ART ACADEMY OF CINCINNATI AND AFFILIATES

May 31, 2010

CONSOLIDATED FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT INCLUDING SUPPLEMENTAL INFORMATION

VonLehman
CPA & ADVISORY FIRM

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ART ACADEMY OF CINCINNATI AND AFFILIATES
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VonLehman
CPA & ADVISORY FIRM

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
Art Academy of Cincinnati
and Affiliates
Cincinnati, Ohio

We have audited the accompanying consolidated statements of financial position of the Art Academy of Cincinnati (a nonprofit organization) and Affiliates as of May 31, 2010 and 2009, and the related consolidated statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Academy's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Art Academy of Cincinnati and Affiliates as of

May 31, 2010 and 2009, and the changes in its consolidated net assets and its consolidated cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 23, 2010 on our consideration of the Art Academy of Cincinnati and Affiliates' internal control over financial reporting and on our tests of its compliance with certain provisions, laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements of the Art Academy of Cincinnati and Affiliates taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, and is not a required part of the basic financial statements. The supplemental information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

VonLehman & Company Inc.

Fort Mitchell, Kentucky
September 23, 2010

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ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
May 31, 2010

	Unrestricted				Permanently Restricted	
ASSETS	**General**	**Board Designated**	**Plant**	**Temporarily Restricted**	**Endowment**	**Total**
Current Assets						
Cash and Cash Equivalents	$ 326,193	$ -	$ 37,694	$ 188,676	$ 1,581	$ 554,144
Accounts Receivable	533,672	-	-	-	-	533,672
Pledges Receivable	-	-	-	9,920	-	9,920
Interest and Dividends Receivable	-	36	-	-	-	36
Prepaid Expenses	28,967	-	27,584	-	-	56,551
Total Current Assets	888,832	36	65,278	198,596	1,581	1,154,323
Buildings and Equipment, Net	-	-	11,255,777	-	-	11,255,777
Investments	19,724	2,165,206	57,342	1,721,704	1,245,222	5,209,198
Pledges Receivable	-	-	-	18,121	-	18,121
Beneficial Interest in Perpetual Trust	-	-	-	-	161,245	161,245
Beneficial Interest in Charitable Remainder Trusts	-	-	-	122,156	-	122,156
Deposits	-	-	9,635	-	-	9,635
Other Assets, Net	-	-	142,724	-	-	142,724
Total Assets	$ 908,556	$ 2,165,242	$ 11,530,756	$ 2,060,577	$ 1,408,048	$ 18,073,179
LIABILITIES AND EQUITY						
Current Liabilities						
Accounts Payable	$ 141,849	$ -	$ 1	$ -	$ -	$ 141,850
Accrued Expenses	157,635	-	110,499	175,159	-	443,293
Interfund Payable (Receivable)	975,000	(975,000)	-	-	-	-
Note Payable - Current Portion	-	-	3,178	-	-	3,178
Total Current Liabilities	1,274,484	(975,000)	113,678	175,159	-	588,321
Long-Term Liabilities						
Charitable Remainder Trust	-	-	-	49,852	-	49,852
Note Payable (Less Current Portion)	-	-	170,774	-	-	170,774
Bond Payable (Less Current Portion)	-	-	4,300,000	-	-	4,300,000
Total Long Term Liabilities	-	-	4,470,774	49,852	-	4,520,626
Fair Market Value of Interest Rate Swap	-	-	146,869	-	-	146,869
Total Liabilities	1,274,484	(975,000)	4,731,321	225,011	-	5,255,816
Equity						
Members' Deficit	-	-	(37,481)	-	-	(37,481)
Fair Market Value of Interest Rate Swap	-	-	(146,869)	-	-	(146,869)
Net Assets	(365,928)	3,140,242	5,307,463	1,835,566	1,408,048	11,325,391
	(365,928)	3,140,242	5,123,113	1,835,566	1,408,048	11,141,041
Other Members' Equity	-	-	1,676,322	-	-	1,676,322
Total Equity	(365,928)	3,140,242	6,799,435	1,835,566	1,408,048	12,817,363
Total Liabilities and Equity	$ 908,556	$ 2,165,242	$ 11,530,756	$ 2,060,577	$ 1,408,048	$ 18,073,179

See accompanying notes.

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
May 31, 2009 (As Restated)

	Unrestricted				Permanently Restricted	
ASSETS	**General**	**Board Designated**	**Plant**	**Temporarily Restricted**	**Endowment**	**Total**
Current Assets						
Cash and Cash Equivalents	$ 209,601	$ 43,866	$ 35,448	$ 555,994	$ 6,500	$ 851,409
Accounts Receivable	250,343	-	-	13,408	-	263,751
Pledges Receivable	-	-	-	17,737	-	17,737
Interest and Dividends Receivable	-	36	-	-	-	36
Prepaid Expenses	83,817	-	14,754	-	-	98,571
Total Current Assets	543,761	43,902	50,202	587,139	6,500	1,231,504
Buildings and Equipment, Net	-	-	11,683,596	-	-	11,683,596
Investments	16,246	1,405,244	66,431	424,294	3,678,458	5,590,673
Pledges Receivable	-	-	-	29,568	-	29,568
Beneficial Interest in Perpetual Trust	-	-	-	-	142,527	142,527
Beneficial Interest in Charitable Remainder Trusts	-	-	-	121,812	-	121,812
Deposits	-	-	9,635	-	-	9,635
Other Assets, Net	-	-	162,168	-	-	162,168
Total Assets	$ 560,007	$ 1,449,146	$ 11,972,032	$ 1,162,813	$ 3,827,485	$ 18,971,483
LIABILITIES AND EQUITY						
Current Liabilities						
Accounts Payable	$ 149,930	$ -	$ 874	$ -	$ -	$ 150,804
Accrued Expenses	184,406	-	108,425	195,460	-	488,291
Interfund Payable (Receivable)	725,000	(725,000)	-	-	-	-
Note Payable - Current Portion	-	-	2,938	-	-	2,938
Bond Payable - Current Portion	-	-	300,000	-	-	300,000
Deferred Compensation Liability	-	90,188	-	-	-	90,188
Total Current Liabilities	1,059,336	(634,812)	412,237	195,460	-	1,032,221
Long-Term Liabilities						
Charitable Remainder Trust	-	-	-	53,793	-	53,793
Note Payable (Less Current Portion)	-	-	173,990	-	-	173,990
Bond Payable	-	-	4,300,000	-	-	4,300,000
Total Long Term Liabilities	-	-	4,473,990	53,793	-	4,527,783
Fair Market Value of Interest Rate Swap	-	-	220,093			220,093
Total Liabilities	1,059,336	(634,812)	5,106,320	249,253	-	5,780,097
Equity						
Members' Deficit	-	-	(37,330)	-	-	(37,330)
Fair Market Value of Interest Rate Swap	-	-	(220,093)	-	-	(220,093)
Net Assets	(499,329)	2,083,958	5,397,128	913,560	3,827,485	11,722,802
	(499,329)	2,083,958	5,139,705	913,560	3,827,485	11,465,379
Other Members' Equity	-	-	1,726,007	-	-	1,726,007
Total Equity	(499,329)	2,083,958	6,865,712	913,560	3,827,485	13,191,386
Total Liabilities and Equity	$ 560,007	$ 1,449,146	$ 11,972,032	$ 1,162,813	$ 3,827,485	$ 18,971,483

See accompanying notes.

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended May 31, 2010

	Unrestricted				Permanently Restricted	
	General	Board Designated	Plant	Temporarily Restricted	Endowment	Total
Revenue and Support						
Grants, Contributions and Gifts	$ 348,452	$ -	$ -	$ 812	$ 1,581	$ 350,845
Tuition Income	4,317,425	-	-	-	-	4,317,425
Investment Income	-	28,904	9	120,445	-	149,358
Investment Income Allocation	754,705	(154,146)	-	(600,559)	-	-
Other Income	1,934	-	128,918	-	-	130,852
Total Revenue and Support	5,422,516	(125,242)	128,927	(479,302)	1,581	4,948,480
Net Assets Released from Restrictions	-	-	760,360	(760,360)	-	-
Total Revenue, Support and Reclassifications	5,422,516	(125,242)	889,287	(1,239,662)	1,581	4,948,480
Expenses						
Program Services	4,599,167	-	961,259	-	-	5,560,426
Management and General	629,665	19,867	119,978	-	-	769,510
Fundraising	46,501	-	3,338	-	-	49,839
Total Expenses	5,275,333	19,867	1,084,575	-	-	6,379,775
Excess (Deficit) of Revenue, Support and Reclassifications Over Expenses	147,183	(145,109)	(195,288)	(1,239,662)	1,581	(1,431,295)
Interfund Equity Transfers	(11,921)	(43,866)	55,787	-	-	-
Interfund Transfer - Implementation of UPMIFA	(1,861)	1,029,409		1,412,188	(2,439,736)	-
Realized Loss on Investments	-	(61,536)	-	(239,750)	-	(301,286)
Unrealized Gain on Investments	-	257,828	-	1,004,503	-	1,262,331
Excess Gain on Endowment Investments	-	19,558	-	(19,558)	-	-
Change in Beneficial Interest in Perpetual Trust	-	-	-	-	18,718	18,718
Change in Beneficial Interest in Charitable Remainder Trusts	-	-	-	4,285	-	4,285
Other Members' Interest	-	-	49,685	-	-	49,685
Change in Net Assets	133,401	1,056,284	(89,816)	922,006	(2,419,437)	(397,562)
Other Members' Interest	-	-	(49,685)	-	-	(49,685)
Change in Fair Market Value of Interest Rate Swap	-	-	73,224	-	-	73,224
	133,401	1,056,284	(66,277)	922,006	(2,419,437)	(374,023)
Net Assets Beginning of Year, As Restated	(499,329)	2,083,958	6,865,712	913,560	3,827,485	13,191,386
Net Assets End of Year	$ (365,928)	$ 3,140,242	$ 6,799,435	$ 1,835,566	$ 1,408,048	$ 12,817,363

See accompanying notes.

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENT OF ACTIVITIES
Nine Months Ended May 31, 2009 (As Restated)

	Unrestricted				Permanently Restricted	
	General	Board Designated	Plant	Temporarily Restricted	Endowment	Total
Revenue and Support						
Grants, Contributions and Gifts	$ 327,362	$ -	$ -	$ 4,040	$ 11,166	$ 342,568
Tuition Income	3,584,438	-	-	-	-	3,584,438
Investment Income	-	58,209	129	394	134,976	193,708
Investment Income Allocation	625,647	(186,115)	-	-	(439,532)	-
Other Income	7,298	-	178,736	-	-	186,034
Total Revenue and Support	4,544,745	(127,906)	178,865	4,434	(293,390)	4,306,748
Net Assets Released from Restrictions	-	-	-	-	-	-
Total Revenue, Support and Reclassifications	4,544,745	(127,906)	178,865	4,434	(293,390)	4,306,748
Expenses						
Program Services	3,831,252	-	821,419	-	-	4,652,671
Management and General	467,397	16,102	69,316	-	-	552,815
Fundraising	119,351	-	2,821	-	-	122,172
Total Expenses	4,418,000	16,102	893,556	-	-	5,327,658
Excess (Deficit) of Revenue, Support and Reclassifications Over Expenses	126,745	(144,008)	(714,691)	4,434	(293,390)	(1,020,910)
Interfund Equity Transfers	27,590	(26,248)	408,658	(410,000)	-	-
Realized Loss on Investments	-	(205,831)	-	-	(498,756)	(704,587)
Unrealized Loss on Investments	-	(393,422)	-	-	(819,248)	(1,212,670)
Change in Beneficial Interest in Perpetual Trust	-	-	-	-	(18,540)	(18,540)
Change in Beneficial Interest in Charitable Remainder Trusts	-	-	-	(22,986)	-	(22,986)
Other Members' Interest	-	-	39,423	-	-	39,423
Change in Net Assets	154,335	(769,509)	(266,610)	(428,552)	(1,629,934)	(2,940,270)
Other Members' Interest	-	-	(39,423)	-	-	(39,423)
Change in Fair Market Value of Interest Rate Swap	-	-	(121,192)	-	-	(121,192)
	154,335	(769,509)	(427,225)	(428,552)	(1,629,934)	(3,100,885)
Net Assets Beginning of Year - As Previously Reported	(653,664)	2,853,467	7,292,937	1,342,112	5,296,352	16,131,204
Prior Period Adjustment - Error Made in Prior Year in Reporting of Beneficial Interest in Perpetual Trust	-	-	-	-	161,067	161,067
Net Assets Beginning of Year - As Restated	(653,664)	2,853,467	7,292,937	1,342,112	5,457,419	16,292,271
Net Assets End of Year	$ (499,329)	$ 2,083,958	$ 6,865,712	$ 913,560	$ 3,827,485	$ 13,191,386

See accompanying notes.

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENT OF MEMBERS' EQUITY

	Members' Deficit	Other Members' Equity	Fair Market Value of Interest Rate Swap	Total
Balance - August 31, 2008 (As Restated)	$ (34,836)	$ 1,765,430	$ (98,901)	$ 1,631,693
Net Loss	(2,494)	-	-	(2,494)
Other Members' Net Loss	-	(39,423)	-	(39,423)
Change in Fair Market Value of Interest Rate Swap	-	-	(121,192)	(121,192)
Balance - May 31, 2009 (As Restated)	(37,330)	1,726,007	(220,093)	1,468,584
Net Loss	(151)	-	-	(151)
Other Members' Net Loss	-	(49,685)	-	(49,685)
Change in Fair Market Value of Interest Rate Swap	-	-	73,224	73,224
Balance - May 31, 2010	$ (37,481)	$ 1,676,322	$ (146,869)	$ 1,491,972

See accompanying notes.

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENTS OF CASH FLOWS

		Year Ended May 31, 2010		Nine Months Ended May 31, 2009 (As Restated)
Cash Flows from Operating Activities				
Change in Net Assets	$	(397,562)	$	(2,940,270)
Adjustments to Reconcile Change in Net Assets to Net Cash Provided by Operating Activities				
Depreciation		441,125		342,728
Amortization		19,444		15,793
Loss on the Disposal of Building and Equipment		21,626		-
Realized Loss on Investments		301,286		704,587
Unrealized (Gain) Loss on Investments		(1,262,331)		1,212,670
Change in Beneficial Interest in Perpetual Trust		(18,718)		18,540
Change in Beneficial Interest in Charitable Remainder Trusts		(4,285)		22,986
Other Members' Interest		(49,685)		(39,423)
Contributions Restricted for Capital Purchases		(812)		(4,040)
Change in Operating Assets				
Accounts Receivable		(269,921)		(124,125)
Pledges Receivable		19,264		25,503
Interest and Dividends Receivable		-		408
Prepaid Expenses		42,020		143,891
Change in Operating Liabilities				
Bank Overdraft		-		(271,519)
Accounts Payable		(8,954)		(93,134)
Accrued Expenses		(44,998)		(733,838)
Deferred Compensation Liability		(90,188)		(11,809)
Net Cash Used by Operating Activities		(1,302,689)		(1,731,052)
Cash Flows from Investing Activities				
Proceeds from Sale of Investments		2,347,183		2,941,750
Purchase of Investments		(1,004,663)		(1,852,308)
Acquisition of Building and Equipment		(34,932)		(40,025)
Net Cash Provided by Investing Activities		1,307,588		1,049,417
Cash Flows from Financing Activities				
Contributions Restricted for Capital Purchases		812		4,040
Payments on Note Payable		(2,976)		(2,175)
Payments on Bond Payable		(300,000)		-
Net Cash (Used) Provided by Financing Activities		(302,164)		1,865
Net Change in Cash and Cash Equivalents		(297,265)		(679,770)
Beginning Balance - Cash and Cash Equivalents		851,409		1,531,179
Ending Balance - Cash and Cash Equivalents	$	554,144	$	851,409

See accompanying notes.

NOTE 1 – ACCOUNTING POLICIES

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.

Academy Advancement Limited is organized in the State of Ohio as a limited liability company. Academy Advancement Limited was formed during fiscal year 2004 to be the managing member of 1212 Jackson, LLC. Academy Advancement Limited is a wholly owned subsidiary of the Art Academy of Cincinnati.

1212 Jackson, LLC is organized in the State of Ohio as a limited liability company. 1212 Jackson, LLC was formed during fiscal year 2004 to own and operate the real estate facilities for the benefit of the Art Academy of Cincinnati.

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.

A summary of significant accounting policies applied in the accompanying financial statements follows:

Principles of Consolidation

The consolidated financial statements also include the accounts of Academy Advancement Limited, 1212 Jackson, LLC, and Art Academy Housing, Inc. These entities are related to the Academy because the Academy has assumed the financial and day-to-day operational management functions for these entities. Under U.S. generally accepted accounting principles, the Academy is required to present consolidated financial statements reflecting the financial position and results of operations of all four entities. All significant inter-entity transactions have been eliminated.

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 $7,287 as of May 31, 2010 and 2009.

Investments

Investments in equity securities and debt securities are stated at fair market value. 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 – ACCOUNTING POLICIES (Continued)

Use of Estimates

The process of preparing financial statements in conformity with U.S. generally accepted accounting principles 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 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.

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.

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.

Donated Facility

The Academy utilized one donated facility in downtown Cincinnati. The Academy has no ownership rights in this facility. The value of rent for this donated facility has not been recorded since it is not readily measured or valued.

Buildings and Equipment

Buildings and equipment are recorded at cost and depreciated over the estimated useful lives of the related assets. Depreciation is computed on the straight-line method. Maintenance and repairs are charged to operations when incurred. Significant betterments and renewals greater than $1,000 are capitalized. When buildings and equipment are sold or otherwise disposed of, the asset account and related accumulated depreciation account are relieved, and any gain or loss is included in operations.

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

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.

NOTE 1 – ACCOUNTING POLICIES (Continued)

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, 2010. 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 fiscal year 2010 or 2009.

The Academy also had a nonqualified deferred compensation plan for its former President. Under the plan, the President deferred a portion of his salary into the plan. There was no employer match under this plan. This plan was paid out in January, 2010.

Advertising Costs

Advertising costs are expensed as incurred.

Amortization

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

Costs associated with the issuance of bonds were capitalized and being amortized over the life of the bonds using the straight-line method.

Costs associated with the organization of 1212 Jackson LLC have been capitalized and are being amortized over five years using the straight-line method.

Income Tax Status

The Academy is a nonprofit organization as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal and state income taxes.

Academy Advancement Limited has elected to be taxed as a corporation and therefore is subject to federal, state and local income taxes.

1212 Jackson LLC is a limited liability company and all of the tax liabilities and benefits are passed directly to its members.

Art Academy Housing is a nonprofit organization as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal and state income taxes. The organization has applied for its exempt status.

Classes of Net Assets

The accompanying financial statements have been prepared in conformity with the requirements of accounting pronouncements. Accordingly, the net assets of the Academy are reported in each of the following three classes: a) unrestricted net assets, b) temporarily restricted net assets and c) 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 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.

NOTE 2 – CASH AND CASH FLOW INFORMATION

At various times throughout the year, the Academy may have cash in certain financial institutions in excess of insured limits. The amount in excess of insured limits approximated $230,000 and $-0- at May 31, 2010 and 2009, respectively.

The cash in excess of insured limits reflects the decrease in Federal Deposit Insurance Corporation (FDIC) limits in January, 2010 from $250,000 on interest bearing accounts in separate financial institutions and 100% cash in non-interest bearing accounts to $250,000 per depositor for both interest bearing and non-interest bearing accounts combined through December 31, 2013.

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

For purposes of the cash flows statement, the Academy considers all highly liquid investments available for current use with an initial maturity of three months or less to be a cash equivalent.

Cash paid for interest was $40,614 and $379,093 in 2010 and 2009, respectively.

NOTE 3 – BUILDINGS AND EQUIPMENT

Buildings and equipment and related accumulated depreciation consist of the following at May 31, 2010 and 2009.

	Cost	Accumulated Depreciation	Net Book Value
2010			
Land	$ 362,100	$ -	$ 362,100
Buildings and Improvements	12,331,108	1,622,077	10,709,031
Office Furniture and Equipment	921,851	737,205	184,646
	$ 13,610,403	$ 1,926,807	$11,255,777
2009			
Land	$ 362,100	$ -	$ 362,100
Buildings and Improvements	12,331,108	1,288,904	11,042,204
Office Furniture and Equipment	917,195	637,903	279,292
	$ 13,610,403	$ 1,926,807	$11,683,596

Included in the above amounts for May 31, 2010 and 2009 is the Walnut Street building which is currently not being used in operations with a small portion being leased. The cost and accumulated depreciation of that land and building as of May 31, 2010 were $508,144 ($508,144 as of May 31, 2009) and $35,709 ($22,596 as of May 31, 2009), respectively.

NOTE 4 – PLEDGES RECEIVABLE

The Academy's pledges receivable are as follows:

	May 31, 2010	August 31, 2009
Receivable in Less than One Year	$ 10,150	$ 18,100
Less Allowance for Uncollectible Pledges Receivable	230	363
Net Receivable in Less than One Year	9,920	17,737
Receivable in One to Five Years	22,040	32,002
Less Present Value Discount (6%)	3,499	1,797
Less Allowance for Uncollectible Pledges Receivable	420	637
Net Receivable in One to Five Years	18,121	29,568
Net Receivable	$ 28,041	$ 47,305

NOTE 5 – INVESTMENTS

The Academy's investments are summarized as follows:

	May 31, 2010		May 31, 2009	
	Cost	Fair Value	Cost	Fair Value
Unrestricted Fund	$ 2,577,513	$ 2,242,272	$ 2,429,456	$ 1,487,921
Temporarily Restricted	2,786,377	1,721,704	424,294	424,294
Permanently Restricted	1,245,222	1,245,222	5,435,235	3,678,458
	$ 6,609,112	$ 5,209,198	$ 8,288,985	$ 5,590,673

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

	May 31, 2010		May 31, 2009	
	Cost	Fair Value	Cost	Fair Value
Cash Equivalents	$ 76,353	$ 76,353	$ 502,918	$ 502,918
U. S. Government Securities	562,294	578,727	76,024	76,587
Corporate Stocks and Bonds	3,773,004	2,575,482	4,076,223	2,169,205
Collective and Mutual Funds	1,975,477	1,729,133	3,633,820	2,841,963
Alternative Strategies	116,787	136,996	-	-
Real Estate Investments	105,197	112,507	-	-
	$ 6,609,112	$ 5,209,198	$ 8,288,985	$ 5,590,673

NOTE 5 – INVESTMENTS (Continued)

The following schedules summarize investment return and its classification in the statements of activities for the years ended May 31, 2010 and 2009.

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
2010				
Interest and Dividends	$ 28,913	$ 120,445	$ -	$ 149,358
Realized Losses	(61,536)	(239,750)	-	(301,286)
Unrealized Gains	257,828	1,004,503	-	1,262,331
Fees	(19,867)	-	-	(19,867)
Total Investment Return	$ 205,338	$ 885,198	$ -	$ 1,090,536
2009				
Interest and Dividends	$ 58,338	$ 394	$ 134,976	$ 193,708
Realized Gains	(205,831)	-	(498,756)	(704,587)
Unrealized Losses	(393,422)	-	(819,248)	(1,212,670)
Fees	(16,102)	-	-	(16,102)
Total Investment Return	$ (557,017)	$ 394	$ (1,183,028)	$ (1,739,651)

With Board of Trustee 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 twelve quarter rolling average. The distribution is recognized in the general fund as investment income.

NOTE 6 – BENEFICIAL INTEREST IN PERPETUAL TRUSTS

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

Trust	Academy’s Percentage of Trust	May 31, 2010	May 31, 2009
Wilmer D. Glenn Trust	100%	$ 161,245	$ 142,527

NOTE 7 – OTHER ASSETS

The following is a summary of other assets:

	May 31, 2010			
	Closing Cost	Bond Issuance Cost	Organizational Cost	Total
Cost	$ 30,361	$ 172,237	$ 50,817	$ 253,415
Accumulated Amortization	9,794	50,121	50,776	110,691
Other Assets, Net	$ 20,567	$ 122,116	$ 41	$ 142,724

NOTE 7 – OTHER ASSETS (Continued)

	May 31, 2009			
	Closing Cost	Bond Issuance Cost	Organizational Cost	Total
Cost	$ 30,361	$ 172,237	$ 50,817	$ 253,415
Accumulated Amortization	7,770	41,251	42,226	91,247
Other Assets, Net	$ 22,591	$ 130,986	$ 8,591	$ 162,168

Estimated amortization for the five years subsequent is as follows:

Years Ending August 31,	
2011	$ 10,935
2012	10,894
2013	10,894
2014	10,894
2015	10,894
Thereafter	88,213
	$ 142,724

NOTE 8 – LINE OF CREDIT

The Academy has an unsecured revolving line of credit agreement for $400,000, which bears interest at LIBOR plus 1.75% at May 31, 2010 (6.73% at May 31, 2010) and the prime rate at May 31, 2009 (3.25% at May 31, 2009). The line matures in March, 2011. At May 31, 2010 and 2009, there was no outstanding balance on the line of credit.

NOTE 9 – BOND PAYABLE

In October, 2004, 1212 Jackson, LLC authorized the issuance of Adjusted Rate Taxable Securities, Series 2004, with a maximum aggregate principal amount up to $8,000,000. The proceeds were used for the renovation of the Jackson Street building. The bond matures in September, 2024. On or prior to July 1, 2007, the Company was required to make payments totaling $3,400,000. In June, 2009, the bank amended the bond agreement requiring the Academy to pay $300,000 by August, 2009 in order to extend the expiration date of the letter of credit. The balance of the bond is $4,300,000 at May 31, 2010. A formal repayment schedule has not been prepared on the remaining balance. The interest rate fluctuates based on the Weekly Interest Rate determined by the Remarketing Agent and was 0.69% and 3.65% at May 31, 2010 and 2009, respectively. The bond is collateralized by the Art Academy's building and $2,000,000 of unrestricted investments. Under terms of the agreement, the Company must, among other things, maintain a capitalized interest fund and certain levels of tangible net worth. As May 31, 2010 and 2009, the covenants associated with the bond pertaining to net tangible worth and debt service coverage ratio were not met. The Academy has obtained a waiver letter.

NOTE 10 – NOTE PAYABLE

	2010	2009
Note payable to bank; due in monthly installments of $1,272, including interest of 7.00%, due April, 2013. The note is collateralized by a parcel of land.	$ 173,952	$ 176,928
Current Portion	3,178	2,938
Long-Term Portion	$ 170,774	$ 173,990

The remaining maturities on this note are as follows:

Years Ending May 31,	Amount
2011	$ 3,178
2012	3,410
2013	167,364
	$ 173,952

NOTE 11 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are restricted as follows:

	May 31, 2010	August 31, 2009
Time Restricted		
Investments - Cash	$ 35,121	$ 38,191
Beneficial Interest in Charitable Remainder Trusts	72,304	68,019
Purpose Restricted		
Building on Rich Tradition Campaign	39,550	786,193
Contributions and Gifts	19,157	21,157
Endowments	1,669,434	-
	$ 1,835,566	$ 913,560

NOTE 12 – ENDOWMENTS

The Academy's endowment consists of 64 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 12 – 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 8%, while growing the funds if possible. Therefore, the Academy expects its endowment assets, over time, to produce an average rate of return of approximately 8% 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 8% of its endowment fund's average fair value of the prior 12 quarters through the calendar year-end preceding the fiscal year in which the distribution is planned. 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 8% 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 May 31, 2010:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Funds	$ 2,165,206	$ 1,669,434	$ 1,245,222	$ 5,079,862

NOTE 12 – ENDOWMENTS (Continued)

Changes in endowment net assets for the year ended May 31, 2010 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, Beginning of Year	$ 1,315,056	$ -	$ 3,684,958	$ 5,000,014
Investment Return				
Investment Income	28,904	112,610	-	141,514
Net Depreciation (Realized and Unrealized)	196,292	764,753	-	961,045
Total Investment Return	225,196	877,363	-	1,102,559
Contributions	1,861	-	-	1,861
Appropriation of Endowment Assets for Expenditures	(424,013)	(600,569)	-	(1,024,572)
Reclassification of Fair Market Value for Implementation of UPMIFA	1,027,548	1,412,188	(2,439,736)	-
Transfer of Restricted Endowments Whose Balance Is Below the Restricted Amount	19,558	(19,558)	-	-
Endowment Net Assets, End of Year	$ 2,165,206	$ 1,669,434	$ 1,245,222	$ 5,079,862

Endowment net asset composition by type of fund as of May 31, 2009:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Funds	$ -	$ -	$ 3,684,958	$ 3,684,958

Changes in endowment net assets for the year ended May 31, 2009:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, Beginning of Year	$ -	$ -	$ 5,296,352	$ 5,296,352
Investment Return				
Investment Income	-	-	134,976	134,976
Net Appreciation (Realized and Unrealized)	-	-	(1,318,004)	(1,318,004)
Total Investment Return	-	-	(1,183,028)	(1,183,028)
Contributions	-	-	11,166	11,166
Appropriation of Endowment Assets for Expenditures	-	-	(439,532)	(439,532)
Endowment Net Assets, End of Year	$ -	$ -	$ 3,684,958	$ 3,684,958

NOTE 12 – ENDOWMENTS (Continued)

In August, 2008, accounting pronouncements were issued regarding endowments of not-for-profit organizations and the net asset classification of funds subject to an enacted version of Uniform Prudent Management of Institutional Funds Act. This pronouncement provides guidance on the net asset classification of donor-restricted endowment funds for a nonprofit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). This pronouncement also requires additional disclosures about an organization's endowment funds (both donor-restricted endowment funds and board-designated endowment funds) whether or not the organization is subject to UPMIFA.

The State of Ohio enacted UPMIFA effective June 1, 2009, the provisions of which apply to endowment funds existing on or established after that date. The Academy has adopted ASC 958-205-65 for the year ending May 31, 2010. The Board of Trustees, on the advice of legal counsel, has determined that the majority of the Academy's permanently restricted net assets meet the definition of endowment funds under UPMIFA. Based on the Academy's interpretation of UPMIFA, the Academy has reviewed all of its endowment funds and has reclassified approximately $1,275,000 from permanently restricted net assets to temporarily restricted net assets and $1,165,000 from permanently restricted net assets to unrestricted net assets as of May 31, 2010 so that the appropriate amount is included in each fund. Also, the Academy has reclassified approximately $134,000 from unrestricted net assets to temporarily restricted net assets as of May 31, 2010 due to endowment funds whose balance has dropped below the restricted amount.

NOTE 13 – OPERATING LEASES

The Academy is the lessee in the following lease agreements:

Equipment

The Academy leases equipment for total monthly payments of $772. The leases have varying expiration dates ranging from April, 2013 to November, 2013. The Academy incurred lease expense of $9,265 and $6,949 for 2010 and 2009, respectively.

Housing

Art Academy Housing leases apartments for the students of the Academy for a base rent of $7,500 per month under an operating lease. The lease expires in August, 2014, with an option to renew for an additional five years. Art Academy Housing incurred lease expense related to this lease of $91,815 and $78,750 for 2010 and 2009, respectively.

In August, 2009, Art Academy Housing entered an operating lease for an apartment. The monthly lease payment is $558. The lease expired in July, 2010. Lease expense was $6,901 for 2010.

Art Academy Housing entered into an additional lease in August, 2008 with Jackson Street Lofts. The lease payments total $1,055 per month under the operating lease for two units. The first payment was pro-rated. The lease expired in July, 2009. Art Academy Housing incurred a lease expense related to this lease of $667 and $9,498 for 2010 and 2009, respectively.

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

Years Ending May 31,	Housing	Equipment	Total
2011	$ 98,058	$ 9,265	$ 107,323
2012	110,837	9,265	120,102
2013	119,600	5,892	125,492
2014	121,317	-	121,317
2015	30,329	-	30,329
	$ 480,141	$ 24,422	$ 504,563

NOTE 13 – OPERATING LEASES (Continued)

The Academy is the lessor in the following lease agreement:

In July, 2008, the Academy started leasing a portion of its Walnut Street building. The lease term is thirty-six months and expires in June, 2011. As part of the lease agreement, the Academy will offset utility expense with the tenant. The net annual rental income was $-0- and $3,334 for the year ended May 31, 2010 and the nine months ended May 31, 2009, respectively.

NOTE 14 – RETIREMENT PLAN EXPENSE

The Academy's contributions and expenses related to the defined contribution plan in 2010 and 2009 were $4,132 and $38,677, respectively. Matching contributions were suspended as of July 31, 2009.

NOTE 15 – RELATED PARTIES

The Academy does business with companies who are either owned by or employ a Board of Trustees member. During fiscal year 2010, the Academy spent $18,184 with one company for the purposes of printing and had $-0- due to this company as of May 31, 2010. During fiscal year 2009, the Academy spent $61,993 with two companies and had $-0- due to these companies as of August 31, 2009.

NOTE 16 - FUNCTIONAL EXPENSES

The detail of functional expenses is as follows:

	Year Ended May 31, 2010				Nine Months Ended August 31, 2009			
	Program Services	Management and General	Fundraising	Total	Program Services	Management and General	Fundraising	Total
Salaries	$ 1,696,160	$ 338,223	$ 12,155	$ 2,046,538	$ 1,503,706	$ 256,599	$ 66,891	$ 1,827,196
Payroll Taxes	139,329	29,475	1,342	170,146	112,599	17,943	5,507	136,049
Retirement Plan	1,380	2,752	-	4,132	30,005	8,672	-	38,677
Employee Benefits	153,223	31,981	994	186,198	126,984	25,702	8,153	160,839
Rent	99,383	-	-	99,383	88,266	-	-	88,266
Telephone	2,371	14,513	-	16,884	1,680	8,904	-	10,584
Utilities	296,049	3,005	1,503	300,557	241,731	7,184	1,127	250,042
Security	193,473	-	-	193,473	148,813	-	-	148,813
Insurance	-	32,484	-	32,484	-	33,311	-	33,311
Bank Charges	6,852	33,979	-	40,831	5,091	25,552	-	30,643
Parking	46,718	666	-	47,384	32,830	450	-	33,280
Supplies	83,868	19,451	200	103,519	84,941	9,396	204	94,541
Purchased Services	54,253	143,372	1,763	199,388	33,821	62,152	8,500	104,473
Model Fees	16,039	-	-	16,039	14,134	-	-	14,134
Lecturer's Honorarium	17,151	-	-	17,151	15,020	-	-	15,020
Hospitality	19,396	2,663	1,965	24,024	22,833	4,691	2,151	29,675
Memberships and Fees	7,000	22,962	813	30,775	7,905	18,254	835	26,994
Books, Videos, and Subscriptions	2,006	59	-	2,065	2,707	-	75	2,782
Email and Internet	4,667	4,667	-	9,334	1,696	1,696	-	3,392
Postage and Mail Service	-	15,184	-	15,184	-	24,856	-	24,856
Travel	13,744	4,318	-	18,062	18,876	1,377	71	20,324
Per Diem	5,645	679	-	6,324	8,331	971	-	9,302
Personnel and Instructional Development	-	-	-	-	866	-	-	866
Promotion	145,895	1,769	4,260	151,924	204,373	1,278	1,422	207,073
Newsletter	-	-	16,872	16,872	700	-	21,311	22,011
Equipment Maintenance and Rental	39,737	20,893	3,324	63,954	45,387	18,619	2,144	66,150
Plant Maintenance	91,459	-	-	91,459	90,782	-	-	90,782
Student Activities	41,551	-	-	41,551	46,550	-	-	46,550
Student Exhibition	4,588	-	-	4,588	2,682	-	-	2,682
Information Technology	-	2,580	-	2,580	-	7,395	-	7,395
Scholarships	1,460,304	-	-	1,460,304	1,012,076	-	-	1,012,076
Other Grants	-	-	-	-	717	-	-	717
Depreciation and Amortization	443,134	15,198	2,237	460,569	345,248	11,529	1,744	358,521
Interest Expense	235,224	2,388	1,194	238,806	227,571	2,310	1,155	231,037
Taxes	138,264	1,404	702	140,370	124,486	1,264	632	126,382
Bond Cost	101,524	1,031	515	103,070	49,263	500	250	50,013
Miscellaneous Expense	39	23,814	-	23,853	-	2,210	-	2,210
	$ 5,560,426	$ 769,510	$ 49,839	$ 6,379,775	$ 4,652,671	$ 552,815	$ 122,172	$ 5,327,658

NOTE 17 – HEDGING ACTIVITIES

1212 Jackson holds derivative financial instruments for the purpose of hedging the risks of certain identifiable and anticipated transactions. In general, the types of risks hedged are those relating to the changes in interest rates. In hedging the transactions 1212 Jackson LLC, in the normal course of business, holds the following type of derivate:

Type of Derivative	Type of Transaction Being Hedged
Interest rate swap	Cash flows of variable rate debt

Derivatives are held only for the purpose of hedging such risks, not for speculation. Generally, the LLC enters into hedging relationships such that changes in the fair values or cash flows of items and transactions being hedged are expected to be offset by corresponding changes in the values of the derivatives. At May 31, 2010, hedging relationships exist for bond indebtedness.

The LLC recognized net gains of $73,224 for 2010 and net losses of $121,192 for 2009 from cash flow hedges. All forecasted transactions currently being hedged are expected to occur by 2012.

NOTE 18 – FAIR VALUES OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Academy in estimating its fair value disclosures for financial instruments:

Cash, cash equivalents, short-term pledges receivable, accounts and other receivables, short-term notes payable and accounts payable and accrued liabilities: The carrying amounts reported in the statement of financial position approximate fair values because of the short maturities of those instruments.

Short-term and endowment investments: The fair values of investments are based on quoted market prices for those or similar investments.

Long-term pledge receivables and long-term bonds payable: The fair values are estimated by discounting the future cash flows using a current risk free rate of return based on the yield of a U.S. Treasury security with a maturity date similar to the expected collection period, or using stated interest rates.

The estimated fair values of the Academy's financial instruments as of May 31, 2010, none of which are held for trading purposes, are as follows:

	Carrying Value	Fair Value
Financial Assets		
Cash and Cash Equivalents	$ 554,144	$ 554,144
Accounts and Other Receivables	533,708	533,708
Pledges Receivable	28,041	28,041
Investments	5,209,198	5,209,198
Beneficial Interests	233,549	233,549
Financial Liabilities		
Accounts Payable, Accrued and Other Liabilities	634,995	634,995
Bond Payable and Note Payable	4,473,952	4,473,952

NOTE 19 – FAIR VALUE MEASUREMENTS

Accounting Pronouncements establish a framework for measuring fair value. That framework 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 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 for 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;
- 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 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 assets and liabilities measured at fair value. There have been no changes in the methodologies used at May 31, 2010 and 2009.

Fair values for investments are determined by reference to quoted market prices and other relevant information generated by market transactions. The fair value for the contribution receivable from a beneficial interest in a charitable remainder trust is determined by using payment streams discounted at 6% over the remaining lives of the donors using standard mortality tables. The fair value of the interest rate swap is determined by market values provided by the bank.

The following assets and liabilities were measured at fair value as of May 31, 2010:

	Level 1 Quoted Price In Active Markets for Identical Assets	Level 2 Significant Other Observable Inputs	Level 3 Significant Unobservable Inputs
Investments	$ 5,209,198	$ -	$ -
Beneficial Interest In Trusts	$ 122,156	$ -	$ 72,304
Fair Market Value of Interest Rate Swap	$ -	$ (146,869)	$ -

NOTE 19 – FAIR VALUE MEASUREMENTS (Continued)

The following assets and liabilities were measured at fair value as of May 31, 2009:

	Level 1 Quoted Price In Active Markets for Identical Assets	Level 2 Significant Other Observable Inputs	Level 3 Significant Unobservable Inputs
Investments	$ 5,590,673	$ -	$ -
Beneficial Interest In Trusts	$ 121,812	$ -	$ 68,019
Fair Market Value of Interest Rate Swap	$ -	$ (220,093)	$ -

NOTE 20 – UNCERTAIN TAX POSITIONS

The Art Academy of Cincinnati and Affiliates have adopted ASC 740-10 as it relates to uncertain tax positions for the year ended May 31, 2010 and has evaluated it's tax positions taken for all open tax years. Currently, the 2009, 2008, 2007, 2006, and 2005 tax years are open and subject to examination by the Internal Revenue Service and the Ohio Department of Taxation. However, the Art Academy of Cincinnati and Affiliates are not currently under audit nor have they been contacted by any jurisdictions. The Art Academy of Cincinnati and Affiliates recognized no interest or penalties in the statement of activities for the year ended May 31, 2010. If the situation arose in which the Art Academy of Cincinnati and Affiliates would have interest to recognize, it would recognize this as interest expense and penalties would be recognized in other expenses. The Art Academy of Cincinnati and Affiliates does not expect the balance of unrecognized tax benefits to change by a material amount in the next twelve months.

Based on the evaluation of the Art Academy of Cincinnati and Affiliates; management believes all positions taken would be upheld under an examination. Therefore, no provision for the effects of uncertain tax positions have been recorded for the year ended May 31, 2010.

NOTE 21 – PRIOR PERIOD ADJUSTMENT

The accompanying financial statements for May 31, 2009 have been restated to correct an error in the reporting of a beneficial interest in a perpetual trust made in a prior year. The effect of the restatement was to increase the change in net assets for the year ended May 31, 2009 by $161,067. Net assets at the beginning of the year ended May 31, 2008 has been adjusted for the effects of the restatement on prior years.

NOTE 22 – SUBSEQUENT EVENTS

Management has evaluated events through September 23, 2010, the date on which the financial statements were available for issue. For the year ended May 31, 2011, the Academy changed their spending policy for its endowments from a twelve quarter rolling average to a four quarter rolling average. The Academy did not have any other events subsequent to May 31, 2010 through September 23, 2010 to disclose.

ADDITIONAL INFORMATION

ART ACADEMY OF CINCINNATI AND AFFILIATES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended May 31, 2010

Federal Grantor/ Program Title	Pass-Through Grantor Number	Federal CFDA Number	Federal Expenditures	
U.S. Department of Education:				
Federal Family Education Loans (2)		84.032	$ 1,625,751	(1)
Federal Pell Grant Program (3)	P063P041983	84.063	268,372	(1)
Supplemental Education Opportunity Grant Program (3)	P007A043229	84.007	22,400	(1)
College Work Study Program (3)	P033A043229	84.033	20,811	(1)
Academic Competitiveness (3)	P038A043229	84.375	11,975	(1)
			$ 1,949,309	

(1) Denotes Major Program (Due to cluster of programs)

(2) Type A Programs ($300,000 and greater)

(3) Type B Programs (all others)

The accompanying notes are an integral part of this schedule.

ART ACADEMY OF CINCINNATI AND AFFILIATES
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended May 31, 2010

NOTE 1 – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Art Academy of Cincinnati and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments and Nonprofit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

REPORT 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 Board of Trustees
Art Academy of Cincinnati
and Affiliates
Cincinnati, Ohio

We have audited the consolidated financial statements of the Art Academy of Cincinnati (a nonprofit organization) and Affiliates as of and for the year ended May 31, 2010, and have issued our report thereon dated September 23, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Art Academy of Cincinnati and Affiliates' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose expressing an opinion on the effectiveness of Art Academy of Cincinnati and Affiliates' internal control over financial reporting. Accordingly, we do not express on an opinion on the effectiveness of the Art Academy of Cincinnati and Affiliates' internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Art Academy of Cincinnati and Affiliates' ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Art Academy of Cincinnati and Affiliates' financial statements that is more than inconsequential will not be prevented or detected by the Art Academy of Cincinnati and Affiliates' internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Art Academy of Cincinnati and Affiliates' internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

We noted certain additional matters that we reported to management of the Academy in a separate letter dated September 23, 2010.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Art Academy of Cincinnati and Affiliates' 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 that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the board of trustees, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

VonLehman & Company Inc.

Fort Mitchell, Kentucky
September 23, 2010

VonLehman
CPA & ADVISORY FIRM

**REPORT ON COMPLIANCE WITH
REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

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

<u>Compliance</u>

We have audited the compliance of the Art Academy of Cincinnati and Affiliates with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended May 31, 2010. The Art Academy of Cincinnati and Affiliates' major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Art Academy of Cincinnati and Affiliates' management. Our responsibility is to express an opinion on the Art Academy of Cincinnati and Affiliates' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133*, Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB A-133 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 federal program occurred. An audit includes examining, on a test basis, evidence about the Art Academy of Cincinnati and Affiliates' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Art Academy of Cincinnati and Affiliates' compliance with those requirements.

In our opinion, the Art Academy of Cincinnati and Affiliates complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended May 31, 2010. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2010-1 and 2010-2.

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Internal Control over Compliance

The management of the Art Academy of Cincinnati and Affiliates is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Art Academy of Cincinnati and Affiliates' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Art Academy of Cincinnati and Affiliates' internal control over compliance.

A control deficiency in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

The Art Academy of Cincinnati and Affiliates' response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Art Academy of Cincinnati and Affiliates' responses and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the board of trustees, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

VonLehman & Company Inc.

Fort Mitchell, Kentucky
September 23, 2010

ART ACADEMY OF CINCINNATI AND AFFILIATES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended May 31, 2010

SECTION I – SUMMARY OF AUDITORS' RESULTS

FINANCIAL STATEMENTS	
Type of Auditor's Report Issued	Unqualified
Material weakness(es) identified?	No
Control Deficiencies identified not considered to be material weaknesses?	None Reported
Noncompliance material to financial statements noted?	No
FEDERAL AWARDS	
Material weakness(es) identified?	No
Control Deficiencies identified not considered to be material weakness?	None Reported
Type of auditors' report issued on compliance for major programs:	Unqualified
Are there any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes
Major Programs (list):	Federal Family Education Loans [CFDA 84.032] Federal Pell Grant Program [CFDA 84.063] Supplemental Education Opportunity Grant Program [CFDA 84.007] College Work Study Program [CFDA 84.033] Academic Competitiveness [CFDA 84.375}
Dollar Threshold: Type A/B Programs	Type A: > $300,000 Type B: > all others
Low Risk Auditee?	No

SECTION II – FINANCIAL STATEMENT FINDINGS

None

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Item 10-01 Return of Funds:

If a student withdraws or drops out, the institution must determine if a return of Title IV funds is necessary. If a return is necessary, the institution is required to deposit the funds to the Student Financial Assistance (SFA) accounts or return the funds the Education Department (ED) to the appropriate Federal Family Educational Loan (FFEL) lender within forty five days after the institution determines the student withdrew.

Out of a sample of eighteen return of Title IV Funds selected for testing, five returns were not returned to the appropriate account within the required time frame.

Corrective Action:

Due to a misunderstanding between departments the withdrawal and leave of absence paperwork were not processed in the usual timely method. The departments that manage student accounts have discussed the issues that caused this break in communication and have determined that an extra reconciliation process will be created and started immediately to prevent this.

Item 10-02 Student Status Changes:

The Academy is required to notify the National Student Loan Data System (NSLDS) of a change in the student's status. Section 34 CFR 682.610(c)(2) of the Federal Family Education Loan (FFEL) Program states that unless it expects to submit its next student status confirmation report to the Secretary or the guaranty agency within the next 60 days, a school must notify the guaranty agency or lender within 30 days if it discovers that a Stafford, Unsubsidized Stafford, or PLUS loan has been made on behalf of a student who has enrolled at that school, but who has ceased to be enrolled on at least a half-time basis.

Out of a sample of twenty-five students selected for testing, one student had a change in status that was not reported to the NSLDS within the required time frame. This finding was the result of the incorrect effective date being shown on the NSLDS system for the date of change in status.

Corrective Action:

Notification to the NSLDS for one student was delayed due to a procedure error. Changes to the reporting schedule will be put into action immediately to increase the frequency of internal reconciliations that will reduce the possibility of errors.

ART ACADEMY OF CINCINNATI AND AFFILIATES
SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS AND QUESTIONED COSTS

SECTION II – FINANCIAL STATEMENT FINDINGS

None

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None

SUPPLEMENTAL INFORMATION

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATING STATEMENT OF FINANCIAL POSITION
May 31, 2010

ASSETS	Art Academy of Cincinnati	Academy Advancement Limited	1212 Jackson, LLC	Art Academy Housing, Inc.	Eliminations	Total
Current Assets						
Cash and Cash Equivalents	$ 516,450	$ -	$ 37,694	$ -	$ -	$ 554,144
Accounts Receivable	533,672	-	2,775,141	-	(2,775,141)	533,672
Pledges Receivable	9,920	-	-	-	-	9,920
Note Receivable - Related Party	3,845,719	-	-	501,311	(4,347,030)	-
Interest and Dividends Receivable	885,637	-	-	-	(885,601)	36
Prepaid Expenses	28,967	-	27,584	-	-	56,551
Total Current Assets	5,820,365	-	2,840,419	501,311	(8,007,772)	1,154,323
Buildings and Equipment, Net	1,043,521	-	10,208,513	3,743	-	11,255,777
Investments	8,154,325	2,965,038	57,342	-	(5,967,507)	5,209,198
Pledges Receivable	18,121	-	-	-	-	18,121
Beneficial Interest in Perpetual Trust	161,245	-	-	-	-	161,245
Beneficial Interest in Charitable Remainder Trusts	122,156	-	-	-	-	122,156
Deposits	-	-	-	9,635	-	9,635
Other Assets, Net	8,372	-	134,352	-	-	142,724
Total Assets	$ 15,328,105	$ 2,965,038	$ 13,240,626	$ 514,689	$ (13,975,279)	$ 18,073,179

LIABILITIES AND EQUITY	Art Academy of Cincinnati	Academy Advancement Limited	1212 Jackson, LLC	Art Academy Housing, Inc.	Eliminations	Total
Current Liabilities						
Accounts Payable	$ 141,849	$ -	$ 1	$ -	$ -	$ 141,850
Accrued Expenses	3,107,935	-	996,100	-	(3,660,742)	443,293
Note Payable - Related Party	511,311	-	3,303,215	532,504	(4,347,030)	-
Note Payable - Current Portion	3,178	-	-	-	-	3,178
Total Current Liabilities	3,764,273	-	4,299,316	532,504	(8,007,772)	588,321
Long-Term Liabilities						
Charitable Remainder Trust	49,852	-	-	-	-	49,852
Note Payable (Less Current Portion)	170,774	-	-	-	-	170,774
Bond Payable (Less Current Portion)	-	-	4,300,000	-	-	4,300,000
Total Long Term Liabilities	220,626	-	4,300,000	-	-	4,520,626
Fair Market Value of Interest Rate Swap	-	-	146,869	-	-	146,869
Total Liabilities	3,984,899	-	8,746,185	532,504	(8,007,772)	5,255,816
Equity						
Members' Equity (Deficit)	-	2,965,038	2,964,988	-	(5,967,507)	(37,481)
Fair Market Value of Interest Rate Swap	-	-	(146,869)	-	-	(146,869)
Net Assets	11,343,206	-	-	(17,815)	-	11,325,391
	11,343,206	2,965,038	2,818,119	(17,815)	(5,967,507)	11,141,041
Other Members' Equity	-	-	1,676,322	-	-	1,676,322
Total Equity	11,343,206	2,965,038	4,494,441	(17,815)	(5,967,507)	12,817,363
Total Liabilities and Equity	$ 15,328,105	$ 2,965,038	$ 13,240,626	$ 514,689	$ (13,975,279)	$ 18,073,179

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATING STATEMENT OF ACTIVITIES
Year Ended May 31, 2010

	Art Academy of Cincinnati	Academy Advancement Limited	1212 Jackson LLC	Art Academy Housing, Inc.	Eliminations	Total
Revenue and Support						
Grants, Contributions and Gifts	$ 350,845	$ -	$ -	$ -	$ -	$ 350,845
Tuition Income	4,317,425	-	-	-	-	4,317,425
Investment Income	347,542	-	9	-	(198,193)	149,358
Other Income	1,934	-	929,000	128,918	(929,000)	130,852
Total Revenue and Support	5,017,746	-	929,009	128,918	(1,127,193)	4,948,480
Expenses						
Program Services	5,687,167	138	852,457	130,988	(1,110,324)	5,560,426
Management & General	658,822	1	121,959	-	(11,272)	769,510
Fundraising	51,146	1	4,328	-	(5,636)	49,839
Total Expenses	6,397,135	140	978,744	130,988	(1,127,232)	6,379,775
Excess (Deficit) of Revenue, Support and Reclassifications Over Expenses	(1,379,389)	(140)	(49,735)	(2,070)	39	(1,431,295)
Realized Loss on Investments	(301,286)	-	-	-	-	(301,286)
Unrealized Gain on Investments	1,262,331	-	-	-	-	1,262,331
Change in Beneficial Interest in Perpetual Trust	18,718	-	-	-	-	18,718
Change in Beneficial Interest in Charitable Remainder Trusts	4,285	-	-	-	-	4,285
Other Members' Interest	-	-	49,685	-	-	49,685
Change in Net Assets	(395,341)	(140)	(50)	(2,070)	39	(397,562)
Members' Contributed Capital	-	-	2,404	-	(2,404)	-
Other Members' Interest	-	-	(49,685)	-	-	(49,685)
Change in Fair Market Value of Interest Rate Swap	-	-	73,224	-	-	73,224
	(395,341)	(140)	25,893	(2,070)	(2,365)	(374,023)
Net Assets Beginning of Year - As Restated	11,738,547	2,965,178	4,468,548	(15,745)	(5,965,142)	13,191,386
Net Assets End of Year	$ 11,343,206	$ 2,965,038	$ 4,494,441	$ (17,815)	$ (5,967,507)	$ 12,817,363

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATING STATEMENT OF MEMBERS' EQUITY

	Academy Advancement LTD.	1212 Jackson LLC	Subtotal	Eliminations	Total
Members' Equity - August 31, 2008 (As Restated)	$ 2,965,232	$ 4,629,202	$ 7,594,434	$ (5,962,741)	$ 1,631,693
Contributed Capital	2,455	-	2,455	(2,455)	-
Net Loss	(2,509)	(39)	(2,548)	54	(2,494)
Subtotal	2,965,178	4,629,163	7,594,341	(5,965,142)	1,629,199
Other Members' Net Loss	-	(39,423)	(39,423)	-	(39,423)
Fair Market Value of Interest Rate Swap	-	(121,192)	(121,192)	-	(121,192)
Members' Equity - May 31, 2009 (As Restated)	2,965,178	4,468,548	7,433,726	(5,965,142)	1,468,584
Contributed Capital	-	2,404	2,404	(2,404)	-
Net Income (Loss)	(140)	(50)	(190)	39	(151)
Subtotal	2,965,038	4,470,902	7,435,940	(5,967,507)	1,468,433
Other Members' Net Loss	-	(49,685)	(49,685)	-	(49,685)
Fair Market Value of Interest Rate Swap	-	73,224	73,224	-	73,224
Members' Equity - May 31, 2010	$ 2,965,038	$ 4,494,441	$ 7,459,479	$ (5,967,507)	$ 1,491,972