

**ART ACADEMY OF CINCINNATI AND
AFFILIATE**

May 31, 2017

*CONSOLIDATED FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT INCLUDING
SUPPLEMENTARY INFORMATION*



**ART ACADEMY OF CINCINNATI AND AFFILIATE
TABLE OF CONTENTS**

	PAGE
Independent Auditors' Report	
Consolidated Financial Statements	
Consolidated Statements of Financial Position	1
Consolidated Statements of Activities	3
Consolidated Statements of Cash Flows	5
Notes to the Consolidated Financial Statements	6
Supplementary Information	
Consolidating Statement of Financial Position	24
Consolidating Statement of Activities	25

INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Art Academy of Cincinnati and Affiliate
Cincinnati, Ohio

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of the Art Academy of Cincinnati and Affiliate (a nonprofit organization), which comprise the consolidated statements of financial position as of May 31, 2017 and 2016, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Art Academy of Cincinnati and Affiliate as of both May 31, 2017 and 2016, and the changes in their consolidated net assets and their consolidated cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating statement of financial position and the consolidating statement of activities on pages 24 and 25 are presented for purposes of additional analysis and are not a required part of the basic 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 of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

VonLehman & Company Inc.

Fort Wright, Kentucky
February 23, 2018

ART ACADEMY OF CINCINNATI AND AFFILIATE
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
May 31, 2017

ASSETS

	Unrestricted			Temporarily Restricted	Permanently Restricted	Total
	General	Board Designated	Plant		Endowment	
Current Assets						
Cash and Cash Equivalents	\$ 10,339	\$ 20,967	\$ -	\$ 51,527	\$ 15,816	\$ 98,649
Accounts Receivable, Net	325,124	-	-	-	-	325,124
Investments	41,563	667,420	-	82,220	-	791,203
Grant Receivable	-	-	-	40,000	-	40,000
Investment Receivable	(16,396)	-	-	16,396	-	-
Due From (to) Funds	16,972	3,035	(33,971)	13,964	-	-
Prepaid Expenses	67,519	-	-	-	-	67,519
Total Current Assets	445,121	691,422	(33,971)	204,107	15,816	1,322,495
Buildings and Equipment, Net	-	-	3,337,605	-	-	3,337,605
Investments	-	-	-	237,957	931,755	1,169,712
Art Inventory	-	-	206,007	-	-	206,007
Grant Receivable	-	-	-	400,000	-	400,000
Beneficial Interest in Perpetual Trust	-	-	-	-	196,063	196,063
Beneficial Interest in Charitable Remainder Trusts	-	-	-	32,480	-	32,480
Deposits	-	-	12,775	-	-	12,775
Other Assets, Net	-	-	1,933	-	-	1,933
Total Assets	<u>\$ 445,121</u>	<u>\$ 691,422</u>	<u>\$ 3,524,349</u>	<u>\$ 874,544</u>	<u>\$ 1,143,634</u>	<u>\$ 6,679,070</u>

LIABILITIES AND NET ASSETS

Current Liabilities						
Line of Credit	\$ 450,000	\$ -	\$ -	\$ -	\$ -	\$ 450,000
Accounts Payable	194,398	-	-	-	-	194,398
Accrued Expenses	110,322	-	-	173,144	-	283,466
Capital Leases	-	-	3,774	-	-	3,774
Note Payable	-	-	13,426	-	-	13,426
Total Current Liabilities	<u>754,720</u>	<u>-</u>	<u>17,200</u>	<u>173,144</u>	<u>-</u>	<u>945,064</u>
Long-Term Liabilities						
Charitable Remainder Trust	-	-	-	3,787	-	3,787
Deferred Revenue	-	-	-	440,000	-	440,000
Capital Leases (Less Current Portion)	-	-	5,317	-	-	5,317
Note Payable (Less Current Portion)	-	-	143,378	-	-	143,378
Total Long-Term Liabilities	<u>-</u>	<u>-</u>	<u>148,695</u>	<u>443,787</u>	<u>-</u>	<u>592,482</u>
Total Liabilities	754,720	-	165,895	616,931	-	1,537,546
Net Assets	<u>(309,599)</u>	<u>691,422</u>	<u>3,358,454</u>	<u>257,613</u>	<u>1,143,634</u>	<u>5,141,524</u>
Total Liabilities and Net Assets	<u>\$ 445,121</u>	<u>\$ 691,422</u>	<u>\$ 3,524,349</u>	<u>\$ 874,544</u>	<u>\$ 1,143,634</u>	<u>\$ 6,679,070</u>

See accompanying notes.

ART ACADEMY OF CINCINNATI AND AFFILIATE
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
May 31, 2016

ASSETS

	Unrestricted			Temporarily Restricted	Permanently Restricted	Total
	General	Board Designated	Plant		Endowment	
Current Assets						
Cash and Cash Equivalents	\$ 8,668	\$ -	\$ -	\$ 286,609	\$ 15,816	\$ 311,093
Accounts Receivable, Net	243,362	-	-	-	-	243,362
Investments	38,872	592,893	-	73,895	-	705,660
Grant Receivable	-	-	-	40,000	-	40,000
Investment Receivable	(38,661)	-	-	38,661	-	-
Prepaid Expenses	59,963	-	-	-	-	59,963
Total Current Assets	312,204	592,893	-	439,165	15,816	1,360,078
Buildings and Equipment, Net	-	-	3,448,418	-	-	3,448,418
Investments	-	-	-	146,987	931,755	1,078,742
Art Inventory	-	-	303,517	-	-	303,517
Grant Receivable	-	-	-	440,000	-	440,000
Beneficial Interest in Perpetual Trust	-	-	-	-	188,059	188,059
Beneficial Interest in Charitable Remainder Trusts	-	-	-	50,304	-	50,304
Deposits	-	-	12,775	-	-	12,775
Other Assets, Net	-	-	6,349	-	-	6,349
Total Assets	<u>\$ 312,204</u>	<u>\$ 592,893</u>	<u>\$ 3,771,059</u>	<u>\$ 1,076,456</u>	<u>\$ 1,135,630</u>	<u>\$ 6,888,242</u>

LIABILITIES AND NET ASSETS

Current Liabilities						
Line of Credit	\$ 300,000	\$ -	\$ -	\$ -	\$ -	\$ 300,000
Accounts Payable	350,076	-	-	-	-	350,076
Accrued Expenses	133,234	-	-	285,609	-	418,843
Capital Lease	-	-	3,600	-	-	3,600
Note Payable	-	-	5,784	-	-	5,784
Total Current Liabilities	783,310	-	9,384	285,609	-	1,078,303
Long-Term Liabilities						
Charitable Remainder Trust	-	-	-	8,068	-	8,068
Deferred Revenue	-	-	-	480,000	-	480,000
Capital Leases (Less Current Portion)	-	-	9,091	-	-	9,091
Note Payable (Less Current Portion)	-	-	158,327	-	-	158,327
Total Long-Term Liabilities	-	-	167,418	488,068	-	655,486
Total Liabilities	783,310	-	176,802	773,677	-	1,733,789
Net Assets	(471,106)	592,893	3,594,257	302,779	1,135,630	5,154,453
Total Liabilities and Net Assets	<u>\$ 312,204</u>	<u>\$ 592,893</u>	<u>\$ 3,771,059</u>	<u>\$ 1,076,456</u>	<u>\$ 1,135,630</u>	<u>\$ 6,888,242</u>

See accompanying notes.

**ART ACADEMY OF CINCINNATI AND AFFILIATE
CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended May 31, 2017**

	<u>Unrestricted</u>			<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
	<u>General</u>	<u>Board Designated</u>	<u>Plant</u>		<u>Endowment</u>	
Revenue and Support						
Grants, Contributions and Gifts	\$ 326,780	\$ -	\$ -	\$ -	\$ -	\$ 326,780
Tuition and Fees Income	5,656,395	-	-	-	-	5,656,395
Community Education	276,323	-	-	-	-	276,323
Investment Income	880	17,754	-	23,212	-	41,846
Other Income	30,127	-	149,005	-	-	179,132
Total Revenue and Support	6,290,505	17,754	149,005	23,212	-	6,480,476
Net Assets Released From Restrictions	71,849	-	-	(71,849)	-	-
Total Revenue, Support and Reclassifications	6,362,354	17,754	149,005	(48,637)	-	6,480,476
Expenses						
Program Services	5,118,799	-	378,272	-	-	5,497,071
Management and General	888,496	9,177	1,718	-	-	899,391
Fundraising	235,974	-	859	-	-	236,833
Total Expenses	6,243,269	9,177	380,849	-	-	6,633,295
Excess (Deficit) of Revenue, Support and Reclassifications Over Expenses	119,085	8,577	(231,844)	(48,637)	-	(152,819)
Interfund Equity Transfers	20,157	25,709	(3,959)	(41,907)	-	-
Realized Gain on Investments	-	11,655	-	14,217	-	25,872
Unrealized Gain on Investments	-	52,588	-	66,969	-	119,557
Change in Excess Loss on Endowment Investments	22,265	-	-	(22,265)	-	-
Change in Beneficial Interest in Perpetual Trust	-	-	-	-	8,004	8,004
Change in Beneficial Interest in Charitable Remainder Trusts	-	-	-	(13,543)	-	(13,543)
Change in Net Assets	161,507	98,529	(235,803)	(45,166)	8,004	(12,929)
Net Assets Beginning of Year	(471,106)	592,893	3,594,257	302,779	1,135,630	5,154,453
Net Assets End of Year	\$ (309,599)	\$ 691,422	\$ 3,358,454	\$ 257,613	\$ 1,143,634	\$ 5,141,524

See accompanying notes.

**ART ACADEMY OF CINCINNATI AND AFFILIATE
CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended May 31, 2016**

	<u>Unrestricted</u>			<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
	<u>General</u>	<u>Board Designated</u>	<u>Plant</u>		<u>Endowment</u>	
Revenue and Support						
Grants, Contributions and Gifts	\$ 374,769	\$ -	\$ 149,560	\$ -	\$ 104,868	\$ 629,197
Tuition and Fees Income	5,492,128	-	-	-	-	5,492,128
Community Education	235,255	-	-	-	-	235,255
Investment Income	-	21,763	-	23,227	-	44,990
Other Income	52,036	-	173,310	-	-	225,346
Total Revenue and Support	<u>6,154,188</u>	<u>21,763</u>	<u>322,870</u>	<u>23,227</u>	<u>104,868</u>	<u>6,626,916</u>
Net Assets Released From Restrictions	<u>2,000</u>	<u>-</u>	<u>-</u>	<u>(2,000)</u>	<u>-</u>	<u>-</u>
Total Revenue, Support and Reclassifications	<u>6,156,188</u>	<u>21,763</u>	<u>322,870</u>	<u>21,227</u>	<u>104,868</u>	<u>6,626,916</u>
Expenses						
Program Services	5,347,612	-	365,051	-	-	5,712,663
Management and General	641,779	3,723	1,667	-	-	647,169
Fundraising	186,485	-	833	-	-	187,318
Total Expenses	<u>6,175,876</u>	<u>3,723</u>	<u>367,551</u>	<u>-</u>	<u>-</u>	<u>6,547,150</u>
(Deficit) Excess of Revenue, Support and Reclassifications Over Expenses	(19,688)	18,040	(44,681)	21,227	104,868	79,766
Interfund Equity Transfers	(18,701)	-	20,890	(2,189)	-	-
Realized Gain on Investments	-	12,122	-	13,520	-	25,642
Unrealized Loss on Investments	-	(56,916)	-	(61,568)	-	(118,484)
Change in Excess Loss on Endowment Investments	(3,587)	-	-	3,587	-	-
Change in Beneficial Interest in Perpetual Trust	-	-	-	-	(18,891)	(18,891)
Change in Beneficial Interest in Charitable Remainder Trusts	-	-	-	(12,903)	-	(12,903)
Change in Net Assets	(41,976)	(26,754)	(23,791)	(38,326)	85,977	(44,870)
Net Assets Beginning of Year	<u>(429,130)</u>	<u>619,647</u>	<u>3,618,048</u>	<u>341,105</u>	<u>1,049,653</u>	<u>5,199,323</u>
Net Assets End of Year	<u>\$ (471,106)</u>	<u>\$ 592,893</u>	<u>\$ 3,594,257</u>	<u>\$ 302,779</u>	<u>\$ 1,135,630</u>	<u>\$ 5,154,453</u>

See accompanying notes.

**ART ACADEMY OF CINCINNATI AND AFFILIATE
CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Years Ended May 31,	
	2017	2016
Cash Flows From Operating Activities		
Change in Net Assets	\$ (12,929)	\$ (44,870)
Adjustments to Reconcile Change in Net Assets to Net Cash Provided by Operating Activities		
Depreciation	150,570	146,389
Amortization	4,416	1,684
Realized Gain on Investments	(25,872)	(25,642)
Unrealized (Gain) Loss on Investments	(119,557)	118,484
Donated Art Inventory	-	(149,560)
Change in Beneficial Interest in Perpetual Trust	(8,004)	18,891
Change in Beneficial Interest in Charitable Remainder Trusts	13,543	12,903
Changes in		
Accounts Receivable, Net	(81,762)	(88,238)
Grant Receivable	40,000	40,000
Art Inventory	97,510	84,117
Prepaid Expenses	(7,556)	19,596
Accounts Payable	(155,678)	2,048
Accrued Expenses	(135,377)	5,072
Deferred Revenue	(40,000)	(40,000)
	(280,696)	100,874
Net Cash (Used) Provided by Operating Activities		
Cash Flows From Investing Activities		
Proceeds From Sale of Investments	739,686	1,017,801
Purchase of Investments	(770,770)	(1,157,055)
Acquisition of Buildings and Equipment	(39,757)	(46,378)
	(70,841)	(185,632)
Net Cash Used by Investing Activities		
Cash Flows From Financing Activities		
Net Change in Line of Credit	150,000	100,000
Payments on Note Payable	(7,307)	(4,945)
Payments on Capital Lease	(3,600)	(7,516)
	139,093	87,539
Net Cash Provided by Financing Activities		
Net Change in Cash and Cash Equivalents	(212,444)	2,781
Beginning Balance - Cash and Cash Equivalents	311,093	308,312
Ending Balance - Cash and Cash Equivalents	\$ 98,649	\$ 311,093

See accompanying notes.

**ART ACADEMY OF CINCINNATI AND AFFILIATE
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation

The Art Academy of Cincinnati's purpose is to serve as an accredited educational institution of degreed and non-degreed students from across the country with diverse majors in studio art and design, notably drawing, painting, printmaking, photography, sculpture, visual communications design, digital arts, photo design, illustration, art history, and art education.

Art Academy Housing, Inc. is organized in the State of Ohio as a nonprofit corporation. Art Academy Housing, Inc. was formed during fiscal year 2006 to lease and operate student housing for the benefit of the Art Academy of Cincinnati. Art Academy Housing, Inc. is a wholly owned subsidiary of the Art Academy of Cincinnati (collectively referred to as the "Academy" hereafter).

The consolidated financial statements include the Art Academy of Cincinnati and Art Academy Housing, Inc. Art Academy Housing, Inc. is related to the Art Academy of Cincinnati because the Art Academy of Cincinnati has assumed the financial and day-to-day operational management functions for Art Academy Housing, Inc. Under accounting principles generally accepted in the United States of America (U.S. GAAP), the Art Academy of Cincinnati is required to present consolidated financial statements reflecting the financial position and results of operations of both entities. All significant inter-entity transactions have been eliminated.

Use of Estimates

The process of preparing consolidated financial statements in conformity with U.S. GAAP requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Certain estimates relate to unsettled transactions and events as of the date of the consolidated financial statements. Other estimates relate to assumptions about the ongoing operations and may impact future periods. Accordingly, upon settlement, actual results may differ from estimated amounts.

Accounts Receivable

Accounts receivable are stated at their contractual outstanding balances, net of any allowance for doubtful accounts. Accounts are considered past due if any portion of an account has not been paid in full within the contractual terms of the account. The Academy begins to assess its ability to collect receivables that are over 90 days past due and provides for an adequate allowance for doubtful accounts based on the Academy's collection history, the financial stability and recent payment history of the student, and other pertinent factors. Based on these criteria, the Academy has estimated an allowance for doubtful accounts of \$86,000 and \$13,500 at May 31, 2017 and 2016, respectively.

Investments

Investments in equity securities and debt securities are stated at fair market value. Investments available for current operations are classified as current assets. Investments not available for current operations are classified as long-term. Investment income and dividends are included in unrestricted revenue unless restricted by donor or law. Realized and unrealized gains (losses) are shown as increases (decreases) in net assets in the period in which the gain (loss) is recognized.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Art Inventory

The Academy's art inventory is made up of art objects that have been acquired through donations. The art inventory is recorded at 60% of the appraised value. Each of the items is catalogued, preserved and cared for as would be appropriate for each of the items within the art inventory. All items within the art inventory that may have been subject to a minimum holding period covenant from the original donor are no longer subject to those covenants, having surpassed the holding periods specified in each of those covenants. Therefore, all items within the art inventory are free of restrictions that would prevent the sale or liquidation of portions of the inventory or the entire inventory. During the years ended May 31, 2017 and 2016, sales of art inventory totaled \$20,967 and \$5,225, respectively.

Buildings and Equipment

The acquisition cost of purchased buildings and equipment is capitalized. Depreciation is computed on the straight-line basis over the estimated useful lives of the related assets. Maintenance and repairs are charged to operations when incurred. Significant betterments and renewals greater than \$1,000 are capitalized.

The useful lives of buildings and equipment for purposes of computing depreciation range from five to forty years.

Long-Lived Assets

Long-lived assets to be held and used are tested for recoverability whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When required, impairment losses on assets to be held and used are measured based on the fair value of the asset, and long-lived assets to be disposed of by sale are reported at the lower of the carrying amount or fair value less costs to sell. Long-lived assets were measured for impairment and no adjustments were deemed necessary during either of the years ended May 31, 2017 or 2016.

Classes of Net Assets

The accompanying consolidated financial statements have been prepared in conformity with the requirements of accounting pronouncements for nonprofit organizations. Accordingly, the net assets of the Academy are reported in each of the following classes: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

Net assets of the two restricted classes are created only by donor-imposed restrictions on their use. All other net assets, including board designated amounts, are legally unrestricted, and are reported as part of the unrestricted net asset class.

The Academy's temporarily restricted net assets are restricted by donors for specific operating purposes or currently not available for use until commitments regarding their use have been fulfilled.

The Academy's permanently restricted net assets consist of various endowment funds.

Revenue and Support Recognition

The Academy records revenue from contributions, tuition and interest when earned. Temporarily restricted support from governmental grants, which reimburse actual costs of the programs, is recognized as such costs are incurred and reimbursements are determinable.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Recognition of Donor Restrictions**

Donor-restricted support is reported as an increase in temporarily or permanently restricted net assets depending on the nature of the restriction. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets. The Academy reflects temporary restricted support as unrestricted when the restrictions are met in the same reporting period.

Contributions

Contributions, including unconditional promises to give, are recorded as made. All contributions are available for unrestricted use unless specifically restricted by a donor. Conditional promises to give are recognized when the conditions on which they depend are substantially met. Unconditional promises to give due in the next year are recorded net of estimated uncollectible pledges. Unconditional promises to give due in subsequent years are reported at present value net of estimated uncollectible pledges, using risk-free interest rates applicable to the years in which the promises are to be received.

Beneficial Interest in Perpetual Trusts

The beneficial interest in perpetual trusts is valued based on quoted market values.

Charitable Remainder Trusts

Charitable remainder trusts are valued using payment streams discounted at market rates over the remaining lives of the donors using standard mortality tables.

Collections

The Academy's collections are made up of art objects that are held for public exhibition, education and research for furtherance of public service. The collections, which were acquired through purchases and contributions since the Academy's inception, are not recognized as assets on the consolidated statements of financial position. Purchases of collection items are recorded as decreases in unrestricted net assets in the year in which the items are acquired. Contributed collection items are not reflected on the consolidated financial statements. Proceeds from sales or insurance recoveries are reflected as increases in temporarily restricted net assets. Each of the items is cataloged, preserved and cared for, and activities verifying their existence and assessing their condition are performed continuously. The collections are subject to a policy that requires proceeds from their sales to be used to acquire other items for collections. During both the years ended May 31, 2017 and 2016, sales of art totaled \$-0-. During both the years ended May 31, 2017 and 2016, there were no items in the Academy's collections that were damaged or destroyed.

Retirement Plan

The Academy has a defined contribution plan for all employees. Under the plan, eligible employees may contribute a percentage of their salaries with a matching contribution by the Academy of up to four percent of compensation. Matching contributions were suspended as of July 31, 2009. In addition, the Academy can contribute a discretionary percentage of compensation to the plan for each eligible participant annually. The discretionary contribution was not made for either of the fiscal years 2017 or 2016.

Advertising Costs

The Academy expenses advertising costs as they are incurred.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Amortization**

Closing costs associated with the purchase of a building and parking lot were capitalized and are being amortized over fifteen years using the straight-line method.

Income Tax Status

The Art Academy of Cincinnati and Art Academy Housing, Inc. are nonprofit organizations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal and state income taxes on related income pursuant to the Internal Revenue Code.

The Art Academy of Cincinnati and Affiliate have adopted the provisions of the accounting pronouncement related to accounting for uncertainty in income taxes. The Art Academy of Cincinnati and Affiliate recognized no interest or penalties in the consolidated statements of activities for either of the years ended May 31, 2017 or 2016. If the situation arose in which the Art Academy of Cincinnati and Affiliate would have interest to recognize, it would recognize this as interest expense and penalties would be recognized in other expenses. Currently, the prior three years are open under federal and state statute of limitations and remain subject to review and change. The Academy is not currently under audit, nor has the Academy been contacted by these jurisdictions.

Based on the evaluation of the Art Academy of Cincinnati and Affiliate's tax positions, management believes all positions taken would be upheld under an examination. Therefore, no provision for the effects of uncertain tax positions has been recorded for either of the years ended May 31, 2017 or 2016.

Reclassifications

Certain amounts in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation in the current year financial statements.

Subsequent Events

The Academy has evaluated subsequent events through February 23, 2018, which is the date the consolidated financial statements were available to be issued.

Recently Issued Significant Accounting Standards*Lease Accounting Standard*

In February, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, Leases (Topic 842.) The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases that are not excluded by this standard. Such leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, *Elements of Financial Statements*, and therefore, recognition of those lease assets and lease liabilities represents an improvement over previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases. The ASU is effective for nonpublic entities for years beginning after December 15, 2019.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)*Revenue Recognition Standard*

In May, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. This standard may have an impact on the timing of when an entity recognizes certain revenue. The ASU is effective for nonpublic entities for years beginning after December 15, 2018.

Nonprofit Standard

In August, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, Presentation of Financial Statements for Not-for-Profit Entities (Topic 958). The core principles of the guidance are a reduction in the number of net asset categories from three to two, reporting investment return net of external and internal investment expenses, the placed-in-service approach for reporting expirations of restrictions on donated assets and enhanced disclosures regarding designations and donor restrictions, qualitative and quantitative liquidity information, expense allocation methods, expenses by natural classification and function and underwater endowments. The ASU is effective for years beginning after December 15, 2017.

The Academy is currently in the process of evaluating the impact of adoption of these ASUs on their consolidated financial statements.

NOTE 2 - CASH AND CASH FLOW INFORMATION

At various times throughout the year, the Academy may have cash in financial institutions in excess of insured limits. The Federal Deposit Insurance Corporation (FDIC) insures account balances up to \$250,000 for each business depositor. As of both May 31, 2017 and 2016, the Academy had \$-0- in cash in financial institutions in excess of insured limits.

The Academy utilizes a separate bank account for receiving federal financial aid funding and monitors interest income relative to these funds in accordance with federal guidelines.

Cash paid for interest was \$16,819 and \$18,609 in 2017 and 2016, respectively.

The Academy had noncash financing or investing activities as follows:

	Years Ended May 31,	
	2017	2016
Equipment Acquired through Capital Lease	\$ -	\$ 14,999
Refinance of Note Payable	\$ 160,000	\$ -

NOTE 3 - BUILDINGS AND EQUIPMENT

Buildings and equipment and related accumulated depreciation consist of the following at May 31, 2017 and 2016.

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
<u>2017</u>			
Land	\$ 89,170	\$ -	\$ 89,170
Buildings and Improvements	3,668,290	491,036	3,177,254
Office Furniture and Equipment	<u>1,184,994</u>	<u>1,113,813</u>	<u>71,181</u>
	<u>\$ 4,942,454</u>	<u>\$ 1,604,849</u>	<u>\$ 3,337,605</u>
<u>2016</u>			
Land	\$ 89,170	\$ -	\$ 89,170
Buildings and Improvements	3,668,290	366,246	3,302,044
Office Furniture and Equipment	<u>1,145,237</u>	<u>1,088,033</u>	<u>57,204</u>
	<u>\$ 4,902,697</u>	<u>\$ 1,454,279</u>	<u>\$ 3,448,418</u>

NOTE 4 - INVESTMENTS

The Academy's investments are summarized as follows:

	May 31,			
	<u>2017</u>		<u>2016</u>	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Unrestricted Fund	\$ 608,432	\$ 708,983	\$ 622,408	\$ 631,765
Temporarily Restricted	350,854	320,177	219,985	220,882
Permanently Restricted	<u>840,398</u>	<u>931,755</u>	<u>900,090</u>	<u>931,755</u>
	<u>\$ 1,799,684</u>	<u>\$ 1,960,915</u>	<u>\$ 1,742,483</u>	<u>\$ 1,784,402</u>

The approximate cost and fair values of investments in securities are summarized as follows:

Cash Equivalents	\$ 38,402	\$ 38,402	\$ 3,520	\$ 3,520
U.S. Government Securities	-	-	4,732	5,356
Corporate Stocks and Bonds	304,474	377,796	291,572	336,315
Collective and Mutual Funds	1,175,896	1,231,108	1,174,098	1,149,422
Exchange-Traded Fund	<u>280,912</u>	<u>313,609</u>	<u>268,561</u>	<u>289,789</u>
	<u>\$ 1,799,684</u>	<u>\$ 1,960,915</u>	<u>\$ 1,742,483</u>	<u>\$ 1,784,402</u>

NOTE 4 - INVESTMENTS (Continued)

The following schedule summarizes investment return and its classification in the consolidated statements of activities for the years ended May 31, 2017 and 2016.

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<u>2017</u>				
Interest and Dividends	\$ 18,634	\$ 23,212	\$ -	\$ 41,846
Realized Gains	11,655	14,217	-	25,872
Unrealized Gains	52,588	66,969	-	119,557
Fees	<u>(9,177)</u>	<u>-</u>	<u>-</u>	<u>(9,177)</u>
Total Investment Return	<u>\$ 73,700</u>	<u>\$ 104,398</u>	<u>\$ -</u>	<u>\$ 178,098</u>
<u>2016</u>				
Interest and Dividends	\$ 21,763	\$ 23,227	\$ -	\$ 44,990
Realized Gains	12,122	13,520	-	25,642
Unrealized Losses	(56,916)	(61,568)	-	(118,484)
Fees	<u>(3,723)</u>	<u>-</u>	<u>-</u>	<u>(3,723)</u>
Total Investment Return	<u>\$ (26,754)</u>	<u>\$ (24,821)</u>	<u>\$ -</u>	<u>\$ (51,575)</u>

With the Board of Trustees' approval, the Academy is permitted to receive a monthly cash distribution from the investments. The spending rate is based on the market value of the investments over a four quarter rolling average and a twelve quarter rolling average for the years ended May 31, 2017 and 2016, respectively. The distribution is recognized in the general fund as investment income. For fiscal years 2017 and 2016, the monthly cash distribution was not made from the investment accounts.

NOTE 5 - GRANT RECEIVABLE

In August, 2013, the Academy finalized a grant agreement with the Ohio Facilities Construction Commission (OFCC). As part of the agreement, the OFCC will hold \$600,000 in escrow to be used as part of the Cultural Project constituting the OFCC-funded improvements to reimburse the Academy for a portion of the costs of the acquisition of the 1212 Jackson Street building and the adjacent parking lot. The cash will be received and the grant will be amortized on a fifteen year straight line basis. There were draws on the grant in fiscal years 2017 and 2016 for \$40,000 each year.

NOTE 6 - BENEFICIAL INTEREST IN PERPETUAL TRUSTS

The Academy's beneficial interest in perpetual trusts consists of the following:

<u>Trust</u>	<u>The Academy's Percentage of Trust</u>	<u>May 31,</u>	
		<u>2017</u>	<u>2016</u>
Wilmer D. Glenn Trust	100%	<u>\$ 196,063</u>	<u>\$ 188,059</u>

NOTE 7 - ART INVENTORY

Art inventory consists of the following:

	May 31,	
	2017	2016
Works of Art	\$ 206,007	\$ 303,517

NOTE 8 - OTHER ASSETS

The following is a summary of other assets:

Cost	\$ 25,247	\$ 25,247
Accumulated Amortization	<u>23,314</u>	<u>18,898</u>
Other Assets, Net	\$ <u>1,933</u>	\$ <u>6,349</u>

Estimated amortization for the five years subsequent is as follows:

Years Ending May 31,	
2018	\$ 331
2019	331
2020	331
2021	331
2022	331
Thereafter	<u>278</u>
	\$ <u>1,933</u>

NOTE 9 - LINE OF CREDIT

The Academy has an unsecured revolving line of credit agreement with a bank for \$1,000,000. The line of credit charges interest at LIBOR plus 1.75% (3.99% and 2.21% at May 31, 2017 and 2016, respectively). The line matures in March, 2018. At May 31, 2017 and 2016, the outstanding balance on the line of credit was \$450,000 and \$300,000, respectively. Art Academy Housing has guaranteed the line of credit.

NOTE 10 - NOTE PAYABLE

	May 31,	
	<u>2017</u>	<u>2016</u>
The Academy had a note payable to a bank which was refinanced during 2017. The note was due in monthly installments of \$1,284 including interest of 6%. The note collateralized by a parcel of land.	\$ -	\$ 164,111
The Academy refinanced its note payable as noted above. The new note charges interest at 3.99% with final payment due in February, 2024. The note is due in monthly principal and interest payments of \$1,623, and is collateralized by a parcel of land.	156,804	-
Less Current Portion	<u>13,426</u>	<u>5,784</u>
Long-Term Portion	<u>\$ 143,378</u>	<u>\$ 158,327</u>

The remaining maturities on this note are as follows:

Years Ending May 31,	
2018	\$ 13,426
2019	13,972
2020	14,540
2021	15,131
2022	15,746
Thereafter	<u>83,989</u>
	<u>\$ 156,804</u>

NOTE 11 - CAPITAL LEASE OBLIGATIONS

The Company entered into a capital lease obligation in 2013, collateralized by the computer server purchased, that charged interest at 12.2%. The Company also entered into a capital lease obligation in July, 2015, collateralized by the computer equipment purchased, that charges interest at 4.72%. Depreciation expense for equipment held under the capital lease obligations was \$3,750 and \$6,750 for the years ended May 31, 2017 and 2016, respectively.

The following is a summary of equipment at cost less accumulated depreciation that was held under the capital lease obligations:

	May 31,	
	<u>2017</u>	<u>2016</u>
Computer Equipment	\$ 14,999	\$ 14,999
Computer Server	18,250	18,250
Less Accumulated Depreciation	<u>24,187</u>	<u>20,437</u>
Net Capital Lease Obligation Equipment	<u>\$ 9,062</u>	<u>\$ 12,812</u>

NOTE 11 - CAPITAL LEASE OBLIGATIONS (Continued)

Minimum future lease payments under capital leases for the remainder of the leases are as follows:

Years Ending May 31,		
2018	\$	4,357
2019		4,357
2020		<u>1,452</u>
Total Minimum Lease Payments		10,166
Less Amounts Representing Interest		<u>(1,075)</u>
Present Value of Net Minimum Lease Payments	9,091	\$ 12,691
Less Current Portion	<u>3,774</u>	<u>3,600</u>
Long-Term Capital Lease Obligation	<u>\$ 5,317</u>	<u>\$ 9,091</u>

NOTE 12 - TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are restricted as follows:

	May 31,	
	<u>2017</u>	<u>2016</u>
Time Restricted		
Cash and Investments	\$ (15,794)	\$ 104,799
Beneficial Interest in Charitable Remainder Trusts	28,693	42,236
Purpose Restricted		
Contributions and Gifts	6,757	8,757
Endowments	<u>237,957</u>	<u>146,987</u>
Temporarily Restricted Net Assets	<u>\$ 257,613</u>	<u>\$ 302,779</u>

NOTE 13 - ENDOWMENTS

The Academy's endowment consists of several individual funds established for a variety of purposes. Its endowment includes donor-restricted funds and funds designated by the Board of Trustees to function as endowments. As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

NOTE 13 - ENDOWMENTS (Continued)

The Board of Trustees of the Academy has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the contributed value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Academy classifies as permanently restricted net assets: (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instruction at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Academy in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Academy considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the various funds, (2) the purposes of the donor-restricted endowment funds, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of the Academy and (7) the Academy's investment policies.

Investment Return Objectives, Risk Parameters and Strategies. The Academy has adopted investment and spending policies, approved by the Board of Trustees, for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment funds while also maintaining the purchasing power of those endowment assets over the long-term. Accordingly, the investment process seeks to achieve an after-cost total real rate of return, including investment income as well as capital appreciation, which exceeds the annual distribution with acceptable levels of risk. Endowment assets are invested in a well-diversified asset mix, which includes equity and debt securities that is intended to result in a consistent inflation-protected rate of return that has sufficient liquidity to make an annual distribution of 4% to 6%, while growing the funds, if possible. Therefore, the Academy expects its endowment assets, over time, to produce an average rate of return of approximately 7% annually. Actual returns in any given year may vary from this amount. Investment risk is measured in terms of the total endowment fund; investment assets and allocation between asset classes and strategies are managed to not expose the fund to unacceptable levels of risk.

Spending Policy. The Academy has a policy of appropriating for distribution each year 4% to 6% of its endowment fund's average fair value using one of the following methods: 1) average value of the endowment using the trailing 12 quarters, 2) average value of the endowment using the trailing 4 quarters or 3) value of the endowment using the most recent quarter. In establishing this policy, the Academy considered the long-term expected return on its investment assets, the nature and duration of the individual endowment funds, many of which must be maintained in perpetuity because of donor restrictions, and the possible effects of inflation. The Academy expects the current spending policy to allow its endowment funds to grow at a nominal average rate of 7% annually. This is consistent with the Academy's objective to maintain the purchasing power of the endowment assets as well as to provide additional real growth through new gifts and investment return.

Endowment net asset composition by type of fund as of May 31, 2017 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Asset Composition by Type of Fund	\$ 667,420	\$ 237,957	\$ 931,755	\$ 1,837,132

NOTE 13 - ENDOWMENTS (Continued)

Changes in endowment net assets for the year ended May 31, 2017 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets, Beginning of Year	\$ 592,893	\$ 146,987	\$ 931,755	\$ 1,671,635
Investment Return				
Investment Income	17,754	23,212	-	40,966
Net Appreciation (Realized and Unrealized)	<u>64,243</u>	<u>81,186</u>	<u>-</u>	<u>145,429</u>
Total Investment Return	81,997	104,398	-	186,395
Contributions	1,707	-	-	1,707
Appropriation of Endowment Assets for Expenditures	<u>(9,177)</u>	<u>(13,428)</u>	<u>-</u>	<u>(22,605)</u>
Endowment Net Assets, End of Year	<u>\$ 667,420</u>	<u>\$ 237,957</u>	<u>\$ 931,755</u>	<u>\$ 1,837,132</u>

As of May 31, 2017, the amount of permanently restricted endowment funds whose balance dropped below the restricted amount was \$16,396. The change for the year ended May 31, 2017 was a decrease of \$22,265.

Endowment net asset composition by type of fund as of May 31, 2016 is as follows:

Endowment Net Asset Composition by Type of Fund	<u>\$ 592,893</u>	<u>\$ 146,987</u>	<u>\$ 931,755</u>	<u>\$ 1,671,635</u>
--	-------------------	-------------------	-------------------	---------------------

Changes in endowment net assets for the year ended May 31, 2016 are as follows:

Endowment Net Assets, Beginning of Year	\$ 619,647	\$ 174,914	\$ 828,962	\$ 1,623,523
Investment Return				
Investment Income	21,763	24,310	-	46,073
Net Appreciation (Realized and Unrealized)	<u>(44,794)</u>	<u>(48,048)</u>	<u>-</u>	<u>(92,842)</u>
Total Investment Return	(23,031)	(23,738)	-	(46,769)
Contributions	-	-	102,793	102,793
Appropriation of Endowment Assets for Expenditures	<u>(3,723)</u>	<u>(4,189)</u>	<u>-</u>	<u>(7,912)</u>
Endowment Net Assets, End of Year	<u>\$ 592,893</u>	<u>\$ 146,987</u>	<u>\$ 931,755</u>	<u>\$ 1,671,635</u>

As of May 31, 2016, the amount of permanently restricted endowment funds whose balance dropped below the restricted amount was \$38,661. The change for the year ended May 31, 2016 was an increase of \$3,587.

NOTE 14 - FUNCTIONAL EXPENSES

The detail of functional expenses is as follows:

	Years Ended May 31,							
	2017				2016			
	Program Services	Management and General	Fundraising	Total	Program Services	Management and General	Fundraising	Total
Salaries	\$ 1,496,149	\$ 437,032	\$ 130,351	\$ 2,063,532	\$ 1,476,514	\$ 353,587	\$ 107,747	\$ 1,937,848
Payroll Taxes	129,249	36,057	11,295	176,601	111,186	26,635	8,573	146,394
Employee Benefits	85,104	91,937	11,319	188,360	131,385	24,096	9,727	165,208
Rent	179,217	-	-	179,217	175,917	-	-	175,917
Telephone	-	-	-	-	-	1,670	-	1,670
Utilities	251,657	-	-	251,657	248,747	-	-	248,747
Security	210,402	-	-	210,402	208,146	-	-	208,146
Insurance	232	34,570	-	34,802	-	34,989	-	34,989
Bank Charges	180	18,015	158	18,353	-	6,586	712	7,298
Supplies	133,106	25,797	7,362	166,265	72,475	20,925	5,847	99,247
Purchased Services	230,390	91,909	47,907	370,206	209,203	94,107	16,013	319,323
Model Fees	12,247	-	-	12,247	10,368	-	-	10,368
Lecturer's Honorarium	7,818	-	-	7,818	5,675	-	-	5,675
Hospitality	16,337	5,209	9,102	30,648	15,426	4,335	8,371	28,132
Memberships and Fees	51,495	22,829	6,731	81,055	55,611	15,850	1,799	73,260
Books, Videos, and Subscriptions	1,168	-	298	1,466	960	563	54	1,577
Email and Internet	18,575	18,595	-	37,170	18,923	18,906	-	37,829
Postage and Mail Service	-	9,404	-	9,404	-	7,658	-	7,658
Travel	40,733	4,431	143	45,307	30,142	2,205	228	32,575
Per Diem	12,882	3,422	-	16,304	11,670	1,540	-	13,210
Promotion	150,371	359	10,764	161,494	214,704	-	20,026	234,730
Equipment Maintenance and Rental	58,915	23,251	544	82,710	68,510	22,862	7,388	98,760
Plant Maintenance	62,941	-	-	62,941	39,267	-	-	39,267
Student Activities	32,739	-	-	32,739	43,135	-	-	43,135
Student Exhibition	16,891	-	-	16,891	18,079	-	-	18,079
Equipment Purchases	6,525	2,356	-	8,881	-	-	-	-
Scholarships	2,122,520	-	-	2,122,520	2,382,440	-	-	2,382,440
Depreciation and Amortization	152,661	1,550	775	154,986	145,850	1,481	740	148,071
Interest Expense	16,567	168	84	16,819	18,330	186	93	18,609
Bad Debt Expense	-	72,500	-	72,500	-	6,213	-	6,213
Miscellaneous Expense	-	-	-	-	-	2,775	-	2,775
	<u>\$ 5,497,071</u>	<u>\$ 899,391</u>	<u>\$ 236,833</u>	<u>\$ 6,633,295</u>	<u>\$ 5,712,663</u>	<u>\$ 647,169</u>	<u>\$ 187,318</u>	<u>\$ 6,547,150</u>

NOTE 15 - OPERATING LEASES

The Academy is the lessee in the following lease agreements:

Equipment

The Academy leases equipment for total monthly payments of \$3,681. The leases have varying expiration dates ranging from November, 2017 to June, 2020. The Academy incurred lease expense of \$43,575 and \$46,608 for 2017 and 2016, respectively.

Housing

Art Academy Housing, Inc. leases apartments for the students of the Academy for a base rent of \$10,110 per month under an operating lease. The lease expires in August, 2024, with an option to renew for an additional five years. Art Academy Housing, Inc. incurred lease expense related to this lease of \$121,320 in both 2017 and 2016.

In September, 2014, the Academy entered into additional leases for student housing. The leases vary in payment from \$425 to \$2,300 per month and are on a month to month basis. The Academy incurred lease expense of \$61,680 and \$54,597 for 2017 and 2016, respectively.

The following are the net minimum lease payments for the remainder of these leases:

<u>Years Ending May 31,</u>	<u>Housing</u>	<u>Equipment</u>	<u>Total</u>
2018	\$ 121,320	\$ 38,065	\$ 159,385
2019	121,320	32,556	153,876
2020	121,320	32,556	153,876
2021	121,320	2,713	124,033
2022	121,320	-	121,320
Thereafter	<u>363,960</u>	<u>-</u>	<u>363,960</u>
	<u>\$ 970,560</u>	<u>\$ 105,890</u>	<u>\$ 1,076,450</u>

NOTE 16 - RELATED PARTIES

The Academy does business with companies who are either owned by or employ a Board of Trustees member. For the fiscal years ended May 31, 2017 and 2016, the Academy had transactions with related parties as follows:

	<u>Years Ended May 31,</u>	
	<u>2017</u>	<u>2016</u>
Legal Services	\$ 12,294	\$ 22,123
Event Rental	<u>4,250</u>	<u>-</u>
	<u>\$ 16,544</u>	<u>\$ 22,123</u>

NOTE 17 - FAIR VALUE MEASUREMENTS

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

LEVEL 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Academy has the ability to access.

LEVEL 2 - Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

LEVEL 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for marketable securities measured at fair value. There have been no changes in the methodologies used at May 31, 2017 and 2016.

Cash and Cash Equivalents - Fair value approximates carrying value due to the initial maturities of the instruments being three months or less.

Mutual Funds and Exchange Traded Funds - Valued at the net asset value (NAV) of shares held by the Company at year end.

Common Stocks and Fixed Income Obligations - Valued at the closing price reported on the active market in which the individual securities are traded.

Beneficial Interest in Remainder Trusts - Valued using an income approach to provide the present value of the expected cash distributions from the trust.

The preceding methods described May provide a fair value calculation that May not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Academy believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the operating date.

NOTE 17 - FAIR VALUE MEASUREMENTS (Continued)

The following assets and liabilities were measured at fair value as of May 31, 2017:

	Quoted Price In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash and Cash Equivalents	\$ 38,402	\$ -	\$ -	\$ 38,402
Mutual Funds				
Government Agency Funds	4,911	-	-	4,911
Blended Funds	80,861	-	-	80,861
Growth Funds	259,169	-	-	259,169
Fixed Funds	607,853	-	-	607,853
International Funds	278,314	-	-	278,314
Total Mutual Funds	1,231,108	-	-	1,231,108
Stocks				
Consumer Discretionary	52,693	-	-	52,693
Consumer Staples	32,138	-	-	32,138
Energy	20,708	-	-	20,708
Financial	63,532	-	-	63,532
Health Care	45,231	-	-	45,231
Industrials	44,820	-	-	44,820
Information Technology	82,268	-	-	82,268
Materials	14,250	-	-	14,250
Telecommunication Services	4,912	-	-	4,912
Real Estate	5,831	-	-	5,831
Utilities	11,413	-	-	11,413
Total Stocks	377,796	-	-	377,796
Exchange-Traded Funds	313,609	-	-	313,609
Total Investments	\$ 1,960,915	\$ -	\$ -	\$ 1,960,915
Beneficial Interest In Trusts	\$ 228,543	\$ -	\$ (3,787)	\$ 224,756

NOTE 17 - FAIR VALUE MEASUREMENTS (Continued)

The following assets and liabilities were measured at fair value as of May 31, 2016:

	Quoted Price In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash and Cash Equivalents	\$ 3,520	\$ -	\$ -	\$ 3,520
Mutual Funds				
Money Market Funds	19,226	-	-	19,226
Blended Funds	73,061	-	-	73,061
Growth Funds	231,544	-	-	231,544
Fixed Funds	595,689	-	-	595,689
International Funds	229,902	-	-	229,902
Total Mutual Funds	1,149,422	-	-	1,149,422
Stocks				
Consumer Discretionary	50,902	-	-	50,902
Consumer Staples	33,569	-	-	33,569
Energy	21,276	-	-	21,276
Financial	50,161	-	-	50,161
Health Care	40,591	-	-	40,591
Industrials	42,089	-	-	42,089
Information Technology	55,143	-	-	55,143
Materials	15,903	-	-	15,903
Telecommunication Services	9,409	-	-	9,409
Utilities	15,643	-	-	15,643
Unclassified Stock	1,629	-	-	1,629
Total Stocks	336,315	-	-	336,315
Fixed Income	5,356	-	-	5,356
Exchange-Traded Funds	289,789	-	-	289,789
Total Investments	\$ 1,784,402	\$ -	\$ -	\$ 1,784,402
Beneficial Interest In Trusts	\$ 238,363	\$ -	\$ (8,068)	\$ 230,295

NOTE 17 - FAIR VALUE MEASUREMENTS (Continued)

Assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3 inputs):

	Beneficial Interest In Trust
May 31, 2015	\$ (14,772)
Change in Value	<u>6,704</u>
May 31, 2016	(8,068)
Change in Value	<u>4,281</u>
May 31, 2017	<u>\$ (3,787)</u>

NOTE 18 - RISKS AND UNCERTAINTIES

The Academy invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credits risks. Due to the level of risks associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect account balances and amounts reported in the consolidated statements of financial position.

NOTE 19 - ECONOMIC DEPENDENCY AND UNCERTAINTY

The Academy is economically dependent on the Federal Title IV Financial Aid Program, provided by the Department of Education. For the years ended May 31, 2017 and 2016, financial aid awards received accounted for approximately 44% and 46%, respectively, of tuition income. In the event the financial aid program ceases, the Academy's future as a going concern would be in jeopardy.

NOTE 20 - GOING CONCERN

As shown in the accompanying consolidated financial statements, the Academy incurred a decrease in net assets of \$12,929 and \$44,870 for the years ended May 31, 2017 and 2016, respectively. During this time, the general fund net asset balance remains in a deficit. In addition, the general fund current liabilities exceed current assets as of both May 31, 2017 and 2016. The Academy was not able to reach its budgeted student FTE numbers for the year ending May 31, 2018 therefore revenue will be under budget. In response, the Academy has made cuts to expenses. Due to the reduction in revenue, the Academy has experienced a shortfall in cash flow. The cash flow needs have been met through the line of credit. The line of credit expires March 31, 2018 and is likely to be renewed. Based on the above factors, the Admissions department has changed the methods to attract and retain students for the 2018 – 2019 school year. The changes made have generated four times the number of prospective student applications for the year ending May 31, 2019. Also the Academy has made significant changes in personnel in both the Financial Aid Office and the Business Office. The experienced professionals have made a positive impact at the Academy.

The ability of the Academy to continue as a going concern is dependent on the success of the recruitment of new students and retention of the experienced professionals in the Business Office and Financial Aid Office. Management feels the changes made have been successful and will lead to increased enrollments and improved cash flow. The consolidated financial statements do not include any adjustments that might be necessary if the Academy is unable to continue as a going concern.

SUPPLEMENTARY INFORMATION

**ART ACADEMY OF CINCINNATI AND AFFILIATE
CONSOLIDATING STATEMENT OF FINANCIAL POSITION
May 31, 2017**

ASSETS

	<u>Art Academy of Cincinnati</u>	<u>Art Academy Housing, Inc.</u>	<u>Eliminations</u>	<u>Total</u>
Current Assets				
Cash and Cash Equivalents	\$ 98,649	\$ -	\$ -	\$ 98,649
Accounts Receivable, Net	325,124	-	-	325,124
Investments	791,203	-	-	791,203
Grant Receivable	40,000	-	-	40,000
Note Receivable - Related Party	1,961,727	1,969,983	(3,931,710)	-
Prepaid Expenses	67,519	-	-	67,519
	<u>3,284,222</u>	<u>1,969,983</u>	<u>(3,931,710)</u>	<u>1,322,495</u>
Total Current Assets	3,284,222	1,969,983	(3,931,710)	1,322,495
Buildings and Equipment, Net	3,306,322	31,283	-	3,337,605
Investments	1,169,712	-	-	1,169,712
Art Inventory	206,007	-	-	206,007
Grant Receivable	400,000	-	-	400,000
Beneficial Interest in Perpetual Trust	196,063	-	-	196,063
Beneficial Interest in Charitable Remainder Trusts	32,480	-	-	32,480
Deposits	-	12,775	-	12,775
Other Assets, Net	1,933	-	-	1,933
	<u>1,933</u>	<u>-</u>	<u>-</u>	<u>1,933</u>
Total Assets	\$ 8,596,739	\$ 2,014,041	\$ (3,931,710)	\$ 6,679,070

LIABILITIES AND NET ASSETS

Current Liabilities				
Line of Credit	\$ 450,000	\$ -	\$ -	\$ 450,000
Accounts Payable	194,398	-	-	194,398
Accrued Expenses	272,516	10,950	-	283,466
Capital Lease	3,774	-	-	3,774
Note Payable - Related Party	1,980,933	1,950,777	(3,931,710)	-
Note Payable	13,426	-	-	13,426
	<u>2,915,047</u>	<u>1,961,727</u>	<u>(3,931,710)</u>	<u>945,064</u>
Total Current Liabilities	2,915,047	1,961,727	(3,931,710)	945,064
Long-Term Liabilities				
Charitable Remainder Trust	3,787	-	-	3,787
Deferred Revenue	440,000	-	-	440,000
Capital Lease (Less Current Portion)	5,317	-	-	5,317
Note Payable (Less Current Portion)	143,378	-	-	143,378
	<u>592,482</u>	<u>-</u>	<u>-</u>	<u>592,482</u>
Total Long-Term Liabilities	592,482	-	-	592,482
Total Liabilities	3,507,529	1,961,727	(3,931,710)	1,537,546
Net Assets	5,089,210	52,314	-	5,141,524
	<u>5,089,210</u>	<u>52,314</u>	<u>-</u>	<u>5,141,524</u>
Total Liabilities and Net Assets	\$ 8,596,739	\$ 2,014,041	\$ (3,931,710)	\$ 6,679,070
	<u>\$ 8,596,739</u>	<u>\$ 2,014,041</u>	<u>\$ (3,931,710)</u>	<u>\$ 6,679,070</u>

**ART ACADEMY OF CINCINNATI AND AFFILIATE
CONSOLIDATING STATEMENT OF ACTIVITIES
Year Ended May 31, 2017**

	<u>Art Academy of Cincinnati</u>	<u>Art Academy Housing, Inc.</u>	<u>Eliminations</u>	<u>Total</u>
Revenue and Support				
Grants, Contributions and Gifts	\$ 326,780	\$ -	\$ -	\$ 326,780
Tuition and Fees Income	5,656,395	-	-	5,656,395
Community Education	276,323	-	-	276,323
Investment Income	41,846	-	-	41,846
Other Income	(46,416)	225,548	-	179,132
	<u>6,254,928</u>	<u>225,548</u>	<u>-</u>	<u>6,480,476</u>
Expenses				
Program Services	5,278,313	218,758	-	5,497,071
Management and General	899,391	-	-	899,391
Fundraising	236,833	-	-	236,833
	<u>6,414,537</u>	<u>218,758</u>	<u>-</u>	<u>6,633,295</u>
(Deficit) Excess of Revenue, Support and Reclassifications Over Expenses	(159,609)	6,790	-	(152,819)
Realized Gain on Investments	25,872	-	-	25,872
Unrealized Gain on Investments	119,557	-	-	119,557
Change in Beneficial Interest in Perpetual Trust	8,004	-	-	8,004
Change in Beneficial Interest in Charitable Remainder Trusts	<u>(13,543)</u>	<u>-</u>	<u>-</u>	<u>(13,543)</u>
Change in Net Assets	(19,719)	6,790	-	(12,929)
Net Assets Beginning of Year	<u>5,108,929</u>	<u>45,524</u>	<u>-</u>	<u>5,154,453</u>
Net Assets End of Year	<u>\$ 5,089,210</u>	<u>\$ 52,314</u>	<u>\$ -</u>	<u>\$ 5,141,524</u>