ART ACADEMY OF CINCINNATI AND AFFILIATES

May 31, 2013

CONSOLIDATED FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT INCLUDING SUPPLEMENTARY INFORMATION

ART ACADEMY OF CINCINNATI AND AFFILIATES
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INDEPENDENT AUDITORS' REPORT

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

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of the Art Academy of Cincinnati (a nonprofit organization) and Affiliates, which comprise the consolidated statements of financial position as of May 31, 2013 and 2012, and the related consolidated statements of activities, members' equity, 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 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 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 consolidated financial position of the Art Academy of Cincinnati and Affiliates as of May 31, 2013 and 2012, and the changes in its consolidated net assets and its consolidated cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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Other Matters

Other Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards* we have also issued our report dated November 11, 2013, 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 of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Art Academy of Cincinnati and Affiliates' internal control over financial reporting and compliance.

VonLehman & Company Inc.

Fort Mitchell, Kentucky
November 11, 2013

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
May 31, 2013

ASSETS

	Unrestricted				Permanently Restricted	
	General	Board Designated	Plant	Temporarily Restricted	Endowment	Total
Current Assets						
Cash and Cash Equivalents	$ 43,500	$ -	$ -	$ 177,385	$ 6,580	$ 227,465
Accounts Receivable, Net	165,786	-	-	-	-	165,786
Investments	29,737	499,810	-	61,368	-	590,915
Grant Receivable	-	-	-	40,000	-	40,000
Investment Receivable	(81,386)	-	-	81,386	-	-
Prepaid Expenses	93,112	-	-	-	-	93,112
Total Current Assets	250,749	499,810	-	360,139	6,580	1,117,278
Buildings and Equipment, Net	-	-	4,217,872	-	-	4,217,872
Investments	-	-	-	36,841	828,963	865,804
Grant Receivable	-	-	-	560,000	-	560,000
Beneficial Interest in Perpetual Trust	-	-	-	-	192,972	192,972
Beneficial Interest in Charitable Remainder Trusts	-	-	-	97,532	-	97,532
Deposits	-	-	12,810	-	-	12,810
Other Assets, Net	-	-	14,495	-	-	14,495
Total Assets	$ 250,749	$ 499,810	$ 4,245,177	$ 1,054,512	$ 1,028,515	$ 7,078,763

LIABILITIES AND NET ASSETS

	General	Board Designated	Plant	Temporarily Restricted	Endowment	Total
Current Liabilities						
Line of Credit	$ 665,000	$ -	$ -	$ -	$ -	$ 665,000
Accounts Payable	192,496	-	-	-	-	192,496
Accrued Expenses	157,038	-	-	176,385	-	333,423
Capital Lease - Current Portion	-	-	5,525	-	-	5,525
Note Payable - Current Portion	-	-	4,834	-	-	4,834
Total Current Liabilities	1,014,534	-	10,359	176,385	-	1,201,278
Long-Term Liabilities						
Charitable Remainder Trust	-	-	-	32,668	-	32,668
Deferred Revenue	-	-	-	600,000	-	600,000
Capital Lease - Long-Term	-	-	11,445	-	-	11,445
Note Payable - Long-Term	-	-	173,735	-	-	173,735
Total Long-Term Liabilities	-	-	185,180	632,668	-	817,848
Total Liabilities	1,014,534	-	195,539	809,053	-	2,019,126
Net Assets	(763,785)	499,810	4,049,638	245,459	1,028,515	5,059,637
Total Liabilities and Net Assets	$ 250,749	$ 499,810	$ 4,245,177	$ 1,054,512	$ 1,028,515	$ 7,078,763

See accompanying notes.

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
May 31, 2012

ASSETS

	Unrestricted				Permanently Restricted	
	General	Board Designated	Plant	Temporarily Restricted	Endowment	Total
Current Assets						
Cash and Cash Equivalents	$ 144,933	$ -	$ 1,689	$ 185,637	$ 8,582	$ 340,841
Accounts Receivable, Net	144,338	-	-	-	-	144,338
Pledges Receivable	-	-	-	2,445	-	2,445
Investments	25,467	1,376	-	56,370	-	83,213
Investment Receivable	(110,138)	-	-	110,138	-	-
Prepaid Expenses	68,145	-	-	-	-	68,145
Total Current Assets	272,745	1,376	1,689	354,590	8,582	638,982
Buildings and Equipment, Net	-	-	10,553,865	-	-	10,553,865
Investments	-	-	-	120,863	1,192,012	1,312,875
Pledges Receivable	-	-	-	1,895	-	1,895
Beneficial Interest in Perpetual Trust	-	-	-	-	171,741	171,741
Beneficial Interest in Charitable Remainder Trusts	-	-	-	102,530	-	102,530
Deposits	-	-	16,610	-	-	16,610
Other Assets, Net	-	-	16,519	-	-	16,519
Total Assets	$ 272,745	$ 1,376	$ 10,588,683	$ 579,878	$ 1,372,335	$ 12,815,017

LIABILITIES AND EQUITY

	General	Board Designated	Plant	Temporarily Restricted	Endowment	Total
Current Liabilities						
Line of Credit	$ 400,000	$ -	$ -	$ -	$ -	$ 400,000
Accounts Payable	172,526	-	-	-	-	172,526
Accrued Expenses	183,527	-	69,645	166,456	-	419,628
Note Payable - Current Portion	-	-	167,339	-	-	167,339
Total Current Liabilities	756,053	-	236,984	166,456	-	1,159,493
Long-Term Liabilities						
Charitable Remainder Trust	-	-	-	34,342	-	34,342
Total Liabilities	756,053	-	236,984	200,798	-	1,193,835
Equity						
Members' Equity	-	-	1,689	-	-	1,689
Net Assets	(483,308)	1,376	10,350,010	379,080	1,372,335	11,619,493
Total Equity	(483,308)	1,376	10,351,699	379,080	1,372,335	11,621,182
Total Liabilities and Equity	$ 272,745	$ 1,376	$ 10,588,683	$ 579,878	$ 1,372,335	$ 12,815,017

See accompanying notes.

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended May 31, 2013

	Unrestricted				Permanently Restricted	
	General	Board Designated	Plant	Temporarily Restricted	Endowment	Total
Revenue and Support						
Grants, Contributions and Gifts	$ 279,730	$ -	$ -	$ (4,340)	$ 6,580	$ 281,970
Tuition Income	4,811,650	-	-	-	-	4,811,650
Investment Income	-	16,568	-	33,912	-	50,480
Investment Income Allocation	70,000	(20,538)	-	(49,462)	-	-
Other Income	419,843	-	173,691	-	-	593,534
Total Revenue and Support	5,581,223	(3,970)	173,691	(19,890)	6,580	5,737,634
Net Assets Released from Restrictions	18,180	555,533	-	(202,082)	(371,631)	-
Total Revenue, Support and Reclassifications	5,599,403	551,563	173,691	(221,972)	(365,051)	5,737,634
Expenses						
Program Services	5,375,348	-	609,029	-	-	5,984,377
Management and General	484,944	1,842	17,550	-	-	504,336
Fundraising	9,561	-	2,068	-	-	11,629
Total Expenses	5,869,853	1,842	628,647	-	-	6,500,342
(Deficit) Excess of Revenue, Support and Reclassifications Over Expenses	(270,450)	549,721	(454,956)	(221,972)	(365,051)	(762,708)
Interfund Equity Transfers	(38,779)	(100,000)	143,114	(4,335)	-	-
Realized Gain on Investments	-	36,671	-	57,292	-	93,963
Unrealized Gain on Investments	-	12,042	-	67,470	-	79,512
Change in Excess Loss on Endowment Investments	28,752	-	-	(28,752)	-	-
Change in Beneficial Interest in Perpetual Trust	-	-	-	-	21,231	21,231
Change in Beneficial Interest in Charitable Remainder Trusts	-	-	-	(3,324)	-	(3,324)
Impairment for Reduction in Carrying Value to Market Value	-	-	(5,990,219)	-	-	(5,990,219)
Change in Net Assets	(280,477)	498,434	(6,302,061)	(133,621)	(343,820)	(6,561,545)
Net Assets Beginning of Year	(483,308)	1,376	10,351,699	379,080	1,372,335	11,621,182
Net Assets End of Year	$ (763,785)	$ 499,810	$ 4,049,638	$ 245,459	$ 1,028,515	$ 5,059,637

See accompanying notes.

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended May 31, 2012

	Unrestricted				Permanently Restricted	
	General	Board Designated	Plant	Temporarily Restricted	Endowment	Total
Revenue and Support						
Grants, Contributions and Gifts	$ 258,214	$ -	$ -	$ 1,847	$ 12,081	$ 272,142
Tuition Income	5,335,302	-	-	-	-	5,335,302
Investment Income	-	2,952	-	51,457	-	54,409
Investment Income Allocation	72,917	(1,894)	-	(71,023)	-	-
Other Income	13,836	-	224,556	-	-	238,392
Total Revenue and Support	5,680,269	1,058	224,556	(17,719)	12,081	5,900,245
Net Assets Released from Restrictions	73,523	-	-	(2,400)	(71,123)	-
Total Revenue, Support and Reclassifications	5,753,792	1,058	224,556	(20,119)	(59,042)	5,900,245
Expenses						
Program Services	5,359,928	-	946,665	-	-	6,306,593
Management and General	597,594	3,782	3,864	-	-	605,240
Fundraising	20,809	-	1,932	-	-	22,741
Total Expenses	5,978,331	3,782	952,461	-	-	6,934,574
Deficit of Revenue, Support and Reclassifications Over Expenses	(224,539)	(2,724)	(727,905)	(20,119)	(59,042)	(1,034,329)
Interfund Equity Transfers	(345,124)	(2,377,586)	4,524,154	(1,801,444)	-	-
Realized Loss on Investments	-	(19,727)	-	(90,647)	-	(110,374)
Unrealized (Loss) Gain on Investments	-	(7,037)	50	(67,105)	-	(74,092)
Change in Excess Loss on Endowment Investments	(110,138)	92,180	-	17,958	-	-
Change in Beneficial Interest in Perpetual Trust	-	-	-	-	(8,966)	(8,966)
Change in Beneficial Interest in Charitable Remainder Trusts	-	-	-	(10,691)	-	(10,691)
Change in Net Assets	(679,801)	(2,314,894)	3,796,299	(1,972,048)	(68,008)	(1,238,452)
Change in Fair Market Value of Interest Rate Swap	-	-	60,784	-	-	60,784
	(679,801)	(2,314,894)	3,857,083	(1,972,048)	(68,008)	(1,177,668)
Net Assets Beginning of Year	196,493	2,316,270	6,494,616	2,351,128	1,440,343	12,798,850
Net Assets End of Year	$ (483,308)	$ 1,376	$ 10,351,699	$ 379,080	$ 1,372,335	$ 11,621,182

See accompanying notes.

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

	Members' Equity	Fair Market Value of Interest Rate Swap	Total
Balance - May 31, 2011	$ 1,561,695	$ (60,784)	$ 1,500,911
Net Loss	(386,395)	-	(386,395)
Dissolution of Entity	(1,173,611)	-	(1,173,611)
Change in Fair Market Value of Interest Rate Swap	-	60,784	60,784
Balance - May 31, 2012	1,689	-	1,689
Dissolution of Entity	(1,689)	-	(1,689)
Balance - May 31, 2013	$ -	$ -	$ -

See accompanying notes.

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended May 31, 2013	Years Ended May 31, 2012
Cash Flows from Operating Activities		
Change in Net Assets	$ (6,561,545)	$ (1,238,452)
Adjustments to Reconcile Change in Net Assets to Net Cash Used by Operating Activities		
Depreciation	396,035	430,088
Amortization	2,024	115,271
Realized (Gain) Loss on Investments	(93,963)	110,374
Unrealized (Gain) Loss on Investments	(79,512)	74,092
Change in Beneficial Interest in Perpetual Trust	(21,231)	8,966
Change in Beneficial Interest in Charitable Remainder Trusts	3,324	10,691
Impairment for Reduction in Carrying Value to Market Value	5,990,219	-
Contributions Restricted for Capital Purchases	-	(1,847)
Change in Operating Assets		
Accounts Receivable	(21,448)	(25,965)
Pledges Receivable	4,340	10,000
Interest and Dividends Receivable	-	29
Prepaid Expenses	(24,967)	33,973
Deposits	3,800	(3,224)
Change in Operating Liabilities		
Accounts Payable	19,970	22,920
Accrued Expenses	(86,205)	(12,503)
Net Cash Used by Operating Activities	(469,159)	(465,587)
Cash Flows from Investing Activities		
Proceeds from Sale of Investments	815,383	5,928,560
Purchase of Investments	(702,539)	(1,649,113)
Acquisition of Building and Equipment	(16,623)	(67,702)
Net Cash Provided by Investing Activities	96,221	4,211,745
Cash Flows from Financing Activities		
Net Change in Line of Credit	265,000	400,000
Contributions Restricted for Capital Purchases	-	1,847
Payments on Note Payable	(4,158)	(3,422)
Payments on Capital Lease	(1,280)	-
Payments on Bond Payable	-	(4,300,000)
Net Cash Provided (Used) by Financing Activities	259,562	(3,901,575)
Net Change in Cash and Cash Equivalents	(113,376)	(155,417)
Beginning Balance - Cash and Cash Equivalents	340,841	496,258
Ending Balance - Cash and Cash Equivalents	$ 227,465	$ 340,841

See accompanying notes.

NOTE 1 – ACCOUNTING POLICIES

The Art Academy of Cincinnati's (the Academy) 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. In December, 2011, the Art Academy of Cincinnati as the sole owner of Academy Advancement Limited voted to dissolve the entity. The majority of the assets and liabilities were transferred to 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.

As of both May 31, 2013 and 2012, the consolidated financial statements include the Art Academy of Cincinnati and Art Academy Housing, Inc.

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

Principles of Consolidation

The consolidated financial statements also include the accounts of Art Academy Housing, Inc. This entity is related to the Academy because the Academy has assumed the financial and day-to-day operational management functions for this entity. Under accounting principles generally accepted in the United States of America, the Academy 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.

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 both May 31, 2013 and 2012.

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 – ACCOUNTING POLICIES (Continued)

Use of Estimates

The process of preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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.

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.

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)

Art Inventory

The Academy's art inventory is made up of art objects that have been acquired through donations. This inventory is not recognized in the accompanying consolidated financial statements due to inconsistent appraisals and valuations for the items individually and as a whole. 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 both the years ended May 31, 2013 and 2012, sales of art inventory totaled $-0-.

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, 2013 and 2012, sales of art totaled $-0-. During both the years ended May 31, 2013 and 2012, 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 fiscal years 2013 or 2012.

Advertising Costs

The Academy expenses advertising costs as they are 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 were being amortized over the life of the bonds using the straight-line method. During 2012, the unamortized issuance costs were written off in connection with the bond retirement.

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. This entity was dissolved as of December 31, 2011.

NOTE 1 – ACCOUNTING POLICIES (Continued)

Art Academy Housing, Inc. 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 Art Academy of Cincinnati and Affiliates has adopted the provisions of the accounting pronouncement related to accounting for uncertainty in income taxes. The Art Academy of Cincinnati and Affiliates recognized no interest or penalties in the consolidated statements of activities for either of the years ended May 31, 2013 and 2012. 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. Tax years still open under federal and state statute of limitations remain subject to review and change.

Based on the evaluation of the Art Academy of Cincinnati and Affiliates' 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, 2013 or 2012.

Classes of Net Assets

The accompanying consolidated 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.

Reclassifications

Certain amounts in the prior year consolidated financial statements have been reclassified for comparative purposes to conform with the presentation of the current year 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. In addition, the FDIC insured 100% of all non-interest bearing accounts through December 31, 2012. Using these criteria, the Academy had no cash in excess of insured limits at both May 31, 2013 and 2012.

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.

For purposes of the consolidated cash flows statements, 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.

NOTE 2 – CASH AND CASH FLOW INFORMATION (Continued)

Cash paid for interest was $28,107 and $79,610 in 2013 and 2012, respectively.

The Academy had noncash financing or investing activities as follows:

	Years Ended May 31, 2013	2012
Equipment Acquired through Capital Lease	$ 18,250	$ -
Leasehold Improvement Paid through Long-Term Debt	$ 15,388	$ -

NOTE 3 – BUILDINGS AND EQUIPMENT

Buildings and equipment and related accumulated depreciation consist of the following at May 31, 2013 and 2012.

	Cost	Accumulated Depreciation	Net Book Value
2013			
Land	$ 189,520	$ -	$ 189,520
Buildings and Improvements	3,976,369	53,136	3,923,233
Office Furniture and Equipment	1,104,318	999,199	105,119
	$ 5,270,207	$ 1,052,335	$ 4,217,872
2012			
Land	$ 362,100	$ -	$ 362,100
Buildings and Improvements	12,331,108	2,277,966	10,053,142
Office Furniture and Equipment	1,070,578	931,955	138,623
	$ 13,763,786	$ 3,209,921	$ 10,553,865

Included in the above amounts for May 31, 2013 is the Walnut Street building which is partially being used in operations. At May 31, 2012 the Walnut Street building was 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, 2013 were $476,430 ($476,430 as of May 31, 2012) and $64,794 ($52,557 as of May 31, 2012), respectively. In September, 2013, the Walnut Street building was sold. The building sales price was $550,000.

At May 31, 2013, the Academy recognized an asset impairment on the 1212 Jackson Street property. A commercial appraisal of the property is $3,705,864 and the book value of the property is $9,696,083, therefore an impairment loss of $5,990,219 was recognized.

NOTE 4 – PLEDGES RECEIVABLE

The Academy’s pledges receivable are as follows:

	May 31, 2013	May 31, 2012
Receivable in Less than One Year	$ -	$ 2,500
Less Allowance for Uncollectible Pledges Receivable	-	55
Net Receivable in Less than One Year	-	2,445
Receivable in One to Five Years	-	2,500
Less Present Value Discount (6%)	-	550
Less Allowance for Uncollectible Pledges Receivable	-	55
Net Receivable in One to Five Years	-	1,895
Net Receivable	$ -	$ 4,340

NOTE 5 – INVESTMENTS

The Academy's investments are summarized as follows:

	May 31, 2013 Cost	2013 Fair Value	2012 Cost	2012 Fair Value
Unrestricted Fund	$ 469,317	$ 529,547	$ 27,847	$ 26,843
Temporarily Restricted	91,264	98,209	175,082	177,233
Permanently Restricted	743,679	828,963	1,125,037	1,192,012
	$ 1,304,260	$ 1,456,719	$ 1,327,966	$ 1,396,088

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

	May 31, 2013 Cost	2013 Fair Value	2012 Cost	2012 Fair Value
Cash Equivalents	$ 15,631	$ 15,631	$ 15,449	$ 15,449
U.S. Government Securities	11,134	11,244	8,795	10,079
Corporate Stocks and Bonds	351,990	446,210	416,699	488,957
Collective and Mutual Funds	748,829	798,893	838,651	832,566
Exchange-Traded Fund	174,267	181,876	48,372	49,037
Partnership	2,409	2,865	-	-
	$ 1,304,260	$ 1,456,719	$ 1,327,966	$ 1,396,088

NOTE 5 – INVESTMENTS (Continued)

The following schedules summarize investment return and its classification in the consolidated statements of activities for the years ended May 31, 2013 and 2012.

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
2013				
Interest and Dividends	$ 16,568	$ 33,912	$ -	$ 50,480
Realized Gains	36,671	57,292	-	93,963
Unrealized Gains	12,042	67,470	-	79,512
Fees	(1,842)	-	-	(1,842)
Total Investment Return	$ 63,439	$ 158,674	$ -	$ 222,113
2012				
Interest and Dividends	$ 2,952	$ 51,457	$ -	$ 54,409
Realized Losses	(19,727)	(90,647)	-	(110,374)
Unrealized Losses	(6,987)	(67,105)	-	(74,092)
Fees	(3,782)	-	-	(3,782)
Total Investment Return	$ (27,544)	$ (106,295)	$ -	$ (133,839)

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 four quarter rolling average and a twelve quarter rolling average for the years ended May 31, 2013 and 2012, respectively. The distribution is recognized in the general fund as investment income.

NOTE 6 – GRANT RECEIVABLE

In August, 2013, the Academy finalized a grant agreement with the Ohio Cultural Facilities Commission. As part of the agreement, the Academy will hold $600,000 in escrow to be used as part of the Cultural Project constituting the Commission-funded improvements to reimburse the Academy for a portion of the costs of acquisition of the 1212 Jackson Street building and the adjacent parking lot. The grant will be amortized on a fifteen year straight line basis. The first draw on the grant is expected in January, 2014.

NOTE 7 – BENEFICIAL INTEREST IN PERPETUAL TRUSTS

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

Trust	The Academy's Percentage of Trust	May 31, 2013	May 31, 2012
Wilmer D. Glenn Trust	100%	$ 192,972	$ 171,741

NOTE 8 – OTHER ASSETS

The following is a summary of other assets:

	Closing Cost May 31, 2013	Closing Cost May 31, 2012
Cost	$ 30,361	$ 30,361
Accumulated Amortization	15,866	13,842
Other Assets, Net	$ 14,495	$ 16,519

Estimated amortization for the five years subsequent is as follows:

Years Ending May 31,	
2014	$ 2,024
2015	2,024
2016	2,024
2017	2,024
2018	2,024
Thereafter	4,375
	$ 14,495

NOTE 9 – LINE OF CREDIT

The Academy has an unsecured revolving line of credit agreement with a bank. In June, 2011, the bank increased the line of credit from $400,000 to $1,000,000. The line of credit charges interest at LIBOR plus 1.75% at May 31, 2013 (2.01% at May 31, 2013) and at LIBOR rate plus 1.75% at May 31, 2012 (2.01% at May 31, 2012). The line matures in December, 2013. At May 31, 2013 and 2012, the outstanding balance on the line of credit was $665,000 and $400,000, respectively.

NOTE 10 – NOTE PAYABLE

	May 31, 2013	May 31, 2012
Note payable to bank; due in monthly installments of $1,272, including interest of 7%, due April, 2013. The note is collateralized by a parcel of land. The note was refinanced in February, 2013; due in monthly installments of $1,284, including interest of 6%; due in February, 2018.	$ 178,569	$ 167,339
Current Portion	4,834	167,339
Long-Term Portion	$ 173,735	$ -

NOTE 10 – NOTE PAYABLE (Continued)

The remaining maturities on this note are as follows:

Years Ending May 31,		
2014	$	4,834
2015		5,132
2016		5,448
2017		5,784
2018		157,371
	$	178,569

NOTE 11 – CAPITAL LEASE OBLIGATION

The Company incurred a capital lease obligation in 2013, collateralized by the computer server purchased, that charged interest at 12.2%. Depreciation expense for equipment held under the capital lease obligation was $1,521 for the year ended May 31, 2013.

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

		May 31, 2013
Computer Server	$	18,250
Less Accumulated Depreciation		1,521
Net Capital Lease Obligation Property	$	16,729

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

Years Ending May 31,		
2014	$	7,293
2015		7,293
2016		5,470
Total Minimum Lease Payments		20,056
Less Amounts Representing Interest		(3,086)
Present Value of Net Minimum Lease Payments		16,970
Less Current Portion		5,525
Long-Term Capital Lease Obligation	$	11,445

NOTE 12 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are restricted as follows:

	May 31, 2013	May 31, 2012
Time Restricted		
Investments - Cash	$ 47,610	$ 60,794
Beneficial Interest in Charitable Remainder Trusts	64,864	68,188
Purpose Restricted		
Building on Rich Tradition Campaign	-	4,340
Contributions and Gifts	14,757	14,757
Endowments	118,228	231,001
Temporarily Restricted Net Assets	$ 245,459	$ 379,080

NOTE 13 – ENDOWMENTS

The Academy's endowment consists of 63 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.

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.

NOTE 13 – ENDOWMENTS (Continued)

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.

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net asset composition by type of fund as of May 31, 2013:				
	$ 499,810	$ 36,841	$ 828,963	$ 1,365,614
Changes in endowment net assets for the year ended May 31, 2013 are as follows:				
Endowment Net Assets, Beginning of Year	$ 1,376	$ 120,863	$ 1,192,012	$ 1,314,251
Investment Return				
Investment Income	16,568	28,916	-	45,484
Net Appreciation (Realized and Unrealized)	48,713	124,762	-	173,475
Total Investment Return	65,281	153,678	-	218,959
Contributions	-	-	8,582	8,582
Appropriation of Endowment Assets for Expenditures	(151,131)	(25,047)	-	(176,178)
Transfer of Assets released from Restrictions to Unrestricted Fund	555,533	(183,902)	(371,631)	-
Transfer of Restricted Endowments Whose Balance Is Above the Restricted Amount	28,751	(28,751)	-	-
Endowment Net Assets, End of Year	$ 499,810	$ 36,841	$ 828,963	$ 1,365,614

As of May 31, 2013, the amount of permanently restricted endowment funds whose balance dropped below the restricted amount had decreased to $81,386. This was a change from the amount at May 31, 2012 of $28,752.

During 2013, in accordance with UPMIFA, the Academy had released into unrestricted an endowment fund that was previously recorded as permanently restricted. Therefore, $555,533 was transferred from permanently and temporarily restricted to unrestricted.

NOTE 13 – ENDOWMENTS (Continued)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net asset composition by type of fund as of May 31, 2012:				
	$ 1,376	$ 120,863	$ 1,192,012	$ 1,314,251
Changes in endowment net assets for the year ended May 31, 2012 are as follows:				
Endowment Net Assets, Beginning of Year	$ 2,316,241	$ 2,191,602	$ 1,245,222	$ 5,753,065
Investment Return				
Investment Income	2,952	51,659	-	54,611
Net Appreciation (Realized and Unrealized)	(26,764)	(157,752)	-	(184,516)
Total Investment Return	(23,812)	(106,093)	-	(129,905)
Contributions	-	-	17,913	17,913
Withdrawals for Bond Retirement	(2,270,607)	(1,903,139)	-	(4,173,746)
Appropriation of Endowment Assets for Expenditures	(2,488)	(79,465)	(71,123)	(153,076)
Transfer of Restricted Endowments Whose Balance Is Below the Restricted Amount	(17,958)	17,958	-	-
Endowment Net Assets, End of Year	$ 1,376	$ 120,863	$ 1,192,012	$ 1,314,251

As of May 31, 2012, the amount of permanently restricted endowment funds whose balance dropped below the restricted amount had increased to $110,138. This was a change from the amount at May 31, 2011 of $17,958.

During 2012, in accordance with UPMIFA, the Academy had released into unrestricted an endowment fund that was previously recorded as permanently restricted. Therefore, $71,123 was transferred from permanently and temporarily restricted to unrestricted.

NOTE 14 - FUNCTIONAL EXPENSES

The detail of functional expenses is as follows:

	Years Ended May 31, 2013				2012			
	Program Services	Management and General	Fundraising	Total	Program Services	Management and General	Fundraising	Total
Salaries	$ 1,693,013	$ 213,192	$ -	$ 1,906,205	$ 1,676,677	$ 250,006	$ -	$ 1,926,683
Payroll Taxes	161,082	22,633	-	183,715	174,632	16,461	-	191,093
Employee Benefits	172,349	26,842	-	199,191	182,055	29,002	-	211,057
Rent	190,002	-	-	190,002	171,252	-	-	171,252
Telephone	-	6,920	-	6,920	848	9,063	-	9,911
Utilities	258,823	8,050		266,873	254,563	7,985	-	262,548
Security	193,599	-	-	193,599	195,755	-	-	195,755
Insurance	-	35,750	-	35,750	-	34,440	-	34,440
Bank Charges	70	12,404	-	12,474	491	15,484	-	15,975
Parking	57,514	-	-	57,514	52,086	5,275	-	57,361
Supplies	74,863	34,412	-	109,275	97,333	21,641	10	118,984
Purchased Services	151,854	66,806	-	218,660	50,153	94,585	-	144,738
Model Fees	14,340	-	-	14,340	15,410	-	-	15,410
Lecturer's Honorarium	6,690	-	-	6,690	13,095	-	-	13,095
Hospitality	17,957	1,179	553	19,689	24,952	4,991	1,179	31,122
Memberships and Fees	13,477	19,170	-	32,647	20,452	26,702	-	47,154
Books, Videos, and Subscriptions	1,127	142	90	1,359	1,722	79	-	1,801
Email and Internet	8,440	8,440	-	16,880	6,403	6,403	-	12,806
Postage and Mail Service	-	4,896	-	4,896	-	10,115	-	10,115
Travel	21,961	1,948	-	23,909	21,863	3,149	48	25,060
Per Diem	7,874	656	-	8,530	8,751	1,067	-	9,818
Promotion	99,037	-	5,648	104,685	162,091	1,494	3,812	167,397
Newsletter	-	-	-	-	30	-	10,908	10,938
Equipment Maintenance and Rental	105,012	24,067	3,270	132,349	41,104	26,396	3,167	70,667
Plant Maintenance	30,636	-	-	30,636	28,498	-	-	28,498
Student Activities	25,860	-	-	25,860	51,275	-	-	51,275
Student Exhibition	26,932	-	-	26,932	4,532	-	-	4,532
Information Technology	434	-	-	434	1,672	-	-	1,672
Scholarships	2,244,047	-	-	2,244,047	2,336,352	-	-	2,336,352
Depreciation and Amortization	379,699	16,433	1,927	398,059	525,190	17,503	2,666	545,359
Interest Expense	27,685	281	141	28,107	78,416	796	398	79,610
Taxes	-	-	-	-	89,990	914	457	91,361
Bond Cost	-	-	-	-	18,950	192	96	19,238
Miscellaneous Expense	-	115	-	115	-	21,497	-	21,497
	$ 5,984,377	$ 504,336	$ 11,629	$ 6,500,342	$ 6,306,593	$ 605,240	$ 22,741	$ 6,934,574

NOTE 15 – OPERATING LEASES

The Academy is the lessee in the following lease agreements:

Equipment

The Academy leases equipment for total monthly payments of $2,786. The leases have varying expiration dates ranging from July, 2015 to December, 2017. The Academy incurred lease expense of $19,518 and $8,073 for 2013 and 2012, respectively.

Housing

Art Academy Housing, Inc. leases apartments for the students of the Academy for a base rent of $19,647 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, Inc. incurred lease expense related to this lease of $124,657 and $111,498 for 2013 and 2012, respectively.

During 2012 and 2013, the Academy entered into additional leases for student housing. The lease payments vary from $400 to $1,000 and have expiration dates ranging from February, 2012 to May, 2014. The Academy incurred lease expense of $57,945 and $59,754 for 2013 and 2012, respectively.

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

Years Ending May 31,	Housing	Equipment	Total
2014	$ 139,962	$ 28,061	$ 168,023
2015	20,220	28,061	48,281
2016	-	14,052	14,052
2017	-	11,019	11,019
2018	-	5,509	5,509
	$ 160,182	$ 86,702	$ 246,884

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 expired in June, 2011. As part of the lease agreement, the Academy was offsetting utility expense with the tenant. The net annual rental income was $-0- for the years ended May 31, 2013 and 2012.

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, 2013 and 2012, the Academy had transactions with related parties as follows:

	Years Ended May 31, 2013	2012
Storage Rental	$ 2,500	$ 3,500
Legal Services	$ 20,238	$ 12,374
Consulting Expense	$ 67,929	$ -

NOTE 17 – HEDGING ACTIVITIES

1212 Jackson, LLC held 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 were held only for the purpose of hedging such risks, not for speculation. Generally, 1212 Jackson, LLC entered 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, 2011, hedging relationships existed for bond indebtedness.

1212 Jackson, LLC recognized net gains of $60,784 for 2012 from cash flow hedges. In September, 2011, the bond payable was paid off along with the interest rate swap.

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 consolidated statements 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, 2013, none of which are held for trading purposes, are as follows:

	Carrying Value	Fair Value
Financial Assets		
Cash and Cash Equivalents	$ 227,465	$ 227,465
Accounts and Other Receivables	765,786	765,786
Prepaid Expenses	93,112	93,112
Investments	1,456,719	1,456,719
Beneficial Interests	257,836	257,836
Financial Liabilities		
Line of Credit	665,000	665,000
Accounts Payable, Accrued and Other Liabilities	1,125,919	1,125,919
Capital Lease	16,970	16,970
Note Payable	178,569	178,569

NOTE 19 – FAIR VALUE MEASUREMENTS

Financial Accounting Standards Board (FASB) *Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures*, provides the 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 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). 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 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 either May 31, 2013 or 2012.

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.

NOTE 19 – FAIR VALUE MEASUREMENTS (Continued)

The following assets and liabilities were measured at fair value as of May 31, 2013:

	Level 1 Quoted Price In Active Markets for Identical Assets	Level 2 Significant Other Observable Inputs	Level 3 Significant Unobservable Inputs
Cash and Cash Equivalents	$ 15,631	$ -	$ -
Mutual Funds			
Money Market Funds	14,840	-	-
Government Agency Funds	6,187		
Value Funds	16,355	-	-
Institutional Funds	92,215		
Blended Funds	15,500	-	-
Growth Funds	77,236	-	-
Fixed Funds	372,116	-	-
International Funds	204,444	-	-
Total Mutual Funds	798,893	-	-
Stocks			
Consumer Discretionary	63,986	-	-
Consumer Staples	46,991	-	-
Energy	33,737	-	-
Financial	82,563	-	-
Health Care	54,485	-	-
Industrials	55,924	-	-
Information Technology	71,551	-	-
Materials	19,259	-	-
Telecommunication Services	5,042	-	-
Utilities	12,672	-	-
Total Stocks	446,210	-	-
Fixed Income	11,244	-	-
Exchange-Traded Funds	181,876	-	-
Partnerships	2,865		
Total Investments	$ 1,456,719	$ -	$ -
Beneficial Interest In Trusts	$ 290,504	$ -	$ (32,668)

NOTE 19 – FAIR VALUE MEASUREMENTS (Continued)

The following assets and liabilities were measured at fair value as of May 31, 2012:

	Level 1 Quoted Price In Active Markets for Identical Assets	Level 2 Significant Other Observable Inputs	Level 3 Significant Unobservable Inputs
Cash and Cash Equivalents	$ 15,449	$ -	$ -
Mutual Funds			
Money Market Funds	12,004	-	-
Value Funds	114,524	-	-
Blended Funds	13,686	-	-
Growth Funds	125,899	-	-
Fixed Funds	442,344	-	-
International Funds	124,109	-	-
Total Mutual Funds	832,566	-	-
Stocks			
Consumer Discretionary	68,082	-	-
Consumer Staples	50,506	-	-
Energy	46,716	-	-
Financial	73,467	-	-
Health Care	62,224	-	-
Industrials	44,286	-	-
Information Technology	97,919	-	-
Materials	20,161	-	-
Telecommunication Services	9,112	-	-
Utilities	16,484	-	-
Total Stocks	488,957	-	-
Fixed Income	10,079	-	-
Exchange-Traded Funds	49,037	-	-
Total Investments	$ 1,396,088	$ -	$ -
Beneficial Interest In Trusts	$ 274,271	$ -	$ (34,342)

NOTE 19 – 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, 2012	$ (34,342)
Change in Value	1,674
May 31, 2013	$ (32,668)

NOTE 20 – 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 21 – SUBSEQUENT EVENTS

The date to which events occurring after May 31, 2013, the date of the most recent consolidated statement of financial position, have been evaluated for possible adjustment to the consolidated financial statements or disclosure is November 11, 2013 which is the date on which the consolidated financial statements were available to be issued.

As of May 31, 2013, the Academy has entered into an agreement to sell the building at 1201 Walnut Street for $550,000. The sale was finalized in September, 2013.

ADDITIONAL INFORMATION

ART ACADEMY OF CINCINNATI AND AFFILIATES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended May 31, 2013

Federal Grantor/Program Title	Pass-Through Grantor Number	Federal CFDA Number		Federal Expenditures
U.S. Department of Education:				
Federal Direct Student Loans		84.268	$	1,652,477
Federal Pell Grant Program	P063P101983	84.063		343,596
Supplemental Education				
Opportunity Grant Program	P007A103229	84.007		15,332
Federal Work Study Program	P033A103229	84.033		23,689
			$	2,035,094

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, 2013

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 consolidated financial statements.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF CONSOLIDATED FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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

We have audited, in accordance with the 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, the consolidated financial statements of the Art Academy of Cincinnati and Affiliates (a nonprofit organization), which comprise the consolidated statement of financial position as of May 31, 2013, and the related consolidated statements of activities, members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated November 11, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Art Academy of Cincinnati and Affiliates' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Art Academy of Cincinnati and Affiliates' internal control. Accordingly, we do not express an opinion on the effectiveness of the organization's internal control.

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

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

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Art Academy of Cincinnati and Affiliates' consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

We noted certain additional matters that we reported to management of the Academy in a separate letter dated November 11, 2013.

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
November 11, 2013

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON 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

Report on Compliance for Each Major Federal Program

We have audited the Art Academy of Cincinnati and Affiliates' compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Art Academy of Cincinnati and Affiliates' major federal programs for the year ended May 31, 2013. 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.

Management's Responsibility

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

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the Art Academy of Cincinnati and Affiliates' major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular 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 on compliance for each major federal program. However, our audit does not provide a legal determination of the Art Academy of Cincinnati and Affiliates' compliance.

Opinion on Each Major Federal Program

In our opinion, the Art Academy of Cincinnati and Affiliates complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended May 31, 2013.

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Other Matters

The results of our auditing procedures disclosed instances of noncompliance, 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 13-01. Our opinion on each major federal program is not modified with respect to these matters.

The Art Academy of Cincinnati and Affiliates' response to the noncompliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The Art Academy of Cincinnati and Affiliates' response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of the Art Academy of Cincinnati and Affiliates is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Art Academy of Cincinnati and Affiliates' internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 the Art Academy of Cincinnati and Affiliates' internal control over compliance.

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

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

VonLehman & Company Inc.

Fort Mitchell, Kentucky
November 11, 2013

ART ACADEMY OF CINCINNATI AND AFFILIATES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended May 31, 2013

SECTION I – SUMMARY OF AUDITORS' RESULTS

CONSOLIDATED FINANCIAL STATEMENTS	
Type of Auditors' Report Issued	Unqualified
Material weakness(es) identified?	No
Significant deficiencies identified not considered to be material weaknesses?	None Reported
Noncompliance material to consolidated financial statements noted?	No
FEDERAL AWARDS	
Material weakness(es) identified?	No
Significant 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 Direct Student Loans [CFDA 84.268] Federal Pell Grant Program [CFDA 84.063] Supplemental Education Opportunity Grant Program [CFDA 84.007] Federal Work Study Program [CFDA 84.003]
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 13-01 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 Direct Loan lender within forty five days after the institution determines the student withdrew.

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

Corrective Action:

While a student and academic advisor were developing a plan of study, multiple methods of communication from both individuals to the Financial Aid Office caused the students financial aid eligibility to be based on a higher credit hour basis than she finally registered for. When this inaccuracy was discovered, a return of funds was initiated. As a result of this situation the Financial Aid Office revised the procedures to determine financial aid eligibility to include an additional reconciliation process with the student enrollment software.

SECTION II – FINANCIAL STATEMENT FINDINGS

None

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Item 12-01 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 Direct Loan lender within forty five days after the institution determines the student withdrew.

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

Corrective Action:

During a complex financial aid application process, one student's eligibility and disbursements changed multiple times. It was uncovered during a reconciliation of direct lending loan disbursements that the reports from the financial aid department to the finance office did not clearly communicate some of these changes. A new process has been created to indicate when special circumstances exist on specific disbursements.

Current Status:

It was determined that the responsibility of monthly Direct Lending reconciliations would transfer to the Financial Aid Office. This had the result of finding discrepancies in a timely manner and resolving this matter.

SUPPLEMENTARY INFORMATION

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATING STATEMENT OF FINANCIAL POSITION
May 31, 2013

ASSETS

	Art Academy of Cincinnati	Art Academy Housing, Inc.	Eliminations	Total
Current Assets				
Cash and Cash Equivalents	$ 227,465	$ -	$ -	$ 227,465
Accounts Receivable, Net	165,786	-	-	165,786
Investments	590,915	-	-	590,915
Grant Receivable	40,000	-	-	40,000
Note Receivable - Related Party	1,104,179	1,076,185	(2,180,364)	-
Prepaid Expenses	93,112	-	-	93,112
Total Current Assets	2,221,457	1,076,185	(2,180,364)	1,117,278
Buildings and Equipment, Net	4,217,245	627	-	4,217,872
Investments	865,804	-	-	865,804
Grant Receivable	560,000	-	-	560,000
Beneficial Interest in Perpetual Trust	192,972	-	-	192,972
Beneficial Interest in Charitable Remainder Trusts	97,532	-	-	97,532
Deposits	-	12,810	-	12,810
Other Assets, Net	14,495	-	-	14,495
Total Assets	$ 8,169,505	$ 1,089,622	$ (2,180,364)	$ 7,078,763

LIABILITIES AND NET ASSETS

	Art Academy of Cincinnati	Art Academy Housing, Inc.	Eliminations	Total
Current Liabilities				
Line of Credit	$ 665,000	$ -	$ -	$ 665,000
Accounts Payable	192,496	-	-	192,496
Accrued Expenses	318,523	14,900	-	333,423
Capital Lease - Current Portion	5,525	-	-	5,525
Note Payable - Related Party	1,079,985	1,100,379	(2,180,364)	-
Note Payable - Current Portion	4,834	-	-	4,834
Total Current Liabilities	2,266,363	1,115,279	(2,180,364)	1,201,278
Long-Term Liabilities				
Charitable Remainder Trust	32,668	-	-	32,668
Deferred Revenue	600,000	-	-	600,000
Capital Lease - Long-Term	11,445	-	-	11,445
Note Payable - Long-Term	173,735	-	-	173,735
Total Liabilities	3,084,211	1,115,279	(2,180,364)	2,019,126
Net Assets	5,085,294	(25,657)	-	5,059,637
Total Liabilities and Net Assets	$ 8,169,505	$ 1,089,622	$ (2,180,364)	$ 7,078,763

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATING STATEMENT OF ACTIVITIES
Year Ended May 31, 2013

	Art Academy of Cincinnati	Art Academy Housing, Inc.	Eliminations	Total
Revenue and Support				
Grants, Contributions and Gifts	$ 281,970	$ -	$ -	$ 281,970
Tuition Income	4,811,650	-	-	4,811,650
Investment Income	50,480	-	-	50,480
Other Income	419,843	173,691	-	593,534
Total Revenue and Support	5,563,943	173,691	-	5,737,634
Expenses				
Program Services	5,767,134	217,243	-	5,984,377
Management and General	504,336	-	-	504,336
Fundraising	11,629	-	-	11,629
Total Expenses	6,283,099	217,243	-	6,500,342
Deficit of Revenue, Support and Reclassifications Over Expenses	(719,156)	(43,552)	-	(762,708)
Realized Gain on Investments	93,963	-	-	93,963
Unrealized Gain on Investments	79,512	-	-	79,512
Change in Beneficial Interest in Perpetual Trust	21,231	-	-	21,231
Change in Beneficial Interest in Charitable Remainder Trusts	(3,324)	-	-	(3,324)
Impairment for Reduction in Carrying Value to Market Value	(5,990,219)	-	-	(5,990,219)
Change in Net Assets	(6,517,993)	(43,552)	-	(6,561,545)
Net Assets Beginning of Year	11,603,287	17,895	-	11,621,182
Net Assets End of Year	$ 5,085,294	$ (25,657)	$ -	$ 5,059,637

ART ACADEMY OF CINCINNATI AND AFFILIATES
CONSOLIDATING STATEMENT OF MEMBERS' EQUITY
Year Ended May 31, 2013

	Academy Advancement Limited	1212 Jackson, LLC	Subtotal	Eliminations	Total
Members' Equity - May 31, 2011	$ 2,995,138	$ 4,533,380	$ 7,528,518	$ (6,027,607)	$ 1,500,911
Dissolution of Entity	(2,667,838)	(4,533,380)	(7,201,218)	6,027,607	(1,173,611)
Net Loss	(386,395)	-	(386,395)	-	(386,395)
Subtotal	(59,095)	-	(59,095)	-	(59,095)
Change in Fair Market Value of Interest Rate Swap	60,784	-	60,784	-	60,784
Members' Equity - May 31, 2012	1,689	-	1,689	-	1,689
Dissolution of Entity	(1,689)	-	(1,689)	-	(1,689)
Members' Equity - May 31, 2013	$ -	$ -	$ -	$ -	$ -