareholder's equity	23,224	45,658
Total liabilities and shareholder's equity	\$ 44,292	\$ 69,142

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

Miami International University of Art & Design (Combined)
 Combined Statements of Operations
(In thousands)

	For the Fiscal Year Ended June 30,	
	2017	2016
Net revenues	\$ 75,609	\$ 98,490
Costs and expenses:		
Educational services	55,395	66,998
General and administrative	19,833	30,064
Long-lived asset impairments	—	14,764
Depreciation and amortization	2,685	3,021
Total costs and expenses	<u>77,913</u>	<u>114,847</u>
Loss before income taxes	(2,304)	(16,357)
Income tax (benefit) expense	42	(7,755)
Net loss	<u>\$ (2,346)</u>	<u>\$ (8,602)</u>

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

Miami International University of Art & Design (Combined)
 Combined Statements of Shareholder's Equity
(In thousands)

	Net Investment of EDMC	Retained Earnings	Total Shareholder's Equity
Balance, June 30, 2015	\$ (83,923)	\$ 131,539	\$ 47,616
Increase in net investment of EDMC	6,644	—	6,644
Net loss	—	(8,602)	(8,602)
Balance, June 30, 2016	(77,279)	122,937	45,658
Decrease in net investment of EDMC	(20,088)	—	(20,088)
Net loss	—	(2,346)	(2,346)
Balance, June 30, 2017	\$ (97,367)	\$ 120,591	\$ 23,224

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

Miami International University of Art & Design (Combined)
 Combined Statements of Cash Flows
 (In thousands)

	For the Fiscal Year Ended	
	June 30,	
	2017	2016
Cash flows from operating activities:		
Net loss	\$ (2,346)	\$ (8,602)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	2,685	3,021
Bad debt expense	5,248	8,000
Non-cash adjustments related to deferred rent	(873)	(784)
Long-lived asset impairments	—	14,764
Deferred income taxes	—	(6,936)
Changes in assets and liabilities:		
Restricted cash	6,771	538
Receivables	(2,845)	(4,655)
Other assets	171	154
Accounts payable	31	(32)
Accrued liabilities	(633)	1,040
Unearned tuition	(848)	2,707
Advance payments	(93)	421
Total adjustments	<u>9,614</u>	<u>18,238</u>
Net cash flows provided by operating activities	<u>7,268</u>	<u>9,636</u>
Cash flows from investing activities:		
Expenditures for long-lived assets	(740)	(853)
Net cash flows used in investing activities	<u>(740)</u>	<u>(853)</u>
Cash flows from financing activities:		
Increase (decrease) in net investment of EDMC	(20,088)	6,644
Net cash flows provided by (used in) financing activities	<u>(20,088)</u>	<u>6,644</u>
Net increase (decrease) in cash and cash equivalents	(13,560)	15,427
Cash and cash equivalents, beginning of year	35,453	20,026
Cash and cash equivalents, end of year	<u>\$ 21,893</u>	<u>\$ 35,453</u>
	As of June 30,	
	2017	2016
Supplemental disclosure of cash flow information		
Capital expenditures in current liabilities	\$ 30	\$ 29

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

Miami International University of Art & Design (Combined)

Notes to Combined Financial Statements

1. OWNERSHIP, OPERATIONS, AND GOVERNANCE

Miami International University of Art & Design, The Art Institute of Tampa, The Art Institute of Jacksonville, The Art Institute of Dallas, The Art Institute of Charlotte, The Art Institute of Raleigh - Durham, and The Art Institute of Fort Worth (collectively, "Miami International University of Art & Design (Combined)" or the "School") are 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 Accessory Design, Fashion Merchandising, Fashion Design, Interior Design, Graphic & Web Design, Digital Filmmaking & Video Production, Film, Media Arts & Animation, Audio Production, Baking & Pastry, Culinary Arts, Culinary Management, Digital Photography, Advertising, Visual Arts, Computer Animation, Game Art & Design, and Visual Effects & Motion Graphics. 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 45 months.

On January 18, 2017, EDMC entered into an Asset Purchase Agreement (the "DCF Purchase Agreement") with Dream Center Foundation ("DCF"), a not for profit entity, and certain of its newly formed subsidiaries (collectively with DCF, the "Buyers") for the sale of substantially all of the assets of South University, Argosy University, all of the "core" Art Institutes school locations which are not currently being taught-out, and certain assets used by The Center and our corporate services (the "DCF Sale Transaction"). On February 24, 2017, the Sellers and the Buyers entered into an Amended and Restated Asset Purchase Agreement to effectuate certain agreed revisions to the terms of the DCF Purchase Agreement, which was amended on July 20, 2017 and October 13, 2017 (the "Restated DCF Purchase Agreement"). The initial closing of the Restated DCF Purchase Agreement occurred on October 17, 2017 (the "Closing Date").

Revisions and Reclassifications

During fiscal 2017, The Art Institute of Dallas, The Art Institute of Charlotte, The Art Institute of Raleigh-Durham, and The Art Institute of Fort Worth were added to Miami International University of Art & Design (Combined) through a re-alignment of entities under common control. The impact from the addition of the aforementioned campuses from the School's financial statements was \$48.5 million and \$(1.7) million respectively, to net revenues and net income for the fiscal year ended June 30, 2016, and \$13.2 million to member's equity as of June 30, 2016. Additionally, as a result of these changes, the composite score, as defined in Note 3 "Governmental Regulations," was recalculated for the Miami International University of Art & Design (Combined) to reflect the new fiscal 2017 presentation resulting in an increase to the composite score from 1.8 to 1.9. The composite scores for the individual school locations did not change as a result of the re-alignment.

Certain reclassifications of prior year data have been made to conform to the fiscal 2017 presentation, with no effect on previously reported net income or shareholder's equity.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation (Including Going Concern)

The combined balance sheet includes the accounts of the School. All intercompany transactions and balances have been eliminated. Unless otherwise specified, any reference to a "year" is to a fiscal year ended June 30.

As of June 30, 2017, the School adopted the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 205-40, Presentation of Financial Statements - Going Concern (ASC 205-40), which requires management to assess the School's ability to continue as a going concern for one year after the date the financial statements are issued. Under ASC 205-40, management has the responsibility to evaluate whether conditions and/or events raise substantial doubt about the School's ability to meet its future financial obligations as they become due within one year after the date that the financial statements are issued. As required by this standard, management's evaluation shall initially not take into consideration the potential

mitigating effects of management's plans that have not been fully implemented as of the date the financial statements are issued.

The School, which relies on its parent company EDMC for cash management and coordinating and support services, as discussed in Note 8, "Related-Party Transactions," has concluded that the following conditions surrounding EDMC raise substantial doubt about the School's ability to meet its financial obligations as they become due:

- EDMC has experienced deteriorating results from operations over the last several fiscal years due primarily to declining student enrollment at its schools, including due to the impact of the announced teach-out of a significant number of school locations. Net cash used in EDMC's operating activities was \$88.7 million during the year ended June 30, 2017 compared to cash provided by operations of \$8.3 million in the prior fiscal year.
- EDMC's results during fiscal 2018 may continue to decline primarily due to declining student enrollment and may further be negatively impacted by the gainful employment regulation promulgated by the U.S. Department of Education. Final results for fiscal 2015 were released by the U.S. Department of Education on January 9, 2017. As a result, EDMC's schools were required to provide warnings to enrolled and prospective students with respect to gainful employment programs considered under the regulations to be in jeopardy of losing Title IV eligibility beginning on February 8, 2017.
- At June 30, 2017, EDMC had \$255.2 million of cash and cash equivalents on hand. EDMC has a history of net losses (\$167.3 million in fiscal 2017) and cash used in operations (\$88.7 million in fiscal 2017). EDMC expects to continue to incur negative cash flows. As a result of the agreed upon sale of all of EDMC's schools currently enrolling new students and other cost saving initiatives, EDMC anticipates that it has sufficient liquidity to meet its operational expenses and capital expenditures through the second quarter of fiscal year 2018.

EDMC and the School have taken the following actions to mitigate this risk:

- In October 2017, EDMC closed an agreement to sell all its remaining school locations which are currently accepting new students, including Miami International University of Art & Design (Combined), for cash proceeds of \$25 million, deferred payments of approximately \$10 million, and a working capital adjustment payment of \$10 million. The cash portion of the purchase price will be adjusted at closing based on the difference between the estimated closing net working capital of the acquired businesses and a target amount of \$0, with a post-closing adjustment to be determined based on the difference between final closing net working capital and a target amount of negative \$10 million.
- EDMC continues to implement cost reduction actions to reduce cash outflows in order to maintain sufficient liquidity to allow it to meet its obligations as they become due.

The accompanying combined financial statements have been prepared on a going-concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The accompanying combined financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from uncertainty related to the School's ability to continue as a going concern.

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, 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 combined 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):

	2017	2016
Cash secured letters of credit ⁽¹⁾	\$ 3,400	\$ 10,200
Title IV funds in excess of charges applied ⁽²⁾	350	321
Total restricted cash	\$ 3,750	\$ 10,521

(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 combined 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 revenues are recorded net of student refunds and scholarships and 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 92% and 91% of its net revenues from tuition and fees in each of the fiscal years ended June 30, 2017 and 2016, 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 represent that portion of payments received but not earned and are recorded as a current liability in the accompanying combined balance sheet.

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. The School reassesses collectability when a student withdraws from the institution (i.e., is no longer enrolled) and records incremental revenue based on cash received.

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.

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 combined balance sheets. 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.

Most of the School's lease agreements include rent escalation clauses, which if fixed and determinable are recognized on a straight-line basis over the lives of the leases, which generally range from approximately ten to 15 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.

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 15 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 that the undiscounted cash flows estimated to be generated by those assets or asset groups are less than their carrying amounts. Events and circumstances that could trigger an impairment review include changes in the regulatory environment, deteriorating economic conditions or poor operating performance at individual campus locations. Any resulting impairment loss is measured as the difference between the fair value of the assets or asset groups and their carrying value with the loss recorded as an operating expense in the combined statement of operations in the period incurred. Refer to Note 4, "Property and Equipment," for more information.

Goodwill and Intangible Assets

The School was acquired by EDMC in fiscal 2002, and the transaction was accounted for as a business combination. Goodwill, which consists of the cost in excess of the fair value of the identifiable net assets acquired, was recorded in connection with EDMC's purchase. The School is required to perform a goodwill impairment test on an annual basis.

Goodwill is impaired when the carrying amount of the School's goodwill exceeds its fair value, as determined using the discounted cash flow method (income approach). If the results of the test indicate the carrying amount of the School is higher than its fair value, an impairment charge is recorded for the difference as an operating expense in the period incurred. Intangible assets primarily consist of curriculum, which is recorded at cost. The School uses the straight-line method of amortization for these intangible assets over an estimated two-year useful life.

Refer to Note 5, "Goodwill and Intangible Assets," for more information.

Art Grant

The Art Institutes introduced a new grant program in fiscal 2015 which provides a tuition discount for students who successfully complete 12 credits towards an associates or bachelor degree, enroll in and satisfy a minimum attendance period for the next term. The School records the discount on tuition for students who have enrolled in the Art Grant program on a proportional basis starting with the first credit earned, net of estimated breakage. If the student becomes ineligible, the School recognizes deferred revenue in the period in which ineligibility occurs. During fiscal years 2017 and 2016, the School recognized \$8.7 million and \$13.2 million, respectively in grants awarded to students participating in the Art Grant program. As of June 30, 2017 and 2016, a liability of \$5.5 million and \$6.4 million was recorded related to these grants, respectively, which is presented within unearned tuition.

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 shareholder's equity as part of the net investment of EDMC in the combined balance sheets as there is no formal repayment schedule related to this amount. The net investment of EDMC balance also includes contributed capital.

The EDMC Board of Directors approved a resolution directing the Chief Financial Officer of EDMC to provide sufficient cash at the end of each fiscal year to the School in order to have a composite score of at least 1.5 calculated pursuant to the financial responsibility standards promulgated by the U.S. Department of Education as outlined in Note 3, "Governmental Regulations".

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 federal 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 combined statement of income 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 in the states where the School provides services.

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 combined financial statements.

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, salaries of administrative and student services staff, facility occupancy costs, bad debt expense, costs of educational materials, information systems costs, and support services provided by The Center as described in Note 9, "Related-Party Transactions." These costs are expensed as services are provided to the School or as incurred.

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. These costs are expensed as services are provided to the School or as incurred.

Marketing costs, which are expensed as incurred and classified as general and administrative expense in the combined statements of operations, were \$8.1 million and \$14.2 million in the fiscal years ended June 30, 2017 and 2016, respectively.

Recent Accounting Pronouncements

In April 2017, the Financial Accounting Standards Board (the "FASB") issued an Accounting Standards Update ("ASU") 2017-04 which will simplify the accounting for goodwill impairment. The revised guidance eliminates Step Two of the current goodwill impairment test, which requires a hypothetical purchase price to measure goodwill impairment. A goodwill impairment loss will instead be measured by the amount by which a reporting unit's carrying amount exceeds its fair value, not to exceed the carrying amount of goodwill. Early adoption is permitted for impairment testing dates after January 1, 2017. The School has decided to early adopt this standard effective with the annual impairment testing date of June 30, 2017.

In November 2016, the Financial Accounting Standards Board (the "FASB") issued an Accounting Standards Update ("ASU") 2016-18, Restricted Cash; which is included in FASB Accounting Standards Codification ("ASC") Topic 230, Statement of Cash Flows. The purpose of this update is to clarify how types of restricted cash should be reported on the Statement of Cash Flows. This amendment is effective for public companies in fiscal years beginning after December 15, 2017, with early adoption permitted. The School is currently evaluating the impact that the standard will have on its financial condition, results of operations, and disclosures.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments, which is included in ASC Topic 230, Statement of Cash Flows. The new guidance clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows, including contingent consideration payments made after a business acquisition. The standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. All entities must apply the guidance retrospectively to all periods presented unless doing so would be impracticable. The implementation of the guidance is not expected to have a material impact on the School's combined financial statements.

In June 2016, the FASB issued ASU 2016-13 that will require entities to use a new forward-looking "expected loss" model on trade and other receivables, held-to-maturity debt securities, loans, and other instruments that generally will result in the earlier recognition of allowances for credit losses. Entities will have to disclose significantly more information, including information they use to track credit quality by year of origination for most financing receivables. The standard is effective for the School for the fiscal years beginning after December 15, 2020, and interim periods therein. Early adoption is permitted for annual periods beginning after December 15, 2018, and interim periods therein. The School is currently evaluating the impact that the standard will have on its financial condition, results of operations, and disclosures.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," replacing the existing guidance in ASC 840, "Leases." The new guidance establishes a right-of-use ("ROU") model which requires the lessee to record a ROU asset and corresponding lease liability on the balance sheet for all leases with terms exceeding twelve months. Leases will be classified as either financing or operating, with the classification affecting the pattern of expense recognition on the income statement. The standard is effective for the School beginning in fiscal year

2021, with early adoption permitted. The new guidance must be applied on a modified retrospective basis at the beginning of the earliest comparative period presented in the financial statements. The School is currently evaluating the impact that the standard will have on its financial condition, results of operations, and disclosures.

In July 2015, the FASB issued ASU 2015-17 "Income Taxes (Topic 740)." The new guidance requires an entity to classify deferred tax liabilities and assets as noncurrent within a classified statement of financial position. The standard is effective for the School beginning fiscal year 2018, with early adoption permitted, and may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The School decided to implement the guidance early, beginning with the fiscal year 2016 financial statements on a prospective basis.

In August 2014, the FASB issued ASU 2014-15 Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which is included in FASB Accounting Standards Codification (ASC) 205-40, Presentation of Financial Statements - Going Concern. The standard requires that management perform a two-step going concern analysis, and make certain disclosures if it is determined that there is substantial doubt about the entity's ability to continue as a going concern. This update is effective for fiscal years ending after December 15, 2016 with early adoption permitted.

In May 2014, the FASB issued ASU 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. In August 2015, the FASB issued ASU 2015-14, which deferred the implementation of ASU 2014-09 by one year for both public and non-public entities. It is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018 for non-public entities. Early adoption is permitted as early as the original public entity effective date of annual reporting dates beginning after December 15, 2016 including the interim periods, however early adoption prior to that date is not permitted. This accounting standard, as amended, is effective for the School beginning in the first quarter of fiscal year 2019. The School is currently evaluating the impact that the standard will have on its financial condition, results of operations, and disclosures.

3. GOVERNMENTAL REGULATIONS

Most of the students at the School's campuses 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, 2017 and 2016, the School satisfied the financial responsibility standards.

As of June 30, 2016, 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. In May 2017, the U.S. Department of Education decreased the amount of the required letter of credit from \$240.6 million to \$194.0 million, which equals 15 percent of the total Title IV aid received by students attending EDMC's institutions during the fiscal year ended June 30, 2016.

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, 2017 and 2016.

4. PROPERTY AND EQUIPMENT

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

Asset Class	2017	2016
Leasehold improvements	\$ 56,526	\$ 56,274
Technology and other equipment	16,187	17,575
Furniture and equipment	10,967	11,050
Library books	2,964	3,111
Total	86,644	88,010
Accumulated depreciation	(83,712)	(83,199)
Property and equipment, net	\$ 2,932	\$ 4,811

The School's depreciation and amortization expense related to property and equipment was approximately \$2.6 million and \$3.0 million in the fiscal years ended June 30, 2017 and 2016, respectively.

Impairments

During fiscal 2016, the School recorded long-lived asset impairment charges of \$1.3 million at one of the Art Institute locations where estimated cash flows were projected to be insufficient to support the carrying value of the related property and equipment.

The School estimated fair value of assets at these locations using the discounted cash flow method (income approach) on a non-recurring basis using unobservable Level Three inputs, including a discount rate ranging from 18.0% to 23.5%. Impairment losses are allocated to the assets and recorded through accumulated depreciation.

5. GOODWILL AND INTANGIBLE ASSETS

The School was acquired by EDMC in fiscal 2002. As part of this business combination, goodwill was recorded, which consists of the cost in excess of the fair value of the identifiable net assets acquired. A roll forward of the School's goodwill balance from June 30, 2016 to June 30, 2017 is as follows (in thousands):

	Total
Balance Sheet as of June 30, 2015:	
Gross	\$ 21,748
Accumulated impairments	—
Goodwill	21,748
Statement of Operations for the Fiscal Year Ended June 30, 2016:	
Impairment charge	(13,395)
Balance Sheet as of June 30, 2016:	
Gross	21,748
Accumulated impairments	(13,395)
Goodwill	8,353
Statement of Operations for the Fiscal Year Ended June 30, 2017:	
Impairment charge	—
Balance Sheet as of June 30, 2017:	
Gross	21,748
Accumulated impairments	(13,395)
Goodwill	<u>\$ 8,353</u>

Goodwill

The annual impairment test was performed as of June 30, 2017 using cash flow projections as of that date. The results indicated that the fair value of the School exceeded its carrying value as of June 30, 2017. Fair value was estimated using the traditional discounted cash flow method (income approach). This approach resulted in goodwill of the School being measured at fair value on a non-recurring basis, which utilized a significant number of unobservable Level Three inputs, such as future cash flow assumptions and discount rate selection. See Note 8, "Fair Value of Financial Instruments," for a description of Level Three inputs.

The valuation of the School under the traditional discounted cash flow method requires the use of internal business plans that are based on judgments and estimates, which account for expected future economic conditions, demand and pricing for the School's educational services, costs, inflation and discount rates, and other factors. The use of judgments and estimates involves inherent uncertainties. The School's measurement of the fair values of its locations is dependent on the accuracy of the assumptions used and how the School's estimates compare to future operating performance. The key assumptions include the following:

- Future cash flow assumptions — The School's projections are based on organic growth and are derived from historical experience and assumptions regarding future growth and profitability trends. These projections also take into account the current economic climate and the extent to which the regulatory environment is expected to impact future growth opportunities. The School's analysis incorporated an assumed period of cash flows of ten years with a terminal value determined using the Gordon Growth Model.
- Discount rate — The discount rate is based on the School's weighted average cost of capital ("WACC"). The three components of WACC are the cost of equity, cost of debt and capital structure, each of which requires judgment by management to estimate. The School develops its cost of equity estimate using the Capital Asset Pricing Model based on perceived risks and predictability of each reporting unit's future cash flows. The cost of debt component represents a market participant's estimated cost of borrowing, which the School estimates using the average return on corporate bonds as of the valuation date, adjusted for taxes. At June 30, 2017, the WACC used to estimate the fair value of the School was 25.0%.

Intangible assets other than goodwill consisted of the following at June 30 (in thousands):

	2017		2016	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Curriculum	\$ 880	\$ (819)	\$ 880	\$ (768)
Other intangibles	500	(482)	500	(467)
Total intangible assets	\$ 1,380	\$ (1,301)	\$ 1,380	\$ (1,235)

The School's amortization expense related to intangible assets was less than \$0.1 million in each of the fiscal years ended June 30, 2017 and 2016.

Estimated annual amortization expense for each of the years ending June 30, 2017 through 2021 is as follows at June 30, 2017 (in thousands):

Fiscal Year:	Amortization Expense
2018	\$66
2019	13
2020	—
2021	—
2022	—

6. STUDENT RECEIVABLES

The School offers four types of financing arrangements to its students to assist with the obligation associated with tuition and fees: retail installment contracts; commitment agreements; paid in full amounts; and lines of credit. These financing arrangements help 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. Paid in full amounts are short-term extensions of credit for typically small balances which are repayable upon demand by the School. Retail installment contracts, commitment agreements, and lines of credit are extensions of credit which include a monthly minimum payment amount, permit students to repay amounts borrowed over a specified period of time, and incur interest charges that accrue each month on unpaid balances when the accounts reach an out-of-school enrollment status.

Student receivables include \$1.4 million (net of \$2.1 million allowance) and \$1.9 million (net of \$2.7 million allowance) recorded in other long-term assets on the accompanying balance sheet related to retail installment contracts, commitment agreements, and lines of credit to students for amounts due beyond one year during the fiscal years ended June 30, 2017 and 2016, respectively.

The School monitors its student receivables based on enrollment status. Receivables from former students who are in collections are almost fully reserved for. Receivables for out-of-school students are reserved for at a higher rate than receivables from students that are in-school. The gross current and noncurrent student receivables by student status were as follows at June 30 (in thousands):

	2017	2016
In-school	\$ 6,581	\$ 8,559
Out-of-school	2,099	4,488
Collections	6,305	8,015
Gross student receivables	\$ 14,985	\$ 21,062

A roll forward of the School's total allowance for doubtful accounts from June 30, 2015 to June 30, 2017 is as follows (in thousands):

Balance, June 30, 2015	\$	17,143
Bad debt expense		8,000
Amounts written off		(13,352)
Balance, June 30, 2016		11,791
Bad debt expense		5,248
Amounts written off		(8,890)
Balance, June 30, 2017	\$	<u>8,149</u>

The amounts set forth above are recorded within student receivables, net and other long-term assets on the combined 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.

7. ACCRUED LIABILITIES

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

	<u>2017</u>	<u>2016</u>
Employee compensation	\$ 995	\$ 1,366
Advertising	534	1,048
Student support services	185	220
Other	109	54
Total accrued liabilities	<u>\$ 1,823</u>	<u>\$ 2,688</u>

8. FAIR VALUE OF FINANCIAL INSTRUMENTS

The School determines the fair value of assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. The fair values are based on assumptions that market participants would use when pricing an asset or liability, including assumptions about risk and the risks inherent in valuation techniques and the inputs to valuations. The fair value hierarchy is based on whether the inputs to valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the School's own assumptions of what market participants would use. The fair value hierarchy includes three levels of inputs that may be used to measure fair value as described below.

Level One - Quoted prices for identical instruments in active markets.

Level Two - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations for which all significant inputs are observable market data.

Level Three - Unobservable inputs significant to the fair value measurement supported by little or no market activity.

In some cases, the inputs used to measure fair value may meet the definition of more than one level of fair value hierarchy. The lowest level input that is significant to the fair value measurement in its totality determines the applicable level in the fair value hierarchy.

As described in Note 4, "Property and Equipment," and Note 5, "Goodwill and Intangible Assets," the School recorded asset impairments during fiscal 2016 resulting in certain long-lived assets being measured at fair value on a non-recurring basis using Level Three inputs.

9. 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 has been providing support services to 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, and support call center services for students and employees. The Center allocates costs to each campus primarily based on the level of transaction volume.

Total costs allocated by The Center and EDMC to the School were approximately \$4.8 million and \$8.8 million, which are included in general and administrative expense and educational services expense in the combined statements of operations in the fiscal years ended June 30, 2017 and 2016, respectively.

Employee Scholarships

The School records revenues and expenses related to its internal tuition grant policy on a gross basis. The School received less than \$0.1 million and \$1.0 million in the fiscal years ended June 30, 2017 and 2016, respectively, relating to employees of other EDMC wholly-owned entities attending the School. In addition, the School paid \$0.4 million and \$1.1 million in the fiscal years ended June 30, 2017 and 2016, respectively, to other EDMC wholly-owned entities relating to its employees attending other EDMC schools.

Leases

The School's Tampa campus shares its physical location with South University of Tampa, a wholly-owned subsidiary of EDMC, and EDMC splits certain building costs, primarily rent expense, between South University of Tampa and The Art Institute of Tampa. Total rent expense of \$2.2 million and \$2.5 million was incurred for fiscal years ended June 30, 2017 and 2016, respectively, relating to this location, of which \$1.0 million and \$1.2 million was allocated to The Art Institute of Tampa in each of the fiscal years ended June 30, 2017 and 2016, and is included in the accompanying combined statements of operations within educational services expense.

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 11, "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.

10. INCOME TAXES

Income tax expense includes current and deferred taxes, as reflected below for the fiscal years ended June 30 (in thousands):

	2017	2016
Current taxes:		
Federal	\$ —	\$ 351
State	42	148
Total current tax expense	42	499
Deferred tax benefit	—	(8,254)
Total income tax expense (benefit)	\$ 42	\$ (7,755)

As a result of the EDMC consolidated group being in a historical three year cumulative loss position, it was concluded that the group may not fully recognize the benefit of its deferred tax assets. As such, valuation allowances have been recorded against the federal and state deferred tax assets of the EDMC consolidated group.

The deferred tax assets presented in the accompanying balance sheet reflect the impact of the recording of such valuation allowances against the School's deferred tax assets.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes. This ASU simplifies the presentation of deferred income taxes by requiring that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent in the balance sheet. The Company elected to adopt this ASU on a prospective basis during the fourth quarter of 2016. The adoption of this ASU did not have a material impact on the Company's financial position and it had no impact on its results of operations or cash flows. Deferred income taxes are presented in the combined balance sheet for all significant temporary difference between tax and financial reporting, which consist primarily of the allowances for doubtful accounts, property and equipment, intangible assets, and deferred rent. Net deferred income tax assets and liabilities consisted of the following at June 30 (in thousands):

	2017	2016
Gross noncurrent deferred tax assets	\$ 7,670	\$ 7,596
Valuation allowance	(7,670)	(5,459)
Total noncurrent deferred tax assets	—	2,137
Noncurrent deferred tax liabilities	(2,924)	(5,061)
Total net noncurrent deferred tax liabilities	\$ (2,924)	\$ (2,924)

11. COMMITMENTS AND CONTINGENCIES

Debt Restructuring Litigation

In October 2014, a complaint captioned *Marblegate Asset Management, et al v. Education Management Corporation, et al.* was filed in federal district court in the Southern District of New York seeking, among other things, a preliminary injunction to block the Debt Restructuring. The plaintiffs, holders of Cash Pay/PIK Notes due 2018, alleged that the Debt Restructuring would force them either to convert their debt to equity or to risk the elimination of their practical ability to recover their principal and remaining interest payments in violation of the Trust Indenture Act of 1939 because substantially all of EDMC's assets would be foreclosed and sold in an asset sale to an affiliate and EDMC would release its guaranty of the Cash Pay/PIK Notes due 2018. In December 2014, the District Court denied the plaintiffs' request for a preliminary injunction enjoining the Debt Restructuring but indicated that the plaintiffs were likely to win on the merits of their claim that the Debt Restructuring as constituted violated the Trust Indenture Act of 1939. EDMC and the debt holders who agreed to participate in the Debt Restructuring subsequently amended the restructuring in response to the District Court's ruling and the initial step of the transaction, including the foreclosure and asset sale and the exchange of debt for equity, was completed in January 2015. Secured creditors also released EDMC of its guarantee of the secured debt in connection with the transaction but EDMC did not take steps required to effectuate the release of EDMC from its guarantee of outstanding Cash Pay/PIK Notes due 2018. In addition, the subsidiary to which EDMC's assets were transferred issued its own guarantee of the Cash Pay/PIK Notes due 2018, which will remain in place so long as EDMC's guarantee of the Cash Pay/PIK Notes due 2018 is not released. EDMC then brought a counterclaim seeking a declaration that it was permitted to effectuate the release of its guarantee. EDMC also reached an agreement with all the plaintiffs in the case - other than Marblegate Asset Management - prior to completing the first step of the Debt Restructuring.

In June 2015, the District Court ruled that EDMC's release of its guaranty of the Cash Pay/PIK Notes due 2018 would violate the Trust Indenture Act of 1939. EDMC appealed the decision to the Second Circuit Court of Appeals in order to protect the interests of the overwhelming majority of its creditors who participated in the Debt Restructuring. On January 17, 2017, the Second Circuit Court of Appeals issued an opinion vacating the District Court's ruling and remanding the case to the District Court. Marblegate Asset Management requested an en banc review of the decision by the full Second Circuit Court of Appeals on February 7, 2017 which was denied on March 21, 2017 and the District Court's ruling was vacated and remanded to the District Court on March 29, 2017. On June 22, the District Court entered an order in favor of EDMC.

The Bank of New York Mellon Trust Company, N.A., Trustee under the Indenture pursuant to which the Cash Pay/PIK Notes due 2018 were issued to Marblegate Asset Management, filed a complaint against Education Management II LLC and Education Management Finance III LLC in federal district court in the Southern District of New York on June 19, 2017 alleging a default on the Indenture and that the defendants are liable as successors to the original issuer of the Notes. Based on information currently available, EDMC cannot reasonably estimate a range of potential loss, if any, for this action because of inherent difficulty in assessing the appropriate measure of damages if we were to be found liable. Accordingly, no liability has been recognized in connection with this matter.

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, of 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 financial position, results of operations or liquidity. At June 30, 2017, the School was not subject to any legal proceedings that are expected to have a material adverse effect on its consolidated financial position, results of operations, or liquidity.

Lease Commitments

The School leases its facilities under various operating leases that expire on various dates through 2025. Rent expense under these leases was approximately \$13.5 million and \$14.6 million in the fiscal years ended June 30, 2017 and 2016, respectively.

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, 2017 (in thousands):

Fiscal Year:		
2018	\$	11,098
2019		9,728
2020		8,396
2021		7,426
2022		6,997
Thereafter		15,645

12. SUBSEQUENT EVENTS

On October 17, 2017 EDMC closed on the sale of substantially all of the assets of South University, Argosy University, all of the "core" Art Institutes school locations which are not currently being taught-out, and certain assets used by The Center and our corporate services. As a result of the closing of this transaction, the effects of this transaction will be included in EDMC's financial statements for the first fiscal quarter of 2018.

The School has evaluated subsequent events through October 27, 2017, the date through which these financial statements were available to be issued.

Supplemental Information

Miami International University of Art & Design (Combined)
Combining Balance Sheet
(In thousands)
June 30, 2017

OPEID #	Miami International University of Art & Design	The Art Institute of Tampa	The Art Institute of Jacksonville	The Art Institute of Dallas	The Art Institute of Charlotte	The Art Institute of Raleigh - Durham	The Art Institute of Fort Worth	Miami International University of Art & Design (Combined)
OPEID #	00887800	00887805	00887806	01303912	01303918	01303919	01303913	
Assets								
Current assets:								
Cash:								
Cash and cash equivalents	\$ 8,083	\$ 2,134	\$ 1	\$ 3,942	\$ 3,529	\$ 4,204	\$ —	\$ 21,893
Restricted cash	312	2	—	3,436	—	—	—	3,750
Total cash	8,395	2,136	1	7,378	3,529	4,204	—	25,643
Receivables:								
Trade	2,189	1,468	166	2,369	3,368	1,766	86	11,412
Allowance for doubtful accounts	(766)	(776)	(85)	(1,131)	(2,300)	(924)	(17)	(5,999)
Notes, advances, and other receivables	57	68	8	12	10	—	10	165
Other current assets	59	54	—	61	8	24	1	207
Total current assets	9,934	2,950	90	8,689	4,615	5,070	80	31,428
Property and equipment, net	797	397	18	1,030	282	408	—	2,932
Other long-term assets	189	117	12	293	601	281	7	1,500
Intangible assets, net of amortization	79	—	—	—	—	—	—	79
Goodwill	8,353	—	—	—	—	—	—	8,353
Total assets	\$ 19,352	\$ 3,464	\$ 120	\$ 10,012	\$ 5,498	\$ 5,759	\$ 87	\$ 44,292
Liabilities and shareholder's equity								
Current liabilities:								
Accounts payable	\$ 225	\$ 40	\$ 1	\$ 35	\$ 32	\$ 31	\$ —	\$ 364
Accrued liabilities	518	217	25	494	310	244	15	1,823
Advance payments	1,520	600	59	372	193	206	—	2,950
Unearned tuition	1,775	746	86	1,414	773	714	5	5,513
Total current liabilities	4,038	1,603	171	2,315	1,308	1,195	20	10,650
Deferred income taxes	2,924	—	—	—	—	—	—	2,924
Deferred rent	337	333	554	3,375	685	1,856	354	7,494
Shareholder's equity:								
Net investment of EDMC	(64,429)	(11,076)	9,376	(34,539)	(5,793)	6,946	2,148	(97,367)
Retained earnings (Accumulated deficit)	76,482	12,604	(9,981)	38,861	9,298	(4,238)	(2,435)	120,591
Total shareholder's equity	12,053	1,528	(605)	4,322	3,505	2,708	(287)	23,224
Total liabilities and shareholder's equity	\$ 19,352	\$ 3,464	\$ 120	\$ 10,012	\$ 5,498	\$ 5,759	\$ 87	\$ 44,292

Miami International University of Art & Design (Combined)
Combining Balance Sheet
(In thousands)
June 30, 2016

OPEID #	Miami International University of Art & Design	The Art Institute of Tampa	The Art Institute of Jacksonville	The Art Institute of Dallas	The Art Institute of Charlotte	The Art Institute of Raleigh - Durham	The Art Institute of Fort Worth	Miami International University of Art & Design (Combined)
OPEID #	00887800	00887805	00887806	01303912	01303918	01303919	01303913	
Assets								
Current assets:								
Cash:								
Cash and cash equivalents	\$ 17,634	\$ 1,831	\$ 1,997	\$ 6,163	\$ 2,020	\$ 3,825	\$ 1,983	\$ 35,453
Restricted cash	5,721	19	1,202	3,441	96	37	5	10,521
Total cash	23,355	1,850	3,199	9,604	2,116	3,862	1,988	45,974
Receivables:								
Trade	2,866	2,079	498	2,969	5,387	2,099	528	16,426
Allowance for doubtful accounts	(1,314)	(1,126)	(247)	(1,432)	(3,506)	(1,194)	(251)	(9,070)
Notes, advances, and other receivables	77	(14)	25	3	30	1	4	126
Other current assets	152	67	4	57	52	46	—	378
Total current assets	25,136	2,856	3,479	11,201	4,079	4,814	2,269	53,834
Property and equipment, net	2,632	539	17	857	331	426	9	4,811
Other long-term assets	169	137	22	371	865	409	26	1,999
Intangible assets, net of amortization	145	—	—	—	—	—	—	145
Goodwill	8,353	—	—	—	—	—	—	8,353
Total assets	\$ 36,435	\$ 3,532	\$ 3,518	\$ 12,429	\$ 5,275	\$ 5,649	\$ 2,304	\$ 69,142
Liabilities and shareholder's equity								
Current liabilities:								
Accounts payable	\$ 83	\$ 62	\$ 12	\$ 54	\$ 57	\$ 55	\$ 9	\$ 332
Accrued liabilities	659	308	110	727	437	363	84	2,688
Advance payments	1,468	383	162	574	224	175	57	3,043
Unearned tuition	2,451	757	326	999	955	674	199	6,361
Total current liabilities	4,661	1,510	610	2,354	1,673	1,267	349	12,424
Deferred income taxes	2,924	—	—	—	—	—	—	2,924
Deferred rent	257	365	745	3,504	748	2,050	467	8,136
Shareholder's equity:								
Net investment of EDMC	(46,686)	(9,972)	10,576	(32,851)	(8,315)	6,645	3,324	(77,279)
Retained earnings (Accumulated deficit)	75,279	11,629	(8,413)	39,422	11,169	(4,313)	(1,836)	122,937
Total shareholder's equity	28,593	1,657	2,163	6,571	2,854	2,332	1,488	45,658
Total liabilities and shareholder's equity	\$ 36,435	\$ 3,532	\$ 3,518	\$ 12,429	\$ 5,275	\$ 5,649	\$ 2,304	\$ 69,142

Miami International University of Art & Design (Combined)
Combining Statement of Operations
(Dollars in thousands)
For the Fiscal Year Ended June 30, 2017

OPEID #	Miami International University of Art & Design 00887800	The Art Institute of Tampa 00887805	The Art Institute of Jacksonville 00887806	The Art Institute of Dallas 01303912	The Art Institute of Charlotte 01303918	The Art Institute of Raleigh - Durham 01303919	The Art Institute of Fort Worth 01303913	Miami International University of Art & Design (Combined)
Net revenues	\$ 24,776	\$ 11,354	\$ 1,938	\$ 15,748	\$ 11,713	\$ 9,433	\$ 647	\$ 75,609
Costs and expenses:								
Educational services	15,053	6,125	3,486	11,743	10,558	7,210	1,220	55,395
General and administrative	6,562	4,028	15	4,298	2,886	2,032	12	19,833
Depreciation and amortization	1,958	226	5	226	140	116	14	2,685
Total costs and expenses	23,573	10,379	3,506	16,267	13,584	9,358	1,246	77,913
(Loss) income before income taxes	1,203	975	(1,568)	(519)	(1,871)	75	(599)	(2,304)
Income tax (benefit) expense	—	—	—	42	—	—	—	42
Net (loss) income	\$ 1,203	\$ 975	\$ (1,568)	\$ (561)	\$ (1,871)	\$ 75	\$ (599)	\$ (2,346)
Composite Score	2.3	2.6	(1.0)	1.9	1.8	2.4	(1.0)	1.9

Miami International University of Art & Design (Combined)
Combining Statement of Operations
(Dollars in thousands)
For the Fiscal Year Ended June 30, 2016

OPEID #	Miami International University of Art & Design 00887800	The Art Institute of Tampa 00887805	The Art Institute of Jacksonville 00887806	The Art Institute of Dallas 01303912	The Art Institute of Charlotte 01303918	The Art Institute of Raleigh - Durham 01303919	The Art Institute of Fort Worth 01303913	Miami International University of Art & Design (Combined)
Net revenues	\$ 31,807	\$ 13,186	\$ 5,028	\$ 17,909	\$ 16,465	\$ 11,117	\$ 2,978	\$ 98,490
Costs and expenses:								
Educational services	17,437	7,143	4,923	13,213	13,557	7,831	2,894	66,998
General and administrative	11,260	5,438	34	6,108	4,254	2,914	56	30,064
Long-lived asset impairments	13,395	—	24	—	1,314	—	31	14,764
Depreciation and amortization	2,073	368	2	215	257	100	6	3,021
Total costs and expenses	44,165	12,949	4,983	19,536	19,382	10,845	2,987	114,847
(Loss) income before income taxes	(12,358)	237	45	(1,627)	(2,917)	272	(9)	(16,357)
Income tax (benefit) expense	(4,642)	160	(712)	(1,112)	(624)	(530)	(295)	(7,755)
Net (loss) income	\$ (7,716)	\$ 77	\$ 757	\$ (515)	\$ (2,293)	\$ 802	\$ 286	\$ (8,602)
Composite Score	1.8	2.1	2.5	1.8	1.7	2.4	2.4	1.8

Miami International University of Art & Design (Combined)

Supplemental Schedule of Expenditures of State Financial Assistance

For the Fiscal Year Ended June 30, 2017

	CSFA No.	Grant No.	Expenditures	Transfers to Subrecipients
FLORIDA DEPARTMENT OF EDUCATION				
Direct Projects:				
Florida Student Assistance Grant	48.054	N/A	\$ 499,014	\$ —
Florida Access to Better Learning and Education Grant	—	N/A	695,500	—
Florida Children and Spouses of Deceased or Disabled Veterans and Service Members Scholarship	48.055	N/A	19,739	—
Florida Bright Futures Scholarship	48.059	N/A	29,031	—
TOTAL DIRECT PROJECTS			<u>\$ 1,243,284</u>	<u>\$ —</u>
Indirect Projects:			<u>\$ —</u>	<u>\$ —</u>
Passed Through:			<u>\$ —</u>	<u>\$ —</u>
TOTAL FLORIDA DEPARTMENT OF EDUCATION			<u>\$ 1,243,284</u>	<u>\$ —</u>
TOTAL EXPENDITURES OF STATE FINANCIAL ASSISTANCE			<u><u>\$ 1,243,284</u></u>	<u><u>\$ —</u></u>

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*.

Miami International University of Art & Design (Combined)

Supplemental Schedule of Expenditures of State Financial Assistance

For the Fiscal Year Ended June 30, 2016

	CSFA No.	Grant No.	Expenditures		Transfers to Subrecipients
FLORIDA DEPARTMENT OF EDUCATION					
Direct Projects:					
Florida Student Assistance Grant	48.054	N/A	\$ 515,139	\$	—
Florida Access to Better Learning and Education Grant	—	N/A	897,000		—
Florida Children and Spouses of Deceased or Disabled Veterans and Service Members Scholarship	48.055	N/A	16,450		—
Florida Bright Futures Scholarship	48.059	N/A	72,684		—
TOTAL DIRECT PROJECTS			\$ 1,501,273	\$	—
Indirect Projects:			\$ —	\$	—
Passed Through:			\$ —	\$	—
TOTAL FLORIDA DEPARTMENT OF EDUCATION			\$ 1,501,273	\$	—
TOTAL EXPENDITURES OF STATE FINANCIAL ASSISTANCE			\$ 1,501,273	\$	—

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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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 Member and Board of Trustees of
Miami International University of Art & Design (Combined)

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 Miami International University of Art & Design (Combined), which comprise the combined balance sheets as of June 30, 2017 and 2016, and the related statements of operations, shareholder's equity and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 27, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Miami International University of Art & Design (Combined)'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 Miami International University of Art & Design (Combined)'s internal control. Accordingly, we do not express an opinion on the effectiveness of Miami International University of Art & Design (Combined)'s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Miami International University of Art & Design (Combined)'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*.

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

October 27, 2017

Miami International University of Art & Design (Combined)

Schedule of Findings

Year Ended June 30, 2017

Our audit disclosed no findings for the year ended June 30, 2017 that are required to be reported herein under *Government Auditing Standards*.

Miami International University of Art & Design (Combined)

Schedule of Findings and Responses

Year Ended June 30, 2016

2016-001

Criteria:

Miami International University of Art & Design (Combined)'s (the "School") financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP).

Condition:

During fiscal year 2016, the School did not maintain effective controls to ensure the proper selection of its revenue recognition policy. Specifically, the process for analyzing the collectability criterion for revenue recognition was not designed to assess collectability, on a student-by-student basis, prior to enrollment in the School. **This material weakness was remediated by June 30, 2016.**

Cause:

The School's lack of adequate internal controls over the selection of the revenue recognition policy did not appropriately address the assertion of collectability being reasonably assured on a student-by-student basis prior to enrollment.

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 recommended that the School implement controls over the selection of the revenue recognition policy to appropriately assess collectability, on a student-by-student basis, prior to enrollment in the School.

Views of responsible officials
planned corrective actions:

During fiscal 2016, the School remediated a historical material weakness on internal controls surrounding its revenue recognition policy by developing a suite of controls that operate together to mitigate the collectability risk associated with day one revenue recognition. **The controls were implemented and fully operational at June 30, 2016, remediating the material weakness.**