UNAUDITED

Ombudsman Educational Services LTD
Balance Sheets

Assets

	July 31, 2007	July 31, 2006
CURRENT ASSETS		
Cash	$ 682,502	$ 1,196,755
Accounts receivable, less allowance for doubtful accounts of $ 18,883 and $ 25,250, respectively	134,460	121,991
Prepaid expenses and other assets	99,354	47,419
Total current assets	916,316	1,366,165
Property, plant and equipment, at cost	6,185,759	5,262,397
Less accumulated depreciation and amortization	(3,822,636)	(3,948,891)
Net property and equipment	2,363,123	1,313,506
OTHER ASSETS		
Goodwill	2,978,603	2,978,603
Contractual rights and student relationships, net of accumulated amortization of $ 798,212 and $ 372,500, respectively	2,181,788	2,607,500
Trade names	1,990,000	1,990,000
Non-compete agreements, net of accumulated amortization of $ 14,062 and $ 6,562, respectively	15,938	23,438
Deposits	321,031	184,635
Other	15,840	-
Total other assets	7,503,200	7,784,176
TOTAL	$ 10,782,639	$ 10,463,847

UNAUDITED

Ombudsman Educational Services LTD
Balance Sheets

Liabilities and Shareholders' Equity

	July 31, 2007	July 31, 2006
CURRENT LIABILITIES		
Trade accounts payable and accrued liabilities	$ 880,369	$ 726,444
Current portion of long-term debt and capital leases	67,800	122,790
Unearned revenue	1,591,960	1,231,095
Total current liabilities	2,540,129	2,080,329
NONCURRENT LIABLIITIES		
Intercompany payable-ESA	9,800,537	9,371,712
Long-term debt and capital leases, net of current portion	-	67,800
Total noncurrent liabilities	9,800,537	9,439,512
SHAREHOLDERS' EQUITY		
Common Stock,no par value-authorized 1,000 shares; issued and outstanding, 500	1,000	1,000
Accumulated deficit	(1,559,027)	(1,056,994)
Total shareholders' equity	(1,558,027)	(1,055,994)
TOTAL	$ 10,782,639	$ 10,463,847

UNAUDITED

Ombudsman Educational Services LTD
Consolidated Statements of Income

	For the Year Ended July 31, 2007	For the 10.5 Months Ended July 31, 2006
REVENUE:		
Tuition	$ 18,742,097	$ 13,606,240
Other	356,979	246,739
Total revenue	19,099,076	13,852,979
OPERATING EXPENSES:		
Personnel costs	10,742,317	8,249,274
Repairs & maintenance	141,268	171,589
Educational costs	789,065	489,601
Utilities	641,824	510,041
Advertising	129,303	131,857
Employee travel and training	375,729	511,657
General, administrative and other operating expense	652,754	820,228
Total operating expenses	13,472,260	10,884,247
EBITDAR	5,626,816	2,968,732
Building Leases	2,833,162	1,915,417
EBITDA	2,793,654	1,053,315
Depreciation and amortization	1,366,022	1,108,039
NON-OPERATING EXPENSES:		
Interest expense	3,714	8,019
Interest income	(15,253)	(12,755)
Total non-operating expenses	(11,539)	(4,736)
NET INCOME(LOSS) BEFORE TAXES AND MANAGEMENT FEES	1,439,171	(49,988)
PROVISION FOR INCOME TAX	31,296	(74)
NET INCOME(LOSS) BEFORE MANAGEMENT FEES	1,407,875	(49,914)
MANAGEMENT FEE	1,909,908	300,000
NET LOSS	$ (502,033)	$ (349,914)

Educational Services of America, Inc.

Consolidated Financial Statements as of and for the Years Ended July 31, 2007 and 2006, Supplemental Schedules for the Years Ended July 31, 2007 and 2006, and Independent Auditors' Report

EDUCATIONAL SERVICES OF AMERICA, INC.

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Deloitte.

Deloitte & Touche LLP
424 Church Street
Suite 2400
Nashville, TN 37219
USA

Tel: 615 259 1800
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
Educational Services of America, Inc.
Nashville, TN

We have audited the accompanying consolidated balance sheets of Educational Services of America, Inc. and subsidiaries (the "Company") as of July 31, 2007 and 2006, and the related consolidated statements of operations, shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company'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. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at July 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the consolidated financial statements, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment*, effective August 1, 2006, which resulted in the Company changing the method in which it accounts for share-based compensation.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplemental schedules listed in the table of contents are presented for the purpose of additional analysis and are not a required part of the basic consolidated financial statements. These schedules are the responsibility of the Company's management. Such schedules have been subjected to the auditing procedures applied in our audits of the basic consolidated financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic consolidated financial statements taken as a whole.

Deloitte & Touche LLP

November 30, 2007

EDUCATIONAL SERVICES OF AMERICA, INC.

CONSOLIDATED BALANCE SHEETS
AS OF JULY 31, 2007 AND 2006

ASSETS	2007	2006
CURRENT ASSETS:		
Cash	$ 2,955,840	$ 4,021,655
Accounts receivable — less allowance for doubtful accounts of $529,699 and $461,740, respectively	4,655,959	3,818,783
Prepaid expenses and other assets	1,260,339	948,852
Total current assets	8,872,138	8,789,290
PROPERTY, PLANT, AND EQUIPMENT — Net	29,841,761	27,876,378
OTHER ASSETS:		
Goodwill	13,412,177	14,438,095
Contractual rights and student relationships — net of accumulated amortization of $3,118,915 and $1,735,225, respectively	5,805,822	7,189,512
Trade names	3,873,419	3,949,647
Non-compete agreements — net of accumulated amortization of $1,215,975 and $792,590, respectively	439,724	865,969
Deferred financing costs — net of accumulated amortization of $644,179 and $325,491, respectively	957,823	435,323
Deposits	697,178	568,728
Other	15,840	-
Total other assets	25,201,983	27,447,274
TOTAL	$ 63,915,882	$ 64,112,942

(Continued)

EDUCATIONAL SERVICES OF AMERICA, INC.

CONSOLIDATED BALANCE SHEETS
AS OF JULY 31, 2007 AND 2006

LIABILITIES AND SHAREHOLDERS' EQUITY	2007	2006
CURRENT LIABILITIES:		
Trade accounts payable and accrued liabilities	$ 5,760,942	$ 5,107,258
Unearned revenue	4,878,723	3,841,660
Current portion of long-term debt and capital leases	7,107,011	2,777,438
Current portion of deferred gain on sale-leaseback	164,091	164,091
Total current liabilities	17,910,767	11,890,447
NONCURRENT LIABILITIES:		
Deferred gain on sale leaseback — net of current portion	574,177	738,268
Long-term debt and capital leases — net of current portion	19,692,669	17,898,850
Other	15,840	-
Total noncurrent liabilities	20,282,686	18,637,118
SHAREHOLDERS' EQUITY:		
Preferred stock, $0.01 par value; authorized, 4,000,000 shares; issued and outstanding, 427,599.3 and 422,252.3, respectively, with a liquidation value of $60,452,885 at July 31, 2007	60,452,885	55,253,698
Common stock, $0.01 par value; authorized, 5,000,000 shares; issued and outstanding, 55,931.8 shares	559	559
Shareholder notes receivable	(330,984)	(319,973)
Additional Paid-In Capital	145,155	
Accumulated deficit	(34,545,186)	(21,348,907)
Total shareholders' equity	25,722,429	33,585,377
TOTAL	$ 63,915,882	$ 64,112,942

See notes to consolidated financial statements. (Concluded)

EDUCATIONAL SERVICES OF AMERICA, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED JULY 31, 2007 AND 2006

	2007	2006
REVENUE:		
Tuition	$64,827,906	$54,836,174
Other	10,054,313	8,676,672
Total revenue	74,882,219	63,512,846
OPERATING EXPENSES:		
Personnel costs	48,963,799	41,729,793
Purchased school services	1,352,141	1,333,146
Repairs and maintenance	1,468,855	1,400,203
Educational costs	2,455,105	1,679,442
Building and equipment leases	7,157,608	5,621,077
Utilities	2,375,754	1,703,356
Advertising	1,035,860	1,067,442
Employee travel and training	1,982,953	1,376,760
Depreciation and amortization	5,536,910	4,295,789
Other operating expense	6,266,813	4,846,107
Loss on trade names and goodwill impairment	883,738	316,019
Total operating expenses	79,479,536	65,369,134
OPERATING LOSS	(4,597,317)	(1,856,288)
NON-OPERATING EXPENSES:		
Interest expense	3,028,151	2,680,627
Interest income	(60,393)	(41,849)
Total non-operating expenses	2,967,758	2,638,778
NET LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(7,565,075)	(4,495,066)
PROVISION FOR INCOME TAX	78,667	98,626
NET LOSS FROM CONTINUING OPERATIONS	(7,643,742)	(4,593,692)
LOSS FROM DISCONTINUED OPERATIONS Operations and loss on sale — Net	(983,761)	(60,909)
NET LOSS	$ (8,627,503)	$ (4,654,601)

See notes to consolidated financial statements.

EDUCATIONAL SERVICES OF AMERICA, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED JULY 31, 2007 AND 2006

	Preferred Stock		Common Stock		Shareholder Notes Receivable	Additional Paid-In Capital	Accumulated Deficit	Total Shareholders' Equity (Deficit)
	Shares	Amount	Shares	Amount				
BALANCE — August 1, 2005	282,251	$ 34,847,386	55,932	$ 559	$ (308,962)	$ 179,231	$ (11,840,463)	$ 22,877,751
Issuance of preferred stock	140,001	16,500,000	-	-	-	-	-	16,500,000
Transaction costs associated with the issuance of preferred stock	-	-	-	-	-	(179,231)	(947,531)	(1,126,762)
Preferred stock dividends	-	3,906,312	-	-	-	-	(3,906,312)	-
Accrued interest on shareholder notes	-	-	-	-	(11,011)	-	-	(11,011)
Net loss	-	-	-	-	-	-	(4,654,601)	(4,654,601)
BALANCE — July 31, 2006	422,252	55,253,698	55,932	559	(319,973)	-	(21,348,907)	33,585,377
Issuance of preferred stock	5,347	630,411	-	-	-	-	-	630,411
Preferred stock dividends	-	4,568,776	-	-	-	-	(4,568,776)	-
Stock compensation expense	-	-	-	-	-	145,155	-	145,155
Accrued interest on shareholder notes	-	-	-	-	(11,011)	-	-	(11,011)
Net loss	-	-	-	-	-	-	(8,627,503)	(8,627,503)
BALANCE — July 31, 2007	427,599	$ 60,452,885	55,932	$ 559	$ (330,984)	$ 145,155	$ (34,545,186)	$ 25,722,429

See notes to consolidated financial statements.

EDUCATIONAL SERVICES OF AMERICA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JULY 31, 2007 AND 2006

	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (8,627,503)	$ (4,654,601)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	5,584,051	4,342,564
Amortization of deferred financing costs and debt discount	318,688	252,367
Allowance for doubtful accounts	256,732	279,581
Loss (gain) on disposition of property	5,171	(40,730)
Loss on trade names and goodwill impairment	883,738	316,019
Loss on disposal of discontinued operations	602,406	-
Interest expense satisfied by conversion to debt	570,404	462,255
Deferred gain on sale-leaseback	(164,091)	(164,091)
Stock compensation expense	145,155	-
Interest income on shareholder notes receivable	(11,011)	(11,011)
Changes in operating assets and liabilities — net of effects of acquisitions and disposals:		
Accounts receivable	(1,093,908)	123,588
Prepaid expenses and other assets	(362,327)	27,284
Deposits	(131,550)	(63,023)
Trade accounts payable and accrued liabilities	413,882	485,063
Unearned revenue and other liabilities	1,103,300	77,227
Net cash (used in) provided by operating activities	(506,863)	1,432,492
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(3,889,498)	(4,507,227)
Cash paid for acquisitions — net of cash acquired	-	(6,597,997)
Proceeds from disposition of property	21,654	29,509
Net cash used in investing activities	(3,867,844)	(11,075,715)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of long-term debt	5,029,197	-
Payments under line of credit — net	-	(760,877)
Principal payments on long-term debt and capital leases	(1,509,528)	(2,349,477)
Proceeds from issuance of preferred stock — net	-	15,373,238
Deferred financing costs paid	(210,777)	(10,259)
Net cash provided by financing activities	3,308,892	12,252,625
(DECREASE) INCREASE IN CASH	(1,065,815)	2,609,402
CASH — Beginning of year	4,021,655	1,412,253
CASH — End of year	$ 2,955,840	$ 4,021,655
SUPPLEMENTAL INFORMATION:		
Cash payments of interest	$ 1,972,323	$ 1,937,828
Cash payments of taxes	$ 143,664	$ 134,110
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Purchase of property for long-term debt and capital leases	$ 2,033,320	$ 1,346,792
Preferred stock issued in consideration of debt	$ 630,411	$ -
Issuance of long-term debt in acquisitions	$ -	$ 500,000

See notes to consolidated financial statements.

1. ORGANIZATION

Educational Services of America, Inc. (the "Company") is a private educational services company founded in July 1999. The Company's primary focus is to acquire or develop schools and learning centers that serve special needs or at-risk students. Special needs students include those that have an identified learning disability, cognitive deficiency, or emotional handicap. At-risk students include those who have experienced difficulty achieving success in a traditional school setting and who are at risk of dropping out of school. As of July 31, 2007, the Company operated 125 schools and learning centers in sixteen states through its four operating divisions - ESA Exceptional, Ombudsman, College Living Experience, and Spectrum.

2. LIQUIDITY AND CAPITAL RESOURCES

Since its inception in July 1999, the Company's annual expenses have exceeded its revenues. The Company had an accumulated deficit of $34,545,186 and $21,348,907 at July 31, 2007 and 2006, respectively. Prior to fiscal year 2005, the majority owner and certain officers provided funding as required to meet the Company's needs. However, during fiscal 2005 and 2006, the Company generated net proceeds of $44,582,434 from the sale of preferred stock. Further, during fiscal 2007 the Company entered into financing arrangements with its principal investors that provided $5,000,000 of new capital for operations and growth. Subsequent to fiscal 2007 the Company entered into an additional financing arrangement with its principal investors to provide up to $7,021,000 of additional capital to provide for future working capital needs and growth (see Notes 10, 13 and 14).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation — The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. All subsidiaries are wholly-owned by the Company. Operating results of subsidiaries are included from their respective acquisition dates.

Reclassifications — Certain reclassifications have been made to the 2006 financial statements in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets.* In accordance with this statement, the income statement for current and prior periods shall report the results of operations of the discontinued component, including any gain or loss recognized, in discontinued operations. These reclassifications had no effect on the previously reported net loss.

Cash and Cash Equivalents — Cash and cash equivalents are comprised of demand deposits at banks and other highly liquid short-term investments purchased with an original maturity of three months or less.

Accounts Receivable — The Company receives payment for services rendered from parents, public school systems and other governmental bodies. The Company provides an allowance for doubtful accounts equal to the estimated uncollectible amounts. The Company's estimate is based on historical collection experience and a review of the current status of accounts receivable. It is reasonably possible that the Company's estimate of the allowance for doubtful accounts will change.

Prepaid Expenses — Prepaid expenses consist primarily of prepaid liability insurance and prepaid rent.

Property, Plant, and Equipment — Property, plant, and equipment are stated at cost and the estimated fair value upon acquisition. Depreciation is calculated using the straight-line method over the estimated service lives of the depreciable assets, which range from three to twenty years. Maintenance and repair costs are expensed as incurred. The cost of renewals and betterments is capitalized and depreciated over the applicable estimated useful lives. The cost and accumulated depreciation of assets sold or otherwise disposed of are removed from the accounts and the related gain or loss is credited or charged to income.

Assets held under capital leases are recorded at the lower of the net present value of the minimum lease payments or the fair value of the leased asset at the inception of the lease. Amortization expense is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the period of the related lease.

The Company assesses the recoverability of property, plant, and equipment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The Company reviews the carrying value of property, plant, and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends, and prospects, as well as the effects of obsolescence, demand, competition, and other economic factors.

Goodwill and Other Intangible Assets — Goodwill and other intangible assets consist of goodwill, contractual rights and student relationships, non-compete agreements, and trade names. Goodwill is recognized for the excess of the purchase price over the fair value of tangible and identifiable intangible net assets of businesses acquired in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*. In accordance with this statement, goodwill is no longer amortized and is tested for impairment at least annually. In addition, identified intangible assets with indefinite lives are recorded and reviewed annually to assess the estimated life of the intangible asset. If the life is determined to remain indefinite the asset is tested for impairment. Intangible assets with a determinable life are amortized over the estimated period benefited, ranging from two to seven years.

In accordance with SFAS No. 142, the Company is required to allocate the purchase price of acquired entities to identifiable assets and liabilities with the residual amount being allocated to goodwill. The identifiable assets include intangible assets such as trade names, contractual rights and student relationships, and non-compete agreements that are subject to valuation. In those instances where the Company has acquired a significant amount of intangible assets, management engages an independent third party to assist in the valuation. Valuation methodologies use estimates of expected useful life, projected revenue, operating margins, and cash flows and weighted average cost of capital.

In accordance with SFAS No. 142, the Company evaluates the carrying value of goodwill as of the end of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. Such circumstances could include, but are not limited to (1) a significant adverse change in legal factors or in business climate, (2) unanticipated competition, or (3) an adverse action or assessment by a regulator. When evaluating whether goodwill is impaired, the Company compares the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. The fair value of the reporting unit is estimated using a combination of the income or discounted cash flows approach. If the carrying amount of a reporting unit exceeds its fair value, then the amount of the impairment loss must be measured. The impairment loss would be calculated by comparing the implied fair value of reporting unit goodwill to its carrying amount. In calculating the implied fair value of reporting unit goodwill, the fair value of the reporting unit is allocated to all of the other assets and liabilities of that unit based on their fair values. The excess of the fair value of a reporting unit over the amount assigned to its other assets and liabilities is the implied fair value of goodwill. An impairment loss would be recognized when the carrying amount of goodwill exceeds its implied fair value. The Company's evaluation of goodwill resulted in recognition of impairment losses of $810,938 and $265,668 for the years ended July 31, 2007 and 2006, respectively.

Contractual rights and student relationships (net) of $5,805,822 and $7,189,512 at July 31, 2007 and 2006, respectively, represents the portion of the purchase price associated with acquisitions allocated to these intangible assets. The related cost is being amortized on the straight-line method over the estimated useful lives of the assets, which range from two to seven years. Accumulated amortization related to these assets totaled $3,118,915 and $1,735,225 at July 31, 2007 and 2006, respectively. Amortization expense charged to operations was $1,383,690 and $1,354,647 for the years ended July 31, 2007 and 2006, respectively. Estimated amortization of contractual rights and student relationships for the five years subsequent to July 31, 2007, is as follows: $1,277,618; $1,243,994; $1,203,027; $1,124,983 and $902,976.

Trade names of $3,873,419 and $3,949,647 at July 31, 2007 and 2006, respectively, represents the portion of the purchase price associated with acquisitions allocated to these intangible assets. The Company has determined that the trade names have indefinite useful lives and are therefore not subject to amortization under the provisions of SFAS No. 142. The trade names are subject to annual evaluation of their estimated lives as well as testing for impairment on an annual basis in accordance with SFAS No. 142. The Company's evaluation of trade names resulted in recognition of impairment losses of $72,800 and $50,351 for the years ended July 31, 2007 and 2006, respectively.

Non-compete agreements (net) of $439,724 and $865,969 at July 31, 2007 and 2006, respectively, represents the portion of the purchase price associated with acquisitions allocated to agreements not to compete. The related cost is being amortized on the straight-line method over the terms of the agreements, which range from two to five years. Accumulated amortization related to the agreements not to compete totaled $1,215,975 and $792,590 at July 31, 2007 and 2006, respectively. Amortization expense charged to operations was $423,385 and $478,440 for the years ended July 31, 2007 and 2006, respectively. Estimated amortization of non-compete agreements for the five years subsequent to July 31, 2007, is as follows: $254,119; $137,500; $48,105; $0 and $0.

Costs relating to obtaining financing are capitalized and amortized over the term of the related debt using a method approximating the interest method. Amortization of deferred financing costs charged to operations was $318,688 and $252,367 for the years ended July 31, 2007 and 2006, respectively. When a loan is paid in full, any unamortized financing costs are removed from the related accounts and charged to operations.

Deposits — Deposits consist primarily of amounts paid under leases for real property.

Shareholder Notes Receivable — In October 2004, the Company issued the Chief Executive Officer 1,697 shares of $0.01 par value common stock and the Chief Accounting Officer 849 shares of $0.01 par value common stock, respectively. The Company issued the shares in exchange for long-term notes receivable totaling $300,003. The notes are due in 2013. Interest accrues on these notes at 3.62%.

Shareholder notes receivable and related accrued interest totaled $330,984 and $319,973 at July 31, 2007 and 2006, respectively.

Use of Estimates in the Preparation of Financial Statements — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition and Unearned Revenue — The Company provides educational services to students on a tuition basis. Revenues related to tuition-based services are recognized as services are rendered. The Company records deferred revenue in the amount of tuition received to date in excess of services rendered to date.

The Company also maintains contracts with various school districts and consortiums of school districts. Revenues related to these contracts are recognized as services are rendered. The contracts are typically annual in duration. The Company expects to renew these contracts for periods consistent with the initial contract term. Contracts containing fixed per diem rates are recorded and recognized based on the per diem rate multiplied by the number of students enrolled during the respective period. The accounts receivable arising from such contracts are unsecured and are generally due within 30–45 days.

Other revenue as reported in the accompanying consolidated statements of operations consists primarily of 1:1 (staff:student) support services, transportation, direct instructional services such as speech and occupational therapy, rental income, before and after school care, summer school fees, activity fees, and tutoring.

Advertising Costs — Advertising and promotional costs are expensed as incurred.

Income Taxes — The Company utilizes SFAS No. 109, *Accounting for Income Taxes*, which requires an asset and liability approach for financial accounting and reporting of income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse (see Note 11).

Stock Based Compensation — On December 16, 2004, the Financial Accounting Standards Board, (“FASB”) issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends SFAS No. 95, *Statement of Cash Flows*. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure of the fair value impact of such awards presented under SFAS No. 123 is no longer an alternative.

Effective August 1, 2006, the Company adopted the provisions of SFAS No. 123(R) and the fair-value-based method of accounting for share-based payments. Because the Company is considered a nonpublic entity, the Company previously used the minimum value method to estimate the value of stock options granted to employees. As a result and as required by SFAS No. 123(R), the Company has adopted the provisions of SFAS No. 123(R) via the prospective transition method, which requires that the Company continue to account for nonvested awards outstanding at the date of adoption of SFAS No. 123(R) in the same manner they had been accounted for prior to adoption. For those options that are granted after the adoption of SFAS No. 123(R) the Company is no longer permitted to use the minimum value method and instead is required to use an acceptable option-pricing model. The Company utilizes the Black-Scholes option pricing model.

Prior to adoption of SFAS No. 123R the Company chose to account for stock-based compensation using the intrinsic value method as prescribed in APB Opinion No. 25, and related interpretations. For the year ended July 31, 2006, no compensation cost related to stock options was recognized as no options were issued with exercise prices equal to or above the fair market value at the date of grant (see Note 10).

SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than an operating cash flow. This requirement reduces net operating cash flows and increases net financing cash flows.

The fair value of options issued in prior years were estimated at the date of grant using an option pricing model with the following assumptions; risk free rate of 3.48-5.73%; no dividend yield; an expected 7 year life to the options; and expected 1-5 year vesting period of the options. The estimated fair value for options granted prior to the adoption of SFAS No. 123(R) was calculated using the minimum value method and may not be indicative of the future impact since this model assumes nominal volatility. Had compensation cost for the Company's stock option plan been determined based on the fair value method consistent with SFAS No. 123 for the year ended July 31, 2006, net loss would have been adjusted to the pro forma amount indicated below:

	2006
Net loss — as reported	$ (4,654,601)
Deduct total stock-based employee compensation expense determined under fair value based method for all awards — net of related tax effects	(166,167)
Pro forma net loss	$ (4,820,768)

As discussed above, the Company adopted the provisions of SFAS No. 123(R) via the prospective transition method. During fiscal 2007, the Company granted 27,138 options with a contractual term of ten years which vest in part ratably over a five year period with the remaining part to vest based on achieving certain performance milestones. As such, the Company recognized $145,155 of compensation expense during the year ended July 31, 2007 in the accompanying consolidated statement of operations for options granted subsequent to the adoption of SFAS No. 123(R). The weighted average fair value of options granted during fiscal 2007 was $25.31. The fair value of stock options was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: expected dividend yield of 0%; forfeiture rate of 5%; risk free interest rate of 4.69%; expected life of 7 years and a volatility of 54%. The expected term and forfeiture assumptions were applied based on contractual terms and the historical exercise and cancellation patterns experienced by the Company. The Company did not have adequate recent trading activity from which to estimate it own volatility, therefore the expected volatility rate was estimated based on the historical volatility of otherwise similar public entities. As of July 31, 2007, the Company had total compensation cost of approximately $507,365 related to non-vested awards not yet recognized, which the Company expects to recognize systematically through 2012 and over a weighted average period of 1.98 years.

Comprehensive Income (Loss) — The Company has no items of other comprehensive income (loss) in any period presented. Therefore, net loss as presented in the Company's consolidated statements of operations equals comprehensive loss.

Financial Instruments — The Company's financial instruments are accounts receivable, shareholder notes receivable, accounts payable, notes payable, and long-term debt. The recorded values of accounts receivable, and accounts payable approximate their fair values based on their short-term nature. The recorded values of shareholder notes receivable approximate their fair values, as interest approximates market rates. The fair value of notes payable and long-term debt is disclosed in Note 8.

Recent Accounting Pronouncements — In June 2006, the FASB issued FIN No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes*, an amendment of an interpretation of SFAS No. 109, *Accounting for Income Taxes*. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2007. The Company has not completed the process of evaluating the impact that will result from adopting FIN 48. The Company is therefore unable to disclose the impact that adopting FIN 48 will have on its financial position, results of operations, and cash flows when such statement is adopted.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements; however, SFAS 157 does not require any new fair value measurements. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact, if any, that SFAS No. 157 will have on its financial position, results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS 159"). SFAS No. 159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Such election, which may be applied on an instrument by instrument basis, is typically irrevocable once elected. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company has not yet determined the impact of the adoption of SFAS No. 159 on its financial statements and note disclosures.

4. ACQUISITIONS

During fiscal year 2007, the Company did not complete any acquisitions.

During fiscal year 2006, the Company acquired the following educational service providers: Ombudsman Educational Services LTD on September 16, 2005, and Bishop Eton School Inc. on May 1, 2006. Total consideration given to the educational service providers was $7,386,831 in cash and notes payable of $500,000. In connection with the purchase agreements, the Company entered into non-compete agreements with terms ranging from two to three years.

In accordance with the provisions of SFAS No. 141, *Business Combinations*, the acquisitions completed by the Company during its fiscal year 2006 were all accounted for using the purchase method of accounting.

In addition to the acquisition costs mentioned above, the Company incurred $177,926 in transaction costs during 2006. The allocation of the aggregate purchase price of the 2006 acquisitions is summarized as follows:

Cash	$ 966,760
Other current assets	37,033
Property and equipment	1,492,982
Noncompete agreements	30,000
Contractual rights and student relationships	2,994,183
Trade names	1,992,127
Deposits	138,616
Goodwill	3,739,286
Assumed liabilities	(3,326,230)
Net purchase price	$ 8,064,757

The purchase prices for the above acquisitions were allocated to the underlying assets based on their estimated relative fair values. The consolidated statements of operations include the results of operations of the acquired businesses from their respective dates of acquisition.

5. DISCONTINUED OPERATIONS

During fiscal year 2007 the Company closed one of its schools and sold the assets of another school to an educational service provider. In conjunction with these transactions the Company recognized a loss from discontinued operations of $983,761. Revenues from discontinued operations and a summary of losses on discontinued operations are as follows:

	2007	2006
Revenues	$ 1,565,341	$ 1,927,707
Operating loss before income taxes	380,845	60,499
Loss on disposal and sale	602,406	-
Provision for income taxes	510	410
Net loss on discontinued operations	$ 983,761	$ 60,909

6. PROPERTY AND EQUIPMENT

At July 31, 2007 and 2006, property, plant, and equipment consist of the following:

	2007	2006
Land and land improvements	$ 4,966,471	$ 4,917,394
Buildings and building improvements	18,648,260	18,262,771
Leasehold improvements	2,872,881	1,885,945
Furniture and fixtures	2,278,293	1,995,050
Computer equipment	4,369,653	2,113,808
Equipment	1,838,103	2,554,043
Software and curriculum	3,752,735	2,767,543
Vehicles	931,746	735,476
	39,658,142	35,232,030
Less accumulated depreciation and amortization	(9,816,381)	(7,355,652)
	$29,841,761	$27,876,378

Depreciation and amortization expense related to these assets was $3,776,975 and $2,504,477 for the years ended July 31, 2007 and 2006, respectively. Amortization of assets under capital lease is included in depreciation expense. Buildings and building improvements include buildings under capital lease of $2,414,107 at July 31, 2007 and 2006.

7. GOODWILL

The change in the carrying value of goodwill for the years ended July 31, 2007 and 2006, is as follows:

Balance — August 1, 2005	$11,012,693
Goodwill acquired during the year	3,739,286
Impairment loss recognized under SFAS No. 142	(265,668)
Goodwill adjustment	(48,216)
Balance — July 31, 2006	14,438,095
Goodwill acquired during the year	-
Goodwill written off during the year	(216,480)
Impairment loss recognized under SFAS No. 142	(810,938)
Goodwill adjustment	1,500
Balance — July 31, 2007	$13,412,177

8. LONG-TERM DEBT, CAPITAL LEASES, CONVERTIBLE NOTES, AND LINE OF CREDIT

At July 31, 2007 and 2006, long-term debt and capital leases consist of the following:

	2007	2006
Mortgage note payable, secured by property, interest at 7%, principal and interest due monthly, with a balloon payment of $190,244 due June 27, 2008	$ 215,485	$ 243,898
Acquisition note payable, secured by property, interest at 7%, principal and interest of $12,102 due monthly beginning October 17, 2004, with a balloon payment of $151,081 due August 17, 2007	162,236	291,159
Convertible notes payable to related parties, unsecured, interest at 10%, principal and interest due October 4, 2009	3,715,328	3,365,903
Convertible notes payable to related parties, unsecured, interest at 10%, principal and interest due October 4, 2009	2,171,563	-
Convertible notes payable to related parties, unsecured, interest at 10%, principal and interest due October 4, 2009	2,049,416	-
Note payable to related party, unsecured, interest at 10%, principal and interest due August 31, 2007	1,000,000	-
Mortgage note payable, secured by property, interest at 11%, interest due monthly, with a balloon payment of $2,500,000 due June 1, 2008	2,500,000	2,500,000
Mortgage note payable, secured by property, interest at 9%, interest due monthly, with a balloon payment of $1,050,000 due June 1, 2010	1,050,000	1,050,000
Mortgage note payable, secured by property, interest at 11.5%, interest due monthly, with a balloon payment of $1,470,000 due June 1, 2010	1,470,000	1,470,000
Mortgage note payable, secured by property, interest at 11.5%, interest due monthly, with a balloon payment of $3,170,000 due June 1, 2010	3,170,000	3,170,000
Mortgage note payable, secured by property, interest at 17%, interest due monthly, with a balloon payment of $1,500,000 due November 18, 2007	1,500,000	1,500,000
Vehicle notes payable, secured by property, interest ranging from 6% to 12.79%, principal and interest due monthly, due dates ranging from September 30, 2007 to May 21, 2112	409,206	425,144

(Continued)

	2007	2006
Mortgage note payable, secured by property, interest at 12%, interest due monthly, with a balloon payment of $850,000 due March 15, 2010	$ 850,000	$ 850,000
Mortgage note payable, secured by property, interest at 12%, principal and interest due monthly, due May 15, 2010	191,542	245,093
Capital lease, secured by property, stated interest at 11%, principal and interest due monthly, due March 18, 2025	2,315,594	2,356,595
Acquisition note payable, secured by stock pledge, interest at 8%, principal and interest due monthly, due May 15, 2010	504,867	549,861
Acquisition note payable, secured by stock pledge, interest at 10%, principal and interest due quarterly, due June 30, 2009	730,000	1,095,000
Acquisition note payable, secured by stock pledge, interest at 8%, interest due monthly, due September 1, 2008	250,000	250,000
Acquisition note payable, secured by stock pledge, interest at 8%, interest due monthly, due September 1, 2008	75,000	75,000
Acquisition note payable, secured by stock pledge, interest at 8%, interest due monthly, due September 1, 2008	175,000	175,000
Capital leases, secured by property, interest ranging from 8% to 16.43%, principal and interest due monthly, due dates ranging from December 20, 2008 to August 20, 2010	2,182,323	873,045
Equipment note payable, secured by property, interest at 12%, principal and interest due monthly, due June 26, 2008	44,320	-
Note payable, unsecured, interest at 3%, principal and interest due monthly, due October 1, 2007	67,800	190,590
	26,799,680	20,676,288
Less current portion	(7,107,011)	(2,777,438)
	$ 19,692,669	$ 17,898,850

(Concluded)

The fair market value of the long-term debt and capital leases approximated $29,478,045 at July 31, 2007.

Principal payments required on long-term debt and payments required on capital leases for the next five years beginning August 1, 2007, are as follows:

	Debt	Capital Lease	Total
2008	$ 6,169,931	$ 1,401,454	$ 7,571,385
2009	1,144,653	1,251,324	2,395,977
2010	14,964,926	779,496	15,744,422
2011	12,055	324,641	336,696
2012	10,198	318,884	329,082
After 2012	-	4,012,625	4,012,625
	22,301,763	8,088,424	30,390,187
Less amounts representing interest	-	(3,590,507)	(3,590,507)
Total	$22,301,763	$ 4,497,917	$26,799,680

Convertible notes are convertible only by approval of 66 2/3 % of the note holders. The notes convert into Series A preferred shares at a rate of $117.86 per share.

In March 2006, the Company entered into a short-term working capital line of credit with a bank. Under the terms of the line of credit, up to $1,000,000 was made available to the Company. The interest rate under the line of credit was the bank's Prime rate plus 3%. The line of credit matured May 22, 2006.

9. COMMITMENTS AND CONTINGENCIES

Operating Leases — The Company has entered into various operating lease agreements for its school and administrative office space and certain equipment under agreements expiring at various dates through 2020, some of which contain provisions for future rent increases or periods in which rent payments are reduced (abated). In accordance with accounting principles generally accepted in the United States of America, the Company records monthly rent expense equal to the total of the payments due over the lease term, divided by the number of months of the lease term. The difference between rent expense recorded and the amount paid is credited or charged to a deferred rent obligation, which for financial reporting purposes is included in trade accounts payable and accrued liabilities in the accompanying consolidated balance sheets.

Future minimum lease payments under the Company's non-cancellable leases for the next five years beginning August 1, 2007, are as follows:

Years Ending July 31	Amount
2008	$ 6,241,398
2009	5,219,611
2010	4,333,504
2011	3,530,710
2012	5,580,287
Thereafter	4,198,826
	$29,104,336

Rent expense for the years ended July 31, 2007 and 2006, was $7,607,777 and $6,062,726, respectively.

The College Living Experience Litigation — The College Living Experience (CLE), a wholly-owned subsidiary of the Company, was named as a defendant in a case involving the alleged assault of a former student while at a night club on September 2004. The Company acquired the stock of CLE on June 1, 2005. The claimant alleges to have been assaulted at a night club, and a lawsuit was brought against CLE for not supervising the claimant. According to the contract between CLE and the claimant, CLE does not provide 24-hour supervision. While CLE discourages individuals from going out on school nights, it does not have the responsibility to prevent such actions. The matter under question was presented to an arbitrator, who believed that CLE had a duty to protect the claimant due to her alleged mental capacity. The arbitrator recommended that the action against CLE be sustained and set the damage amount at $500,000. The Company disputed this outcome and moved for the case to be set for trial before a jury. Subsequently, in June 2007 CLE reached a settlement whereby CLE paid the claimant $45,000. Pursuant to its stock purchase agreement with the former owners of CLE, the Company then exercised its right to offset payments due the former owners under a related acquisition note payable against the amount paid to settle this outstanding litigation. Consequently, the Company will recover fully the amount paid to settle this litigation.

Other Litigation — The Company is subject to various other claims and legal actions which arise in the ordinary course of business. In the opinion of management, the ultimate resolution of such matters will not have a material adverse effect on the Company's financial position or results of operations.

10. SHAREHOLDERS' EQUITY

Reverse Stock Split — Effective September 26, 2005, the Company effected a 1 for 10 reverse stock split, whereby each ten shares of the Company's $0.01 par value common stock and $0.01 par value preferred stock were exchanged for one share of the Company's $0.01 par value common stock or preferred stock. The number of shares and amounts per share in the consolidated financial statements have been retroactively adjusted to reflect the reverse stock split.

Private Placement of Preferred Stock — In October 2004, the Company closed on a $35,000,000 commitment for the purchase of preferred stock with Trimaran Capital Partners ("Trimaran"), a leading middle market private equity investment firm. During fiscal 2005 and 2006, pursuant to this commitment, the Company issued 296,972 shares of preferred stock ("Series A"), generating net proceeds of $30,835,709. In August 2005, the Company closed on a commitment from Trimaran for an additional $25,000,000 for the purchase of preferred stock. During fiscal 2006, pursuant to this new commitment, the Company issued 125,280 shares of Series A, generating net proceeds of $13,746,725. Trimaran earned a 4% fee on the placement of the $35,000,000 and $25,000,000 commitments for the purchase of preferred stock.

Other Preferred Stock Issuance — During fiscal 2007, in conjunction with the issuance of certain convertible notes, the Company issued 5,347 shares of Series A as additional consideration to Trimeran.

Series A Convertible Preferred Stock — Holders of the Series A are entitled to vote on each matter on which the holders of common stock are entitled to vote. Each share of Series A has the number of votes equal to the number of shares of common stock into which such share is convertible. The consent of the majority of the holders of the Series A shall be necessary to create, issue, or authorize for issuance any shares of capital stock; to make, declare, or pay any dividend or distribution upon any share or shares of capital stock of the Company; to alter or change the rights, preferences, or privileges of the Series A; to effect a liquidity event; to redeem, purchase, or otherwise acquire any share or shares of capital stock of the Company (unless due to termination of employment of any employee, officer, director, or consultant); and to amend or repeal the Company's Certificate of Incorporation or Bylaws.

Series A holders shall have liquidation preference before any other holders of capital stock of the Company. Additionally, holders of Series A shall be entitled to receive cumulative preferential dividends equal to 8% per annum of the stated value, as defined, per share of the Series A.

Dividends shall accrue on a quarterly basis from the issuance date of each share of Series A by being added to the Series A Stated Value on each October 1, January 1, April 1, and July 1, whether or not earned or declared and whether or not in any fiscal year there shall be net profits or surplus available for the payment of dividends. As of July 31, 2007, the Series A Stated Value was approximately $141.38. All accrued and unpaid dividends shall become immediately due and payable in cash upon the earlier of a liquidation event or change in control.

The Series A shall be convertible into common stock. Each share of Series A shall be converted by dividing the Series A Stated Value plus the aggregate amount of accrued but unpaid dividends, if any, through such date that have not been added to the Series A Stated Value by the conversion price, as defined. The initial conversion price shall be the original stated value, subject to any adjustments.

Series A holders also have the option from time to time to cause the Company to purchase all or any part of the holders' pro rata portion of their shares at the stated value per share for cash in immediately available funds with the proceeds of any key man insurance policies received by the Company. The Company shall notify the holders upon the receipt by the Company of the proceeds of any such key man insurance policies. Holders determining to exercise the put option shall deliver to the Company up to the pro rata portion of their shares of Series A preferred stock within two business days after receipt of such notice. All such shares delivered to the Company upon exercise of the put option shall be cancelled. The Company has a $10,000,000 key man policy on the Chief Executive Officer.

Stock Option Plan — Effective October 2004, in conjunction with the Company's private placement of preferred stock, the Company's Board of Directors approved the adoption of the Educational Services of America, Inc. Stock Option Plan (the "Plan"). 65,000 shares of common stock have been reserved for issuance upon the exercise of options granted under the Plan. The maximum term of an option granted pursuant to the Plan is specified in the individual option agreements. Options awarded under this plan during fiscal 2007 are exercisable as to (i) 50% of the number of shares awarded in increments of 20% per year and (ii) the remaining 50% upon the achievement of agreed upon performance milestones. Shares subject to the Plan which expire, terminate, or are cancelled without having been exercised in full become available again for future grants.

Information with respect to the Plan for the periods ended July 31, 2007 and 2006, is as follows:

	Number of Shares	Weighted-Average Exercise Price	Remaining Contractual Term
Outstanding — August 1, 2005	29,206.2	$ 102.41	9.7
Granted	-	-	-
Exercised	-	-	-
Expired	-	-	-
Forfeited	(378.1)	117.86	-
Outstanding — July 31, 2006	28,828.1	102.21	8.7
Granted	27,138.0	117.90	-
Exercised	-	-	-
Expired	-	-	-
Forfeited	-	-	-
Outstanding — July 31, 2007	55,966.1	109.82	8.5
Fully vested or expected to vest at July 31, 2007	53,167.8	109.82	8.5
Exercisable — July 31, 2007	13,512.3	$ 84.47	7.7

Exercise prices of outstanding options at July 31, 2007 range from $27.80 to $117.90 per share.

11. INCOME TAXES

Components of income tax expense are as follows:

	2007	2006
Current:		
Federal	$ -	$ -
State	78,667	98,626
Total current	78,667	98,626
Deferred:		
Federal	-	-
State	-	-
Total deferred	-	-
	$ 78,667	$ 98,626

For the years ended July 31, 2007 and 2006, the historical income tax expense differs from the amounts computed by applying the federal statutory rate of 34% to loss before taxes as follows:

	2007	2006
Federal tax benefit at statutory rate	$ (3,012,982)	$ (1,548,892)
State income taxes	(309,418)	322,877
Non deductible expenses	9,194	54,558
Increase in valuation allowance	3,391,873	1,270,083
Total taxes	$ 78,667	$ 98,626

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets as of July 31, 2007 and 2006, are as follows:

	2007	2006
Deferred tax assets (liabilities):		
Amortization expense	$ 693,978	$ (51,873)
Federal and state net operating loss carryforwards	6,220,229	4,032,247
Book over tax depreciation	627,995	314,076
Other	792,930	648,809
Total deferred tax assets	8,335,132	4,943,259
Valuation allowance for deferred tax assets	(8,335,132)	(4,943,259)
Total deferred tax assets	-	-
Total deferred tax liabilities	-	-
Net deferred tax asset (liability)	$ -	$ -

Management has evaluated the need for a valuation allowance for all or a portion of the deferred tax assets, as realization of the deferred tax assets is uncertain at July 31, 2007 and 2006. The Company has recorded a valuation allowance equal to 100% of the excess of net operating loss carryforwards and future deductible temporary differences over future taxable temporary differences. The valuation allowance increased $3,391,873 and $1,270,083 in 2007 and 2006, respectively. At July 31, 2007, the Company had net operating loss carryforwards of approximately $16,386,000, which begin to expire in 2020.

12. EMPLOYEE BENEFIT PLANS

On January 4, 2001, the Company adopted the Educational Services of America 401(k) Profit Sharing Plan and Trust (the "Plan"). The Plan is a Company-sponsored 401(k) plan to which employees may contribute up to 12% of their salaries. In order to be eligible to join the Plan, an employee must have completed six months of service with the Company and must be at least 21 years of age. Beginning in 2003, the Plan began providing for employer-matching contributions of 0.25% for each 1% of an employee's elective salary deferral, up to a maximum matching contribution of 1%. The Company's matching contribution was $105,608 and $76,383 for the years ended July 31, 2007 and 2006, respectively.

13. RELATED-PARTY TRANSACTIONS

In January 2003, the Company completed sale-leaseback transactions for two of its properties with entities owned by the Company's Chairman. Pursuant to the terms of these transactions, the Company entered into 10-year lease agreements on each of these properties; terms of the leases include 2% annual escalators. In June 2001, the Company completed a sale-leaseback transaction with a real estate investment company in which the Company's Chairman has a significant ownership interest. Pursuant to the terms of the transaction, the Company entered into a 10-year lease agreement on the property; terms of the lease include a 2% annual escalator.

In October 2004, in conjunction with its private placement of preferred stock, the Company entered into a five-year loan agreement with Trimaran, and certain entities in which the Company's Chairman has a significant ownership interest (the "Related Entities"). Under this agreement, the Company received $5,000,000 in loan proceeds from Trimaran which were used to provide a portion of the purchase price of the Company's acquisition of the assets of the Spectrum Center for Educational and Behavioral Development. Additionally, under the terms of the loan agreement, the Related Entities agreed to refinance $1,532,465 of obligations due those entities as of October 2004. The underlying notes payable (the "First Bridge Notes") were secured by real estate, carry an interest rate of 10%, and mature in October 2009. In consideration for these notes, the Company paid Trimaran an original issue discount of $250,000 (5%), which is included in deferred financing costs and is being amortized over the term of the notes.

In May 2005, the Company refinanced the outstanding debt on the properties acquired in the Spectrum acquisition referred to above. Proceeds were used to retire an obligation due the seller, as well as to pay down the obligations due Trimaran and the Related Entities. Pursuant to the terms of the refinancing, Trimaran and the Related Entities released their secured interests in the underlying real estate. Total principal and interest paid was $3,662,302 and $410,906, respectively. Pursuant to the terms of the loan agreement, Trimaran received a fee of $140,158, representing 5% of the amount of principal repaid.

Under the terms of the First Bridge Notes, the Company has the option of paying interest quarterly or adding the interest to the unpaid principal balance of the notes. To date, the Company has not made any quarterly interest payments. Further, under the terms of the First Bridge Notes, as the notes were not repaid by the first anniversary of their issuance, the note holders received an additional interest payment of 5% of the principal amount then outstanding. In October 2005, $2,976,239 remained unpaid, and $148,812 of additional interest was added to the principal outstanding. As of July 31, 2007, the outstanding obligation under the First Bridge Notes was $3,715,328. Of this amount, $845,164 represents interest that had been unpaid and added to the principal amount of the notes.

The Company paid fees to Trimaran in relation to the placement of preferred stock for the year ended July 31, 2006, of $1,000,000.

In conjunction with the private placement of preferred stock, the Company entered into a monitoring agreement with Trimaran. Amounts due under this agreement are payable quarterly in advance. Effective November 1, 2006, the quarterly fee increased from $62,500 to $87,500. Total payments made under this agreement were $325,000 and $250,000 in fiscal 2007 and 2006, respectively.

In September 2006, the Company issued a series of 10% convertible notes, (the "Second Bridge Notes"), due in October 2009, which totaled $2,000,000. Of this amount, $1,970,803 was issued to Trimaran, and $29,197 was issued to the Company's Chief Accounting Officer. The Company paid original issue discount of $100,000 (5%) on the Second Bridge Notes. This amount is included in deferred financing costs and is being amortized over the term of the notes.

In January 2007, the Company issued an additional series of 10% convertible notes, (the "Third Bridge Notes"), due in October 2009, which also totaled $2,000,000. Of this amount, $1,816,983 was issued to Trimaran and $183,017 was issued to entities controlled by the Company's Chairman. The Company paid original issue discount of $100,000 (5%) on the Third Bridge Notes. This amount is included in deferred financing costs and is being amortized over the term of the notes. Additionally, in conjunction with the issuance of the Third Bridge Notes the Company issued 5,347 shares of its Series A preferred stock as additional consideration to the makers of the Third Bridge Notes. The value of these shares, $630,411, is included in deferred financing costs and is being amortized over the term of the notes.

Both the Second Bridge Notes and the Third Bridge Notes carry the same terms and conditions. The Company has the option of paying interest quarterly or adding the interest to the unpaid principal balance of the notes. To date, the Company has not made quarterly interest payments. Further, should the notes not be repaid by the first anniversary of their issuance, the note holders are entitled to receive an additional interest payment of 5% of the principal amount then outstanding. As of July 31, 2007, the outstanding balances under the Second Bridge Notes and the Third Bridge Notes totaled $2,171,563 and $2,049,416, respectively. Of these amounts, $171,563 and $49,416 represent interest that has been unpaid and added to the principal amount of the Second Bridge Notes and the Third Bridge Notes, respectively.

14. SUBSEQUENT EVENT

In August 2007, the Company entered into a loan agreement with Trimaran and entities controlled by the Company's Chairman. Under the terms of this agreement, up to $7,021,000 of new financing has been made available to the Company through December 31, 2007. In August 2007, the Company received $2,502,418 under this loan agreement. Of this amount, $1,000,000 was used to repay a short term advance from Trimaran that was outstanding at July 31, 2007. In conjunction with this loan agreement the Company issued 5,400 shares of Series B preferred stock as consideration to the makers of the underlying notes.

In October 2007, the Company entered into an agreement to refinance certain of its outstanding mortgage notes payable. Gross proceeds of this refinancing totaled $11,000,000. After retiring the related mortgage notes payable, the Company used a portion of the proceeds to retire an existing acquisition note payable. Remaining proceeds after debt retirement and payment of fees were approximately $500,000.

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SUPPLEMENTAL SCHEDULES

EDUCATIONAL SERVICES OF AMERICA, INC.

CONSOLIDATED SCHEDULES OF OPERATING EXPENSES
FOR THE YEARS ENDED JULY 31, 2007 AND 2006

	2007	2006
Salaries	$ 41,736,758	$ 34,687,049
Payroll taxes	3,546,062	3,067,341
Employee benefits	3,519,425	3,908,374
Contract labor	161,554	67,029
Building leases	6,839,745	5,347,655
Repairs and maintenance	865,460	900,686
Housekeeping	482,051	395,797
Sanitation services	121,345	103,720
Educational services	1,065,434	608,911
Educational supplies	1,002,402	757,387
Books and subscriptions	116,219	108,408
Dues and memberships	271,052	204,736
Student transportation	696,493	734,153
Field trips/activities	340,221	260,412
Lunch services	315,426	338,582
Telephone	638,752	467,373
Utilities	945,863	806,794
Internet/network services	673,163	316,158
Security services	117,975	113,031
Advertising and promotion	1,035,859	1,067,442
Travel	1,768,962	1,265,059
Meetings and training	213,990	111,701
Insurance	1,308,131	1,219,697
Equipment rental	317,864	273,422
Bad debt expense	200,813	181,328
Legal and accounting	488,180	522,590
Consulting and professional services	1,773,349	1,400,611
Recruitment	233,826	169,120
Payroll/benefit plan processing fees	123,685	75,023
Office equipment and supplies	463,148	356,789
Bank fees	87,208	51,567
Postage	256,577	217,514
Gifts	70,753	58,857
Charitable donations	640,791	-
Taxes, other than income	586,025	597,878
Depreciation and amortization	5,536,910	4,295,790
Loss on goodwill impairment	883,738	316,019
Other	34,327	(4,869)
Total operating expenses	$ 79,479,536	$ 65,369,134

EDUCATIONAL ALTERNATIVE OUTREACH PROGRAMS EXPENDITURE REPORT
FOR THE YEAR ENDED JULY 31, 2007

Contracting Agency: Ombudsman Educational Services, Ltd.

Number of Students FTE Slots: 700

Grade Levels: 9–12

	ACTUAL EXPENDITURES							
EXPENDITURES	**100 Salaries**	**200 Fringe Benefits**	**300 Purchased Services**	**400 Energy Services**	**500 Materials & Supplies**	**600 Capital Outlay**	**700 Other Expense**	**Total**
5000 Instruction	$ 1,011,079	$ 137,735	$ -	$ -	$ 44,867	$ -	$ -	$ 1,193,681
6100 Pupil Personnel	124,966	17,024	-	-	-	-	-	141,990
6200 Instructional Media Services	-	-	42,561	-	-	189,678	-	232,239
6300 Instruction and Curr. Develop.	131,441	13,143	-	-	-	-	-	144,584
6400 Instructional Staff Training	115,876	11,587	-	-	-	-	-	127,463
7100 Board of Directors	-	-	-	-	-	-	-	-
7200 General Administration	177,940	17,794	-	-	-	-	-	195,734
7300 School Administration	233,504	23,349	38,802		6,670	-	5,625	307,950
7400 Facilities Acquisition	-	-	-	-	-	65,080	-	65,080
7500 Fiscal Services	20,000	2,000	-	-	-	-	-	22,000
7600 Food Services	-	-	-	-	-	-	-	-
7700 General Support	-	-	10,720	-	1,604	-	-	12,324
7800 Pupil Transportation	-	-	-	-	-	-	-	-
7900 Operation of Plant	-	-	719,140	55,303	-	38,316	-	812,759
8100 Maintenance of Plant	-	-	33,955	-	-	-	-	33,955
9100 Community Services	-	-	-	-	-	-	-	-
9200 Debt Service	-	-	-	-	-	-	-	-
TOTAL EXPENDITURES	$ 1,814,806	$ 222,632	$ 845,178	$ 55,303	$ 53,141	$ 293,074	$ 5,625	$ 3,289,759

/s/ Caroline Damask
Signature

October 10, 2007
Date

Miami-Dade County Public Schools
giving our students the world

November 14, 2007

Ms. Caroline Damask
Director of Finance
Ombudsman Educational Services, Ltd.

VIA FACSIMILE
847/367-6191

RE: AUDITED FINANCIAL STATEMENTS FOR THE FISCAL YEAR ENDED JULY 31, 2007

We received the draft audited financial statements for Educational Services of America (ESA), Inc. on November 8, 2007. Please note that the final audited financial statements were due on November 1, 2007, in accordance with the contractual agreement between your company and the School Board of Miami-Dade County, Fl. A review of the draft statements raises concerns that require further explanation.

For the second consecutive year, ESA had a significant net loss, which was $(8,940,889) in FY07 or 12% of total revenues. Additionally, ESA had an Accumulated Deficit of $(34,863,606) as of July 31, 2007. What is being done by management to reverse this apparent worsening financial condition?

Please respond in writing to this and submit the final audited financial statements by November 26, 2007. We plan to present the audited financial statements of ESA and your response to this letter, to the School Board Audit Committee at its next regularly scheduled meeting: Tuesday, December 11, 2007, in room 916 of the School Board Administration Building, 1450 N.E. 2nd Avenue at 12:30 p.m. Please plan on attending or sending a representative from your organization to respond to questions that the Audit Committee may have.

Should you have any questions, please call Mr. Jon Goodman at 305-995-1323. Thank you in advance for your cooperation.

Sincerely,

Trevor Williams

Trevor Williams, CPA, Assistant Chief Auditor

cc: Dr. Steve Gallon III
Mr. Antonio Martinez

Office of Management and Compliance Audits
1450 N.E. Second Avenue, Room 415 • Miami, Florida 33132
305-995-1436 • Fax 305-995-1331 • www.mca.dadeschools.net

Educational Services of America

Mr. Jon Goodman
Miami-Dade County Public Schools
Office of Management and Compliance Audits
1450 N. E. Second Avenue, Room 415
Miami, Florida
33132

Dear Mr. Goodman,

As we discussed on Monday of this week, I am providing the following supplementary information regarding Educational Services of America, Inc. ("ESA" or the "Company") (parent company of Ombudsman Educational Services, LTD ("Ombudsman") and its financial performance for its fiscal year ended July 31, 2007. Also, as we discussed on Monday, ESA will be providing its final audit report to you next week.

Company Profile

Educational Services of America, Inc., headquartered in Nashville, Tennessee, is the nation's leading provider of special education and alternative education services. Most of ESA's schools serve students with learning disabilities such as autism, emotional disturbance and attention deficit disorder. Founded in 1999, ESA currently operates in 17 states with 130 schools and 1,500 teachers, administrators and staff serving 7,700 students.

Established on the core values of academics, structure and integrity, the Company is dedicated to providing an educational advantage to all students regardless of their learning style or disability. ESA schools focus on providing highly individualized planning for each student, building on skills as opposed to the remediation of weaknesses, smaller class sizes, smaller campuses, a nurturing and enrichment focus, and the provision of a highly structured environment.

The largest shareholder of the Company is Trimaran Capital Partners ("Trimaran"), a New York-based private equity firm whose investment originated in October 2004. Subsequently, ESA has grown its platform tremendously with strategic acquisitions (seven since October 2004 including the September 2005 acquisition of Ombudsman) and expanded development opportunities. Revenue has grown from $16 million in 2004 to $75 million in 2007 while the number of schools and centers has increased from 21 to 130.

1321 Murfreesboro Pike
Suite 702
Nashville, TN 37217
P: 615-361-4000
F: 615-577-5695

Operations

The Company has built a solid infrastructure with (1) experienced management, (2) industry expertise in government relations and business development, (3) seasoned sales and marketing professionals, (4) enhanced information systems and (5) a streamlined approach to operations combining quality curriculums with appropriate educational and behavioral oversight.

ESA has four distinct operating divisions providing varying levels of services and programs in special education and alternative education:

1. **Ombudsman Learning Centers** provide a very specialized type of alternative education aimed at students who are at risk of dropping out of the school system. Tuition is funded through local school districts in each of the 82 learning centers located across the United States (Arizona, Colorado, Florida, Georgia, Illinois, Indiana, Kansas, Maryland, Michigan, Mississippi, Missouri, New Hampshire, Ohio, Pennsylvania, South Carolina and Texas).

2. **ESA Exceptional Schools** provide personalized instructional programs through K-12 private academies with tuition funded from government-sponsored voucher programs and/or private pay. Twenty-two of the 27 ESA Exceptional Schools operate in Florida with regionally recognized brands such as Atlantis Academy, Broach Schools and Crossroads Schools. The other five ESA Exceptional Schools operate in Arizona, California and Colorado.

3. **Spectrum Center Schools** operate in collaboration with public schools as a contract service provider, focusing on autism and severely disabled students. ESA operates 15 Spectrum Center Schools in California with tuition funded from government-sponsored programs through regional school districts.

4. **College Living Experience ("CLE")** assists students with learning disabilities make the transition from high school to college while providing academic tutoring, mentoring and life skills training. CLE expands the Company's continuum of educational services to students at the post secondary level through its six locations in California, Colorado, Florida, Illinois, Maryland and Texas.

Fiscal 2007 Operating Results and Liquidity

For the fiscal year ended July 31, 2007 the Company reported a net loss of $ 8,580,585, compared to a net loss for the prior year of $ 4,654,601. However, cash flow from operating activities was almost at break even ($506,863) due in large measure to significant non cash items (depreciation and amortization of $ 5,536,910 and goodwill impairment of $833,738) incurred by the Company. During fiscal 2007 the Company invested significantly in the creation of a new sales and marketing team. The cost of this undertaking, approximately $2,800,000, generated a negative comparison in fiscal 2007 versus fiscal 2006. However, investment in the sales and marketing team is viewed by management as a key element in positioning the Company for positive future results through organic growth. The Company's operating budget for fiscal 2008, which ends July 31, 2008, calls for an increase in revenues to approximately $ 91 million and a reduction in the Company's net loss to approximately $1.5 million. Further, the Company expects to generate positive earnings in fiscal 2009 and beyond.

To insure adequate liquidity the Company has entered into a loan agreement with its significant investors, primarily Trimaran, for up to $ 7,021,000 of new financing. Funding under this agreement will be available to the Company through December 31, 2007. To augment this loan agreement, the Company has also executed a firm commitment with CIT Healthcare to enter into a revolving credit agreement, under which up to $ 7,000,000 of credit will be made available to the Company. This agreement is expected to be fully negotiated and in place by December 1, 2007. Management is confident that these agreements provide access to capital that will be more than sufficient to carry the Company through fiscal 2008 and beyond. Management forecasts that the Company will turn profitable in fiscal 2009, and that operating cash flows will provide the Company with the liquidity needed to meet its current obligations as well as provide capital for future growth.

Please do not hesitate to contact me should you require further information.

Sincerely,

Donald B. Whitfield

Donald B. Whitfield
Executive Vice President and Chief Accounting Officer