SOUTH UNIVERSITY

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

TABLE OF CONTENTS

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

Robert D. Hoag, CPA, CGMA, MST
David A. Keefe, CPA, CGMA
John C. Fogle, CPA
Ronald L. Parker, CPA
M. Kent Moorhead II, CPA

Donald J. Reddinger, CPA
Marlene A. Will, CPA
Joseph M. Dickert, CPA
Jonathan J. Unico, CPA

Associates:
Robert L. Hall, CPA
William R. Rader, CPA
Gregory J. Palmieri, CPA
Maureen Gallagher, CPA

2607 NICHOLSON ROAD
SEWICKLEY, PA 15143

(724) 778-3333
FAX (724) 778-3335
Email: jfogle@rdhcpallc.com
Web: www.rdhcpallc.com

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
South University

Report on Compliance for Each Major State Project

We have audited South University'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 South University's major State projects for the year ended June 30, 2017. South University'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 South University'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 South University'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 South University's compliance.

Opinion on Each Major State Project

In our opinion, South University 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 South University 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 South University'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 South University's internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of South University'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.

RJ Hays & Associates, LLC

Sewickley, Pennsylvania
March 23, 2018

SOUTH UNIVERSITY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - STATE PROJECTS

Year Ended June 30, 2017

A. SUMMARY OF AUDITORS' RESULTS

1. The consolidated financial statements of South University, LLC and Subsidiaries were audited by another independent registered public accounting firm whose report dated October 27, 2017 expressed an unmodified opinion.

2. The consolidated financial statements of South University, LLC and Subsidiaries 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 South University expresses an unmodified opinion.

4. The audit of the major state projects of South University disclosed no findings or questioned costs required to be disclosed 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*.

Consolidated Financial Statements and Supplemental Information

South University, LLC and Subsidiaries
Fiscal Years Ended June 30, 2017 and 2016
With Report of Independent Auditors

South University, LLC and Subsidiaries

Consolidated Financial Statements
and Supplemental Information

Fiscal Years Ended June 30, 2017 and 2016

Contents

Ernst & Young LLP
2100 One PPG Place
Pittsburgh, PA 15222

Tel: +1 412 644 7800
Fax: +1 412 644 0477
ey.com

Report of Independent Auditors

The Member and Board of Trustees of
South University, LLC and Subsidiaries

We have audited the accompanying consolidated financial statements of South University LLC and Subsidiaries, which comprise the consolidated balance sheets as of June 30, 2017 and 2016, and the related consolidated statements of operations, member's equity and cash flows for the years then ended, and the related notes to the consolidated 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 consolidated financial position of South University, LLC and Subsidiaries at June 30, 2017 and 2016, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

South University, LLC and Subsidiaries Ability to Continue as a Going Concern

The accompanying consolidated financial statements have been prepared assuming that South University, LLC and Subsidiaries will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, South University, LLC and Subsidiaries 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 South University, LLC and Subsidiaries ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The consolidated 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 consolidated financial statements as a whole. The accompanying consolidating 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 consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated 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 South University, LLC and Subsidiaries' 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 South University, LLC and Subsidiaries' internal control over financial reporting and compliance.

Ernst & Young LLP

October 27, 2017

South University, LLC and Subsidiaries
Consolidated Balance Sheets
(In thousands)

	June 30, 2017	June 30, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 27,884	$ 32,160
Restricted cash	42,665	47,076
Student accounts receivable, net of allowance of $7,647 and $10,651	38,581	37,427
Notes, advances, and other receivables	6,787	2,090
Other current assets	603	1,025
Total current assets	116,520	119,778
Property and equipment, net	29,341	31,458
Other long-term assets	13,006	8,556
Intangible assets, net	1,477	1,191
Goodwill	15,533	44,295
Total assets	$ 175,877	$ 205,278
Liabilities and member's equity		
Current liabilities:		
Accounts payable	$ 4,329	$ 2,718
Accrued liabilities	11,744	10,095
Unearned tuition	52,730	51,211
Advance payments	3,712	22,309
Total current liabilities	72,515	86,333
Deferred income taxes	5,489	17,249
Deferred rent	21,133	23,174
Member's equity:		
Net investment of EDMC (Note 2)	(7,590)	(3,005)
Accumulated earnings	84,330	81,527
Total member's equity	76,740	78,522
Total liabilities and member's equity	$ 175,877	$ 205,278

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

South University, LLC and Subsidiaries
Consolidated Statements of Operations
(In thousands)

	For the Fiscal Year ended June 30,	
	2017	**2016**
Net revenues	$ 302,547	$ 310,584
Costs and expenses:		
Educational services	161,834	156,253
General and administrative	111,881	116,991
Long-lived asset impairments	28,762	—
Depreciation and amortization	8,836	10,417
Total costs and expenses	311,313	283,661
Income before income taxes	(8,766)	26,923
Income tax (benefit) expense	(11,569)	14,891
Net income	$ 2,803	$ 12,032

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

South University, LLC and Subsidiaries
Consolidated Statements of Member's Equity
(In thousands)

	Net Investment of EDMC	Accumulated Earnings	Total Member's Equity
Balance, June 30, 2015	$ 27,949	$ 69,495	$ 97,444
Decrease in net investment of EDMC	(30,954)	—	(30,954)
Net income	—	12,032	12,032
Balance, June 30, 2016	(3,005)	81,527	78,522
Decrease in net investment of EDMC	(4,585)	—	(4,585)
Net income	—	2,803	2,803
Balance, June 30, 2017	$ (7,590)	$ 84,330	$ 76,740

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

South University, LLC and Subsidiaries
Consolidated Statements of Cash Flows
(In thousands)

	For the Fiscal Year Ended June 30,	
Cash flows from operating activities:	**2017**	**2016**
Net income	$ 2,803	$ 12,032
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,836	10,417
Bad debt expense	16,657	13,207
Long-lived asset impairments	28,762	—
Non-cash adjustments related to deferred rent	(2,041)	(1,642)
Deferred income taxes	(11,760)	656
Changes in assets and liabilities:		
Restricted cash	4,411	(1,393)
Receivables	(27,036)	(12,308)
Reimbursements for tenant improvements	600	1,460
Other assets	(100)	203
Accounts payable	1,502	(831)
Accrued liabilities	1,971	4,634
Unearned tuition and advance payments	(17,078)	1,809
Total adjustments	4,724	16,212
Net cash flows provided by operating activities	7,527	28,244
Cash flows from investing activities:		
Expenditures for long-lived assets	(5,754)	(2,613)
Reimbursements for tenant improvements	(600)	(1,460)
Net cash flows used in investing activities	(6,354)	(4,073)
Cash flows from financing activities:		
Decrease in net investment of EDMC	(5,449)	(32,492)
Net cash flows used in financing activities	(5,449)	(32,492)
Net decrease in cash and cash equivalents	(4,276)	(8,321)
Cash and cash equivalents, beginning of year	32,160	40,481
Cash and cash equivalents, end of year	$ 27,884	$ 32,160

	As of June 30,	
Supplemental disclosure of cash flow information	**2017**	**2016**
Capital expenditures in current liabilities	$ 343	$ 556

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

South University, LLC and Subsidiaries
Notes to Consolidated Financial Statements

1. OWNERSHIP, OPERATIONS, AND GOVERNANCE

South University, LLC and Subsidiaries ("South University" or the "University") is a nonsectarian, coeducational institution of higher education with campuses in the following cities:

- Savannah, Georgia
- West Palm Beach, Florida
- Montgomery, Alabama
- Tampa, Florida
- Columbia, South Carolina
- Richmond, Virginia
- Virginia Beach, Virginia
- Novi, Michigan
- Cleveland, Ohio
- High Point, North Carolina
- Austin, Texas
- Orlando, Florida (a learning site)

The University is a wholly-owned subsidiary of Education Management Corporation ("EDMC") and South University is accredited by the Commission on Colleges of the Southern Association of Colleges and Schools Commission on Colleges ("SACSCOC") to award Associate's, Bachelor's, Master's, and Doctoral degrees. Additionally, South University offers degree programs fully-online through South University-Savannah or through a flexible combination of both online and campus-based instruction.

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 removed from South University, LLC and Subsidiaries through a re-alignment of entities under common control. The impact from the exclusion of the aforementioned campuses from the University'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 South University, LLC and Subsidiaries to reflect the fiscal 2017 presentation resulting in a decrease to the composite score from 1.7 to 1.4. The decrease is due to the funding requirement being based on the fiscal 2016 presentation in the prior year. The composite scores for the individual school locations did not change as a result of the re-alignment.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation (Including Going Concern)

The combined balance sheet includes the accounts of the University. 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 University 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 University'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 University'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 University, 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 it to meet its operational expenses and capital expenditures through the second quarter of fiscal year 2018.

EDMC and the University 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 South University, LLC and Subsidiaries, 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 University'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 University 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 University holds funds from the United States government under various student aid grants and loan programs in separate bank accounts. The University 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 consolidated 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)	$	40,555	$	40,555
Title IV funds in excess of charges applied (2)		2,110		6,521
Total restricted cash	$	42,665	$	47,076

(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 information.

(2) U.S. Department of Education regulations require Title IV Program funds received by the University 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 University's consolidated balance sheet. 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 University's ability to fund daily operations.

Revenue Recognition

The University'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 University derived approximately 98% and 99% of its net revenues from tuition and fees in the fiscal years ended June 30, 2017 and 2016, respectively. The University 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 consolidated balance sheet.

If a student withdraws from the University, 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, various state education authorities that regulate the University's schools, SACSCOC and the University's institutional policies (collectively, “Refund Policies”). In the vast majority of situations, if a student withdrew from one of the University's schools after attending class for a portion of a term of instruction (ranging from approximately 40% to 70%), he or she would not be eligible for any reduction in tuition under the University's Refund Policies. Accordingly, the student would have to pay the University 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 one of the University's schools prior to attending the full term of instruction (ranging from approximately 40% to 70%), the University 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 University for the tuition and fees related to that academic term.

Based on the application of its Refund Policies, the University may be entitled to incremental revenue on the day the student withdraws from one of its schools. The University reassesses collectability when a student withdraws from the institution (i.e., is no longer enrolled) and records this incremental revenue based on cash received.

Student Receivables

The University 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 University 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 University'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 consolidated balance sheet. Concurrent with the expenditures for lease improvements, the University records increases to leasehold improvement assets in property and equipment. Other current assets are reduced once the landlord reimburses the University. 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 University'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 approximately five to 15 years with one or more renewal options. For leases with renewal options, the University 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 University records rent expense over the new lease term.

Property and Equipment

Property and equipment is recorded at cost less accumulated depreciation. The University'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 University 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 and when events and 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 consolidated statement of operations in the period incurred. Refer to Note 4, "Property and Equipment," for more information.

Goodwill and Intangible Assets

On June 1, 2006, in connection with the Transaction, property, equipment, intangible assets other than goodwill, and other assets and liabilities were recorded at fair value. The excess of the amount paid to acquire the University at the time of the Transaction over the fair values of these net assets represented the intrinsic value of the University beyond its tangible and identifiable intangible net assets and was assigned to goodwill.

The University formally evaluates the carrying amount of goodwill for each of its locations on April 1 of each fiscal year. In addition, the University performs an evaluation on an interim basis if it determines that recent events or prevailing conditions indicate a potential impairment of goodwill. A significant amount of judgment is involved in determining whether an indicator of impairment has occurred between annual impairment tests. These indicators include, but are not limited to, overall financial performance such as adverse changes in recent forecasts of operating results, industry and market considerations, updated business plans, and regulatory and legal developments.

Goodwill is impaired when the carrying amount of a location's goodwill exceeds its implied fair value, as determined under a two-step approach. In the first step, the University determines the fair value of each reporting unit and compares that fair value to each location's carrying value. The University estimates the fair value of its locations using a combination of the discounted cash flow method (income approach) and the guideline public company method (market approach), which takes into account the invested capital and associated earnings multiples of publicly-traded peer companies. If the results of the first step indicate the carrying amount of a reporting unit is higher than its fair value, a second step must be performed, which requires the University to determine the implied fair value of goodwill in the same manner as if it had acquired the location in an arm’s length transaction as of the testing date. This second step is performed by deducting the estimated fair value of all tangible and identifiable intangible net assets of the reporting unit from the estimated fair value of the location. If the recorded amount of goodwill exceeds this implied fair value, an impairment charge is recorded for the difference as an operating expense in the period incurred.

Indefinite-lived intangible assets, consisting of the licensing, accreditation and Title IV program participation assets for the University are also evaluated annually on April 1 for impairment and on an interim basis if events or changes in circumstances between annual tests indicate that the asset might be impaired. The University uses a combination of the cost and income approaches to establish the asset value of licenses, accreditation, and Title IV program participation assets. On the impairment testing date, if the fair value of the intangible asset is less than its carrying value, an impairment loss is recognized for an amount equal to the difference. The intangible asset is then carried at its new fair value.

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

Unearned Tuition

Due to the fact that the University has academic terms with starting and ending dates that differ throughout the period, there may be tuition from these academic terms for which the associated revenue has not been earned. Such amounts are recorded as unearned tuition as a current liability in the accompanying consolidated balance sheet.

Net Investment of EDMC

The University 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 University's disbursement bank account as they clear the disbursing bank. The difference between the cash provided to EDMC by the University and the day-to-day funding provided by EDMC to the University has been classified in member's equity as part of the net investment of EDMC in the consolidated 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 University 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 University 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 University is included in the federal consolidated tax return filed by EDMC. The University and EDMC do not have a formal tax-sharing agreement. The provision for income taxes in the accompanying consolidated 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 consolidated 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 University provides services.

Contingencies

The University 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 consolidated financial statements.

Costs and Expenses

Educational services expense consists primarily of costs related to the development, delivery and administration of the University'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 University 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 University's students. These costs are expensed as services are provided to the University or as incurred.

Marketing costs, which are expensed as incurred and classified as general and administrative expense in the consolidated statements of operations, were $44.5 million and $47.6 million in the fiscal years ended June 30, 2017 and 2016, respectively.

Recent Accounting Pronouncements

In November 2016, the Financial Accounting Standards Board (the "FASB") issued an Accounting Standards Update ("ASU") 2016-18, Restricted Cash; which is included in 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 University 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 University's consolidated 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 University 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 University 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 University 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 University 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 University 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 University 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 conern. 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 University beginning in the first quarter of fiscal year 2019. The University 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 University'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 university 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 consolidated 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 University satisfied the financial responsibility standards.

As of June 30, 2017, 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 University 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	$ 52,507	$ 50,303
Furniture and equipment	16,267	15,673
Technology and other equipment	17,190	14,772
Library books	5,446	5,163
Construction in progress	253	428
Total	91,663	86,339
Less accumulated depreciation	(62,322)	(54,881)
Property and equipment, net	$ 29,341	$ 31,458

The University's depreciation and amortization expense related to property and equipment was $8.1 million and $8.9 million in the fiscal years ended June 30, 2017 and 2016, respectively. Included in depreciation expense was approximately $0.9 million and $1.5 million for the fiscal years ended June 30, 2017 and 2016, respectively, that has been allocated from EDMC for assets which are not recorded in the University's consolidated financial statements but are utilized by the University.

5. GOODWILL AND INTANGIBLE ASSETS

The University was acquired by EDMC in fiscal 2004. 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 University's goodwill balance from June 30, 2015 to June 30, 2017 is as follows (in thousands):

		Total
Balance Sheet as of June 30, 2015:		
Gross	$	44,902
Accumulated impairments		(607)
Goodwill		44,295
Statement of Operations for the Fiscal Year Ended June 30, 2016:		
Impairment charge		—
Balance Sheet as of June 30, 2016:		
Gross		44,902
Accumulated impairments		(607)
Goodwill		44,295
Statement of Operations for the Fiscal Year Ended June 30, 2017:		
Impairment charge		(28,762)
Balance Sheet as of June 30, 2017:		
Gross		44,902
Accumulated impairments		(29,369)
Goodwill	$	15,533

Goodwill Impairment Charges

The University formally evaluates the carrying amount of goodwill for each of its reporting units on April 1 of each fiscal year. In addition, the University performs an evaluation on an interim basis if it determines that recent events or prevailing conditions indicate a potential impairment of goodwill. A significant amount of judgment is involved in determining whether an indicator of impairment has occurred between annual impairment tests. These indicators include, but are not limited to, overall financial performance such as adverse changes in recent forecasts of operating results, industry and market considerations, updated business plans, and regulatory and legal developments.

As a result of the University's decision to early adopt ASU 2017-04 during the third quarter of fiscal 2017, the University determines the fair value of each reporting unit and compares that value to the reporting unit's carrying value. The University would recognize an impairment charge for the amount by which the carrying value exceeds fair value.

Consistent with prior years, management performed its annual goodwill impairment testing as of April 1, 2017. The University estimated the fair value of the South University reporting unit at March 31, 2017 using the guideline public company method (market approach), which takes into account the relative price and associated earnings multiples of publicly-traded peer companies which are adjusted to account for the differences in growth prospects and risk profiles of the reporting unit. The Restated DCF Purchase Agreement was considered the best indicator of value as of the March 31, 2017 valuation date; therefore, it was the primary driver of the earnings multiples selected. The results indicated that the South University reporting unit's fair value fell below its carrying value as of March 31, 2017. As a result of the impairment testing, a goodwill impairment charge of $5.4 million was recorded.

During the fourth quarter, a change in market factors indicated potential impairment to the University's goodwill. As was the case in the annual impairment testing, the Restated DCF Purchase Agreement was considered the best indicator of value as of the June 30, 2017 valuation date; therefore, it was the primary driver of the earnings multiples selected. The results indicated that the South University reporting unit's fair value fell below its carrying value as of June 30, 2017. As a result of the impairment testing, a goodwill impairment charge of $23.3 million was recorded.

Intangible Assets

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

	2017		2016	
	Gross Carrying Amount	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Curriculum	$ 8,725	$ (7,292)	$ 8,044	$ (6,919)
Other intangibles	350	(306)	350	(284)
Total intangible assets	$ 9,075	$ (7,598)	$ 8,394	$ (7,203)

The University's amortization expense related to intangible assets was approximately $0.7 million and $1.5 million in the fiscal years ended June 30, 2017 and 2016, respectively. Estimated annual amortization expense for each of the years ending June 30, 2018 through 2022 is as follows at June 30, 2017 (in thousands):

Fiscal Year:	**Amortization Expense**
2018	$ 894
2019	562
2020	21
2021	—
Thereafter	—

6. STUDENT RECEIVABLES

The University 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 University. 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 $13.0 million (net of $12.4 million allowance) and $8.4 million (net of $7.8 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 University 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	$ 45,433	$ 41,543
Out-of-school	11,821	8,360
Collections	14,317	14,391
Gross student receivables	$ 71,571	$ 64,294

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

Balance, June 30, 2015	$	23,268
Bad debt expense		13,207
Amounts written off		(18,033)
Balance, June 30, 2016		18,442
Bad debt expense		16,657
Amounts written off		(15,063)
Balance, June 30, 2017	$	20,036

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

	2017		2016	
Employee compensation	$	4,865	$	4,775
Advertising		3,300		3,133
Student support services		1,904		1,096
Student refunds		1,013		261
Taxes		498		432
Capital expenditures		—		323
Other		164		75
Total accrued liabilities	$	11,744	$	10,095

8. FAIR VALUE OF FINANCIAL INSTRUMENTS

The University 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 University'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," the University 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 University receives coordinating and support services from EDMC, such as legal, insurance, and information technology-related services. EDMC allocates costs to the University based upon certain factors including the University's revenues and student enrollment, which estimate the amount that the University 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 based primarily based on the level of transaction volume.

Total costs allocated by The Center and EDMC to the University were approximately $39.3 million and $42.5 million, which are included in general and administrative expense and educational services expense in the consolidated statements of operations in the fiscal years ended June 30, 2017 and 2016, respectively.

Employee Scholarships

The University records revenues and expenses related to its internal tuition grant policy on a gross basis. The University received $1.5 million and $2.3 million in fiscal 2017 and 2016, respectively, relating to employees of other EDMC wholly-owned entities attending the University. In addition, the University paid $0.4 million and $1.2 million in fiscal 2017 and 2016, respectively, to other EDMC wholly-owned entities relating to its employees attending other EDMC wholly-owned institutions.

Leases

The University's Tampa campus shares its physical location with the Art Institute of Tampa, which is also wholly-owned by EDMC. Certain building costs, primarily rent expense, are allocated by EDMC between South University of Tampa and the Art Institute of Tampa. Total rent expense for this shared location was $2.2 million and $2.5 million in fiscal years ended June 30, 2017 and 2016, respectively. Included in this amount was approximately $1.2 million and $1.3 million that was allocated to South University of Tampa in the fiscal years ended June 30, 2017 and 2016, respectively, and is included in the accompanying consolidated statements of operations within educational services expense.

EDMC guarantees all of the University’s lease agreements, under which EDMC assumes all obligations, liabilities, and duties of the University 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 University’s remaining lease obligations.

Cash Management

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

10. INCOME TAXES

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

	2017	2016
Current taxes:		
Federal	$ —	$ 14,473
State	192	789
Total current tax provision	192	15,262
Deferred tax benefit	(11,761)	(369)
Total income tax expense (benefit)	$ (11,569)	$ 14,893

As a 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 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 University'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. EDMC 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 EDMC's financial position and it had no impact on its results of operations or cash flows. Deferred income taxes are presented in the consolidated 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
Total noncurrent deferred tax assets	$ 12,478	$ 13,049
Valuation allowance	(9,108)	(8,961)
Total noncurrent deferred tax assets	3,370	4,088
Noncurrent deferred tax liabilities	(8,859)	(21,338)
Total net noncurrent deferred tax liabilities	$ (5,489)	$ (17,250)

At June 30, 2017 and 2016, South University of North Carolina had net operating loss carry forwards of approximately $5.0 million and $3.0 million, respectively. A full valuation allowance has been recorded against the corresponding deferred tax asset. These carry forwards begin to expire in fiscal 2028.

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 University 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 University leases its facilities under various operating leases, some of which are with related parties (see Note 9, "Related-Party Transactions"), that expire on various dates through 2029. Rent expense under these leases was approximately $15.0 million and $14.9 million in the fiscal years ended June 30, 2017 and 2016, respectively.

The annual minimum future cash commitments for the fiscal years ending June 30 under the University's noncancelable, long-term operating leases are as follows at June 30, 2017 (in thousands):

Fiscal Year:		
2018	$	14,423
2019		14,211
2020		14,532
2021		14,568
2022		14,844
Thereafter		60,018

Surety Bonds

At June 30, 2017, the University has provided $7.3 million of surety bonds primarily to state regulatory agencies through three different surety providers.

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 crrentlyi 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 University has evaluated subsequent events through October [XX], 2017, the date through which these financial statements were available to be issued.

Supplemental Information

South University, LLC and Subsidiaries

Consolidating Balance Sheet

(Dollars in thousands)

June 30, 2017

	South University-Savannah	South University-Tampa	South University-West Palm Beach	South University-Montgomery	South University-Richmond	South University-Columbia	South University Virginia Beach	South University-Novi	South University - Austin	South University - Cleveland	South University - Highpoint	South University - Orlando	Reclass-ifications & Eliminations	South University, LLC and Subsidiaries
OPEID #	01303900	01303908	01303904	01303906	01303910	01303907	01303911	01303914	01303915	01303922	01303923	01303926		
Cash and cash equivalents	$ 549	$ 2,601	$ 16	$ 2,411	$ 3,593	$ 3,102	$ 3,558	$ 3,502	$ 4,222	$ 1,340	$ 2,218	$ 772	$ —	$ 27,884
Restricted cash	28,925	—	5,467	159	200	365	—	1,400	1,100	2,549	2,500	—	—	42,665
Total cash	29,474	2,601	5,483	2,570	3,793	3,467	3,558	4,902	5,322	3,889	4,718	772	—	70,549
Receivables:														
Trade	20,144	3,035	2,907	2,057	3,040	5,750	2,016	1,703	1,978	1,600	1,905	93	—	46,228
Allowance for doubtful accounts	(4,284)	75	331	(483)	(677)	(974)	(439)	(60)	(195)	(413)	(537)	9	—	(7,647)
Notes, advances, and other receivables	6,680	3	1	1	19	54	1	1	1	26	—	—	—	6,787
Other current assets	313	144	—	7	3	60	24	2	3	2	45	—	—	603
Total current assets	52,327	5,858	8,722	4,152	6,178	8,357	5,160	6,548	7,109	5,104	6,131	874	—	116,520
Property and equipment, net	2,849	1,643	2,862	1,082	3,570	3,630	2,839	1,795	3,425	2,373	2,680	593	—	29,341
Investment in subsidiaries	44,718	—	—	—	—	—	—	—	—	—	—	—	(44,718)	—
Deferred income taxes	—	—	175	—	—	—	—	—	—	—	—	—	(175)	—
Other long-term assets	3,355	854	916	695	1,428	2,268	656	755	574	796	699	10	—	13,006
Intangible assets, net of amortization	1,384	—	45	30	—	18	—	—	—	—	—	—	—	1,477
Goodwill	15,533	—	—	—	—	—	—	—	—	—	—	—	—	15,533
Total assets	$ 120,166	$ 8,355	$ 12,720	$ 5,959	$ 11,176	$ 14,273	$ 8,655	$ 9,098	$ 11,108	$ 8,273	$ 9,510	$ 1,477	$ (44,893)	$ 175,877
Current liabilities:														
Accounts payable	$ 3,527	$ 88	$ 40	$ 74	$ 58	$ 130	$ 68	$ 65	$ 101	$ 39	$ 100	$ 39	$ —	$ 4,329
Accrued liabilities	7,069	569	452	346	454	876	481	385	361	332	388	31	—	11,744
Unearned tuition	23,422	4,152	4,190	1,887	2,933	5,635	2,645	2,126	1,993	1,624	1,748	375	—	52,730
Advance payments	2,522	93	411	35	109	190	106	79	24	82	50	11	—	3,712
Total current liabilities	36,540	4,902	5,093	2,342	3,554	6,831	3,300	2,655	2,479	2,077	2,286	456	—	72,515
Deferred income taxes	5,664	—	—	—	—	—	—	—	—	—	—	—	(175)	5,489
Deferred rent	1,220	708	3,319	1,342	2,298	2,461	1,156	1,583	2,854	1,939	2,099	154	—	21,133
Member's equity:														
Net investment of EDMC	(3,539)	(10,509)	(25,205)	(8,446)	6,387	(47,185)	2,990	12,319	21,071	16,700	14,298	1,538	11,991	(7,590)
Accumulated earnings (deficit)	80,281	13,254	29,513	10,721	(1,063)	52,166	1,209	(7,459)	(15,296)	(12,443)	(9,173)	(671)	(56,709)	84,330
Total member's equity	76,742	2,745	4,308	2,275	5,324	4,981	4,199	4,860	5,775	4,257	5,125	867	(44,718)	76,740
Total liabilities and member's equity	$ 120,166	$ 8,355	$ 12,720	$ 5,959	$ 11,176	$ 14,273	$ 8,655	$ 9,098	$ 11,108	$ 8,273	$ 9,510	$ 1,477	$ (44,893)	$ 175,877

South University, LLC and Subsidiaries

Consolidating Balance Sheet

(Dollars in thousands)

June 30, 2016

	South University-Savannah	South University-Tampa	South University-West Palm Beach	South University-Montgomery	South University-Richmond	South University-Columbia	South University Virginia Beach	South University-Novi	South University - Austin	South University - Cleveland	South University - Highpoint	South University - Orlando	Reclass-ifications & Eliminations	South University, LLC and Subsidiaries
OPEID #	01303900	01303908	01303904	01303906	01303910	01303907	01303911	01303914	01303915	01303922	01303923	01303926		
Cash and cash equivalents	$ 646	$ 2,745	$ 3,540	$ 2,301	$ 3,357	$ 3,516	$ 2,562	$ 2,529	$ 4,946	$ 1,872	$ 3,286	$ 860	$ —	$ 32,160
Restricted cash	34,823	—	4,188	155	200	200	—	1,400	1,100	2,510	2,500	—	—	47,076
Total cash	35,469	2,745	7,728	2,456	3,557	3,716	2,562	3,929	6,046	4,382	5,786	860	—	79,236
Receivables:														
Trade	21,715	3,000	2,646	2,218	3,639	5,567	2,161	1,846	1,523	1,850	1,859	54	—	48,078
Allowance for doubtful accounts	(6,374)	(107)	112	(616)	(1,268)	(857)	(359)	(248)	(128)	(577)	(236)	7	—	(10,651)
Notes, advances, and other receivables	2,039	11	1	1	—	54	1	1	1	17	1	(37)	—	2,090
Other current assets	144	146	4	(3)	598	61	26	(7)	(1)	17	40	—	—	1,025
Total current assets	52,993	5,795	10,491	4,056	6,526	8,541	4,391	5,521	7,441	5,689	7,450	884	—	119,778
Property and equipment, net	1,487	1,417	3,768	1,285	2,992	4,156	3,523	2,276	3,858	2,776	3,174	746	—	31,458
Investment in subsidiaries	55,640	—	—	—	—	—	—	—	—	—	—	—	(55,640)	—
Deferred income taxes	—	—	175	—	—	—	—	—	—	—	—	—	(175)	—
Other long-term assets	1,000	586	501	641	1,146	2,020	491	709	302	594	566	—	—	8,556
Intangible assets, net of amortization	1,052	—	67	45	—	27	—	—	—	—	—	—	—	1,191
Goodwill	44,295	—	—	—	—	—	—	—	—	—	—	—	—	44,295
Total assets	$ 156,467	$ 7,798	$ 15,002	$ 6,027	$ 10,664	$ 14,744	$ 8,405	$ 8,506	$ 11,601	$ 9,059	$ 11,190	$ 1,630	$ (55,815)	$ 205,278
Current liabilities:														
Accounts payable	$ 1,702	$ 152	$ 98	$ 45	$ 61	$ 178	$ 139	$ 80	$ 63	$ 93	$ 96	$ 11	$ —	$ 2,718
Accrued liabilities	6,006	414	375	340	672	710	253	323	302	325	333	42	—	10,095
Unearned tuition	18,952	4,447	4,725	2,197	2,988	6,259	2,830	2,633	1,974	1,917	1,959	330	—	51,211
Advance payments	19,389	545	363	249	183	408	403	404	107	137	105	16	—	22,309
Total current liabilities	46,049	5,558	5,561	2,831	3,904	7,555	3,625	3,440	2,446	2,472	2,493	399	—	86,333
Deferred income taxes	17,424	—	—	—	—	—	—	—	—	—	—	—	(175)	17,249
Deferred rent	1,226	942	3,791	1,537	2,558	2,506	1,340	1,821	2,828	2,152	2,274	199	—	23,174
Member's equity:														
Net investment of EDMC	11,706	(9,684)	(22,412)	(8,857)	5,324	(43,492)	2,297	9,638	20,323	14,552	13,527	1,712	2,361	(3,005)
Accumulated earnings (deficit)	80,062	10,982	28,062	10,516	(1,122)	48,175	1,143	(6,393)	(13,996)	(10,117)	(7,104)	(680)	(58,001)	81,527
Total member's equity	91,768	1,298	5,650	1,659	4,202	4,683	3,440	3,245	6,327	4,435	6,423	1,032	(55,640)	78,522
Total liabilities and member's equity	$ 156,467	$ 7,798	$ 15,002	$ 6,027	$ 10,664	$ 14,744	$ 8,405	$ 8,506	$ 11,601	$ 9,059	$ 11,190	$ 1,630	$ (55,815)	$ 205,278

South University, LLC and Subsidiaries

Consolidating Statement of Operations

(Dollars in thousands)

For the Fiscal Year Ended June 30, 2017

	South University-Savannah	South University-Tampa	South University-West Palm Beach	South University-Montgomery	South University-Richmond	South University-Columbia	South University Virginia Beach	South University-Novi	South University - Austin	South University - Cleveland	South University - Highpoint	South University - Orlando	Reclass-ifications & Eliminations	South University, LLC and Subsidiaries
OPEID #	01303900	01303908	01303904	01303906	01303910	01303907	01303911	01303914	01303915	01303922	01303923	01303926		
Net revenues	$ 160,239	$ 19,760	$ 20,891	$ 9,515	$ 13,878	$ 28,314	$ 12,973	$ 10,034	$ 9,068	$ 8,016	$ 8,458	$ 1,401	$ —	$ 302,547
Costs and expenses:														
Educational services	67,612	11,273	12,817	6,476	9,861	16,514	8,783	7,111	6,637	6,675	7,290	785	—	161,834
General and administrative	72,069	5,735	5,642	2,530	2,991	6,731	3,386	3,455	3,140	3,106	2,674	422	—	111,881
Long-lived asset impairments	28,762	—	—	—	—	—	—	—	—	—	—	—	—	28,762
Depreciation and amortization	2,008	480	981	419	967	835	738	534	565	561	563	185	—	8,836
Total costs and expenses	170,451	17,488	19,440	9,425	13,819	24,080	12,907	11,100	10,342	10,342	10,527	1,392	—	311,313
Earnings in investment in subsidiaries	1,292	—	—	—	—	—	—	—	—	—	—	—	(1,292)	—
Income (loss) before income taxes	(8,920)	2,272	1,451	90	59	4,234	66	(1,066)	(1,274)	(2,326)	(2,069)	9	(1,292)	(8,766)
Income tax expense (benefit)	(11,723)	—	—	(115)	—	243	—	—	26	—	—	—	—	(11,569)
Net income (loss)	$ 2,803	$ 2,272	$ 1,451	$ 205	$ 59	$ 3,991	$ 66	$ (1,066)	$ (1,300)	$ (2,326)	$ (2,069)	$ 9	$ (1,292)	$ 2,803
Composite Score	1.8	2.1	2.1	2.0	2.3	2.1	2.2	1.8	1.8	1.8	1.8	2.5		1.2

South University, LLC and Subsidiaries
Consolidating Statement of Operations
(Dollars in thousands)
For the Fiscal Year Ended June 30, 2016

	South University-Savannah	South University-Tampa	South University-West Palm Beach	South University-Montgomery	South University-Richmond	South University-Columbia	South University-Virginia Beach	South University-Novi	South University-Austin	South University-Cleveland	South University-High Point	South University - Orlando	Reclass-ifications & Eliminations	South University, LLC and Subsidiaries
OPEID #	01303900	01303908	01303904	01303906	01303910	01303907	01303911	01303914	01303915	01303922	01303923	01303926		
Net revenues	$ 158,870	$ 21,132	$ 22,845	$ 11,317	$ 14,283	$ 30,422	$ 13,877	$ 12,608	$ 7,122	$ 8,655	$ 8,580	$ 873	$ —	$ 310,584
Costs and expenses:														
Educational services	66,418	10,550	11,807	6,728	9,391	16,066	8,120	7,910	5,689	6,574	6,538	462	—	156,253
General and administrative	71,355	6,005	6,135	3,745	3,745	7,395	4,693	4,015	3,056	3,227	2,837	783	—	116,991
Depreciation and amortization	3,556	506	1,102	419	904	916	598	572	513	588	565	178	—	10,417
Total costs and expenses	141,329	17,061	19,044	10,892	14,040	24,377	13,411	12,497	9,258	10,389	9,940	1,423	—	283,661
Earnings in investment in subsidiaries	3,531	—	—	—	—	—	—	—	—	—	—	—	(3,531)	—
Income (loss) before income taxes	21,072	4,071	3,801	425	243	6,045	466	111	(2,136)	(1,734)	(1,360)	(550)	(3,531)	26,923
Income tax expense (benefit)	10,761	1,866	1,219	1,362	(16)	2,306	(179)	(28)	(1,313)	(385)	(567)	(135)	—	14,891
Net (loss) income	$ 10,311	$ 2,205	$ 2,582	$ (937)	$ 259	$ 3,739	$ 645	$ 139	$ (823)	$ (1,349)	$ (793)	$ (415)	$ (3,531)	$ 12,032
Composite Score	2.8	1.3	2.4	1.5	1.9	1.8	1.6	1.8	1.8	1.8	1.8	1.8	—	1.4

South University, LLC and Subsidiaries

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	$ 314,000	$ —
Florida Access to Better Learning and Education Grant		N/A	712,750	—
Florida Children and Spouses of Deceased or Disabled Veterans and Service Members Scholarship	48.055	N/A	4,935	—
Florida Bright Futures Scholarship	48.059	N/A	24,933	—
TOTAL DIRECT PROJECTS			$ 1,056,618	$ —
Indirect Projects:			$ —	$ —
Passed Through:			$ —	$ —
TOTAL FLORIDA DEPARTMENT OF EDUCATION			$ 1,056,618	$ —
TOTAL EXPENDITURES OF STATE FINANCIAL ASSISTANCE			$ 1,056,618	$ —

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.*

South University, LLC and Subsidiaries
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	$ 263,500	$ —
Florida Access to Better Learning and Education Grant		N/A	849,000	—
Florida Children and Spouses of Deceased or Disabled Veterans and Service Members Scholarship	48.055	N/A	3,290	—
Florida Bright Futures Scholarship	48.059	N/A	35,088	—
TOTAL DIRECT PROJECTS			$ 1,150,878	$ —
Indirect Projects:			$ —	$ —
Passed Through:			$ —	$ —
TOTAL FLORIDA DEPARTMENT OF EDUCATION			$ 1,150,878	$ —
TOTAL EXPENDITURES OF STATE FINANCIAL ASSISTANCE			$ 1,150,878	$ —

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.*

Ernst & Young LLP
2100 One PPG Place
Pittsburgh, PA 15222

Tel: +1 412 644 7800
Fax: +1 412 644 0477
ey.com

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
South University, LLC and Subsidiaries

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 South University, LLC and Subsidiaries, which comprise the consolidated 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 South University, LLC and Subsidiaries' 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 South University, LLC and Subsidiaries' internal control. Accordingly, we do not express an opinion on the effectiveness of South University, LLC and Subsidiaries' 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.

Building a better
working world

Compliance and Other Matters

As part of obtaining reasonable assurance about whether South University, LLC and Subsidiaries' 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

South University, LLC and Subsidiaries

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*.

South University, LLC and Subsidiaries

Schedule of Findings and Responses

Year Ended June 30, 2016

2016-001

Criteria:	South University, LLC and Subsidiaries' (the "University") financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP).
Condition:	During fiscal year 2016, the University 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 University. **This material weakness was remediated by June 30, 2016.**
Cause:	The University'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 University's financial statements that could be material.
Recommendation:	We recommended that the University 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 University.
Views of responsible officials planned corrective actions:	During fiscal 2016, the University remediated a historical material weakness on internal controls surrounding in 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.**