ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Financial Statements and Supplemental Information

May 31, 2006 and 2005

(With Independent Auditors' Report Thereon)

ILLINOIS INSTITUTE OF TECHNOLOGY

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KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' Report

The Board of Trustees
Illinois Institute of Technology:

We have audited the accompanying consolidated statements of financial position of Illinois Institute of Technology (the University) as of May 31, 2006 and 2005, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 University'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, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Illinois Institute of Technology as of May 31, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

November 1, 2006

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statements of Financial Position

May 31, 2006 and 2005

(In thousands of dollars)

Assets		**2006**	**2005**
Cash	$	3,817	15,735
Bond proceeds held by trustees		51,681	12,097
Investments (note 4)		250,425	201,382
Investments from sale of IITRI net assets (note 4)		60,007	81,788
Notes and accounts receivable:			
Grants and contracts, less allowance of $105 in 2006 and 2005		15,677	10,486
Students:			
Tuition receivable , less allowance of $7,775 in 2006 and $7,563 in 2005		6,492	5,708
Notes receivable, less allowance of $373 in 2006 and 2005		9,304	9,949
Pledges receivable, less allowance of $283 in 2006 and $1,200 in 2005 (note 5)		9,376	13,245
Other		8,215	4,389
Inventories, prepaid expenses, and deferred charges		2,538	3,899
Physical properties, less accumulated depreciation (note 6)		217,107	200,930
Beneficial interest in perpetual trusts (note 7)		20,853	19,553
Total assets	$	655,492	579,161
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued expenses	$	20,523	17,429
Accrued salaries and wages		14,408	12,728
Deferred revenue		25,332	21,561
Deposits by students and others		2,899	2,709
Obligation under split-interest agreements		1,295	1,272
Notes and bonds payable (note 8)		179,202	129,044
Advances from the U.S. Government for student loans		8,094	8,094
Other long term liabilities (note 3)		9,930	—
Total liabilities		261,683	192,837
Net assets (note 11):			
Unrestricted		222,669	226,610
Temporarily restricted		24,209	22,894
Permanently restricted		146,931	136,820
Total net assets		393,809	386,324
Total liabilities and net assets	$	655,492	579,161

See accompanying notes to consolidated financial statements.

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statement of Activities

Year ended May 31, 2006

(In thousands of dollars)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Operating revenue:				
Tuition and fees, net of scholarships of $35,038	$ 77,035	—	—	77,035
Government grants and contracts	37,180	—	—	37,180
Private grants and contracts	18,140	—	—	18,140
Private gifts	11,453	6,601	—	18,054
Endowment spending distribution (note 4)	12,600	—	—	12,600
Interest from Alion investments (note 4)	2,394	—	—	2,394
Sales and services of auxiliary enterprises	11,388	—	—	11,388
Other sources	12,066	664	—	12,730
Net assets released from restrictions	6,177	(6,177)	—	—
Total operating revenue	188,433	1,088	—	189,521
Operating expenses:				
Faculty salaries	40,458	—	—	40,458
Administrative salaries	33,998	—	—	33,998
Part-time salaries	10,919	—	—	10,919
Employee benefits	14,566	—	—	14,566
Operations and maintenance	19,475	—	—	19,475
Supplies and services	34,625	—	—	34,625
Professional fees and advertising	8,996	—	—	8,996
IITRI research	19,154	—	—	19,154
Depreciation	12,088	—	—	12,088
Total operating expenses	194,279	—	—	194,279
Increase (decrease) in net assets from operating activities	(5,846)	1,088	—	(4,758)
Nonoperating revenue and expenses:				
Private gifts	—	—	7,021	7,021
Change in donor restriction		(1,284)	1,284	—
Interest on indebtedness	(5,978)	—	—	(5,978)
Net gain on investments (note 4)	8,561	49	1,449	10,059
Endowment income (note 4)	4,915	—	—	4,915
Net gain on disposal of assets	(341)	—	—	(341)
Early retirements	—	—	—	—
Loss on refunding of bond issue (note 8)	(2,750)	—	—	(2,750)
Gain on call of Alion mezzanine warrants (note 4)	8,574	—	—	8,574
Other	(1,146)	1,462	357	673
Increase in net assets from nonoperating activities	11,835	227	10,111	22,173
Increase in net assets before cumulative effect of change in accounting principle	5,989	1,315	10,111	17,415
Cumulative effect of change in accounting principle (note 3)	(9,930)	—	—	(9,930)
Increase (decrease) in net assets	(3,941)	1,315	10,111	7,485
Net assets at beginning of year	226,610	22,894	136,820	386,324
Net assets at end of year	$ 222,669	24,209	146,931	393,809

See accompanying notes to consolidated financial statements.

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statement of Activities

Year ended May 31, 2005

(In thousands of dollars)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Operating revenue:				
Tuition and fees, net of scholarships of $31,583	$ 71,667	—	—	71,667
Government grants and contracts	38,029	—	—	38,029
Private grants and contracts	16,237	—	—	16,237
Private gifts	12,766	4,871	—	17,637
Endowment spending distribution (note 4)	11,700	—	—	11,700
Interest from Alion investments (note 4)	2,394	—	—	2,394
Sales and services of auxiliary enterprises	11,370	—	—	11,370
Other sources	11,470	568	—	12,038
Net assets released from restrictions	13,152	(13,152)	—	—
Total operating revenue	188,785	(7,713)	—	181,072
Operating expenses:				
Faculty salaries	38,306	—	—	38,306
Administrative salaries	32,511	—	—	32,511
Part-time salaries	10,067	—	—	10,067
Employee benefits	14,442	—	—	14,442
Operations and maintenance	15,778	—	—	15,778
Supplies and services	34,462	—	—	34,462
Professional fees and advertising	10,110	—	—	10,110
IITRI research	16,063	—	—	16,063
Depreciation	11,964	—	—	11,964
Total operating expenses	183,703	—	—	183,703
Increase (decrease) in net assets from operating activities	5,082	(7,713)	—	(2,631)
Nonoperating revenue and expenses:				
Private gifts	—	—	891	891
Interest on indebtedness	(4,858)	—	—	(4,858)
Net gain on investments (note 4)	24,168	30	742	24,940
Endowment income (note 4)	4,218	—	—	4,218
Net loss on disposal of assets	(260)	—	—	(260)
Early retirements	(158)	—	—	(158)
Gain on call of Alion mezzanine notes (note 4)	7,161	—	—	7,161
Other	(1,850)	759	1,031	(60)
Increase (decrease) in net assets from nonoperating activities	28,421	789	2,664	31,874
Increase (decrease) in net assets	33,503	(6,924)	2,664	29,243
Net assets at beginning of year	193,107	29,818	134,156	357,081
Net assets at end of year	$ 226,610	22,894	136,820	386,324

See accompanying notes to consolidated financial statements.

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statements of Cash Flows

Years ended May 31, 2006 and 2005

(In thousands of dollars)

		2006	2005
Cash flows from operating activities:			
Increase in net assets	$	7,485	29,243
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:			
Cumulative effect of change in accounting principle		9,930	—
Private gifts restricted for long-term investment		(8,305)	(891)
Depreciation		12,088	11,964
Amortization of bond issue costs		—	176
Gain on beneficial interest in perpetual trusts		(1,300)	(510)
Contribution of fixed assets		(169)	(175)
Net (gain) loss on disposal of assets		341	260
Net gain on Alion notes and warrants		(8,574)	(22,606)
Gain on investments		(21,358)	(13,525)
Changes in assets and liabilities:			
Receivables: tuition, grants, pledges, affiliate and other		(5,932)	1,822
Inventories, prepaid expenses, and deferred charges		1,361	(947)
Accounts payable and accrued expenses		3,094	3,404
Accrued salaries and wages		1,680	391
Deferred revenue		1,171	(2,260)
Deposits by students and others		190	(1,464)
Obligations under split-interest agreements		23	(91)
Net cash provided by (used in) operating activities		(8,275)	4,791
Cash flows from investing activities:			
Proceeds from sale of investments		50,215	118,481
Purchase of investments		(47,545)	(100,670)
Bond proceeds held by trustees		(39,584)	(10,530)
Purchase of physical properties		(28,437)	(27,608)
Proceeds from the sales-leaseback of physical properties		2,600	—
Issuance of notes receivable		(1,306)	(1,298)
Payments received on notes receivable		1,951	15,560
Net cash used in investing activities		(62,106)	(6,065)
Cash flows from financing activities:			
Private gifts restricted for endowments		8,305	891
Payments on notes and bonds payable		(109,995)	(11,834)
Proceeds from borrowings under notes and bonds payable		160,153	20,750
Advances of refundable grants		—	1
Net cash provided by financing activities		58,463	9,808
Increase (decrease) in cash		(11,918)	8,534
Cash at:			
Beginning of year		15,735	7,201
End of year	$	3,817	15,735
Supplemental disclosure of cash flow information:			
Cash paid for interest	$	4,081	2,280

See accompanying notes to consolidated financial statements.

(1) Nature of Organization

Illinois Institute of Technology

Illinois Institute of Technology (the University) is a private not-for-profit coeducational technical engineering institution that is dedicated to superior teaching and excellent scholarship. Located in Chicago, Illinois, the University enrolls a diverse student body from across the nation and a number of foreign countries.

IIT India is a private not-for-profit coeducational technical engineering institution that is dedicated to superior teaching and excellent scholarship. Located in Bangalore, India, the institution services students from across India.

IIT France is a private not-for-profit entity located in Paris, France. The entity has been created to promote to French and European students the programs of the University and to welcome visiting students from the University as they discover and study European architecture while they carry out their architectural studies.

IIT Research Institute

IIT Research Institute (IITRI) is a not-for-profit membership corporation working for the advancement of knowledge and the beneficial application of science to meet the needs of society. IITRI's articles of incorporation provide that in addition to its primary purpose, it will support and assist the University and, in event of dissolution, IITRI's assets would be distributed to the University. Members of the executive committee of the board of trustees of the University elect IITRI's Board of Governors. IITRI also prepares separate annual financial statements as of September 30, its fiscal year-end.

(2) Summary of Significant Accounting Policies and Reporting Practices

(a) Principles of Consolidation

The accompanying consolidated financial statements, which have been prepared on the accrual basis of accounting, include the accounts of Illinois Institute of Technology, IIT India, IIT France, and IITRI. All significant intercompany transactions between these entities have been eliminated from the accompanying consolidated financial statements.

(b) Basis of Presentation

The University maintains its accounts in accordance with the principles and practices of fund accounting. Fund accounting is the procedure by which resources for various purposes are classified for accounting purposes in accordance with activities or objectives specified by donors.

For financial statement reporting purposes, however, the University's financial statements have been prepared to focus on the organization as a whole and to present balances and transactions in accordance with donor-imposed restrictions.

(Continued)

Net assets and related activity are classified and reported as follows:

Unrestricted – Net assets that are not subject to donor-imposed restrictions.

Temporarily Restricted – Net assets that are subject to donor-imposed restrictions that will be met either by actions of the University or the passage of time. Items that affect this net asset category are gifts for which restrictions have not been satisfied and annuity and life income gifts for which the ultimate purpose of the proceeds is not permanently restricted.

Permanently Restricted – Net assets that are subject to donor-imposed restrictions that require them to be maintained permanently by the University. Items that affect this net asset category include gifts wherein donors stipulate that the corpus be held in perpetuity (primarily gifts for endowment and providing loans to students) and only the income be made available for program operations, and annuity and life income gifts for which the ultimate purpose of the proceeds is permanently restricted.

(c) Operations

Operating results in the statements of activities reflect all transactions increasing or decreasing unrestricted net assets except those items of a capital nature; that is, associated with long-term investment including reinvestment of realized and unrealized gains and losses on investments or physical plant.

(d) Revenue

Revenue is reported as an increase in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or law. Expiration of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between applicable classes of net assets.

Private gifts, including pledges, are recognized in the period received. Conditional pledges are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at estimated fair value. Contributions to be received after one year are discounted at an appropriate rate commensurate with the risks involved. Amortization of discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions. An allowance for uncollectible pledges receivable is provided based upon management’s judgment, including such factors as prior collection history, type of contribution, and nature of fundraising activity.

(Continued)

Contributions received with donor-imposed restrictions that are met in the same year as the gifts are received are reported as revenue of the unrestricted net asset class. Contributions of land, building, and equipment without donor-imposed restrictions concerning the use of such long-lived assets are reported as revenue of the unrestricted net asset class. Contributions of cash or other assets to be used to acquire land, building, and equipment with such donor restrictions are reported as revenue of the temporarily restricted net asset class; the restrictions are considered to be released at the time of acquisition of such long-lived assets.

Revenue from University government grant and contract agreements is recognized as it is earned through expenditure in accordance with the agreement.

Tuition and other revenue received prior to the end of one fiscal year, which relates to future periods, is recorded as deferred revenue.

IITRI's research project revenue results from contract research and other services under a variety of contracts, some of which provide for reimbursement of cost plus fees and others which are fixed-price or time and materials type contracts. IITRI generally recognizes revenue when a contract has been executed, the contract price is fixed or determinable, delivery of the services or product has occurred, and collectibility of the contract price is considered probable. Revenue on cost-plus contracts is recognized as costs are incurred and include a proportionate share of the fees earned. The percentage of completion method is used to recognize revenue on fixed contracts based on various performance measures. From time to time, facts develop that require IITRI to revise its estimated total costs or revenues expected. The cumulative effect of revised estimates is recorded in the period in which the facts requiring revisions become known. The full amount of anticipated losses on any type of contract are recognized in the period in which they become known. Under time-and-materials contracts, labor and related costs are reimbursed at negotiated, fixed hourly rates. Revenue on time-and-materials contracts is recognized at contractually billable rates as labor hours and direct expenses are incurred.

Historically, governmental clients have been a major source of revenue for IITRI. For the fiscal years ended May 31, 2006 and 2005, these governmental clients accounted for approximately 35% and 42%, respectively, of IITRI's operating revenue of $24,538 and $21,201, respectively. In addition, IITRI has one significant industrial customer, which comprised approximately 51% and 46%, respectively, of their contract revenue in 2006 and 2005, respectively. Included in IITRI's revenue for 2006 and 2005 and accounts receivable at May 31, 2006 and 2005 are unbilled receivables in the amounts of approximately $3,567 and $2,234, respectively.

The amount of contract and grant revenue reflected in the consolidated financial statements is subject to review and adjustment by contracting agencies, principally the federal government. The amount, if any, of expenditures which may be disallowed by the contracting agencies cannot be determined at this time. It is the opinion of management that such disallowances, if any, will not be significant.

(Continued)

(e) Investments

Investments are reported at fair value. The fair values of investments are generally determined based on quoted market prices or estimated fair values provided by external investment managers or other sources. Direct investments in real estate included in the investment portfolio are recorded at fair value determined based on the discounted value of the future cash flows. Management's estimate of the fair value of private equity and hedge fund investments is determined based on valuations provided by the external investment managers. The valuations for these investments necessarily involve estimates, appraisals, assumptions, and methods which are reviewed by the University.

Cash equivalents, consisting primarily of fixed income securities and money market accounts with original maturities of three months or less, related to endowment funds, are classified as investments. Investment transactions are recorded on the trade date. Realized gains and losses on the sale of investments are calculated on the basis of specific identification of the securities sold. Investment management fees and service charges are netted against investment income for financial reporting purposes.

(f) Investments from the Sale of IITRI Net Assets

Investments from the sale of IITRI net assets consist of cash equivalents and Alion notes receivable with detachable stock warrants received, which are reported at fair value. The fair value of the notes receivable are determined based on the discounted value of the interim interest payments and the face amount of each note over their respective lives, plus the discounted projected value of the attached warrants, based on their respective required rates of return as estimated by management.

(g) Notes Receivable

Student notes receivable consist primarily of Perkins loans, the Illinois Student Assistance Commission Federal Family Educational Loan program, and University loans. Perkins loans are comprised of 89% U.S. Government funds and 11% University funds. The University establishes valuation allowances for notes receivable based on estimates of future collectibility.

(h) Inventory

Inventories are stated at cost, which is determined by the first in, first out method for both the University and IITRI.

(i) Physical Properties

The University and IITRI's fixed assets are recorded at cost of construction or acquisition. The University and IITRI depreciate land improvements, buildings, and equipment on the straight-line method over their estimated useful lives which range from three to 50 years.

(Continued)

Upon sale or retirement of an asset, cost and the related accumulated depreciation are deducted from the accounts, and a gain or loss is recorded. Minor expenditures for renovations, construction, and replacement of equipment are charged to current operations and are not capitalized.

(j) Impairment of Long-lived Assets

The University and IITRI account for long-lived assets in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets*. SFAS No. 144 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

(k) Beneficial Interest in Perpetual Trusts

The University has a beneficial interest in certain perpetual trusts, which are held by third parties. The University recognizes contribution revenue equal to its proportionate share of the fair value of the trust assets upon notification and determination that its right to receive benefits under the agreement is unconditional. Changes in the fair value of the University's interest in the trust assets are reflected as gains or losses in the period they occur.

(l) Split-interest Agreements

The University's split-interest agreements with donors consist of irrevocable charitable remainder trusts, annuity trusts, and charitable gift annuities for which the University is either the remainder beneficiary or both the trustee and the remainder beneficiary.

Assets held in trust for which the University serves as trustee are included in investments. In addition, the present value of the estimated future payments to be made to the donors and/or other beneficiaries is included as liabilities. The liabilities are adjusted during the term of the agreements for changes in the value of the assets, accretion of the discount, and other changes in the estimates of future benefits.

Assets held in trust for which the University does not serve as trustee are not reported as investments in the consolidated financial statements. However, contribution revenue and a receivable are recognized at the date the trusts are established at the fair value of the trust assets, which represents the estimated present value of the expected future cash flows to be received.

(Continued)

(m) Income Taxes

The University and IITRI have each received a determination letter from the Internal Revenue Service indicating that they are tax-exempt organizations as provided in Section 501(c)(3) of the Internal Revenue Code of 1986 and, except for taxes related to unrelated business income, are exempt from Federal and state income taxes.

Accordingly, no provision for income tax has been made in the accompanying consolidated financial statements as the University and IITRI have no significant unrelated business income.

(n) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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 revenue and expenses during the reporting period. Actual results could differ from these estimates.

(o) Reclassifications

Certain amounts in the 2005 financial statements have been reclassified to conform with the 2006 presentation.

(3) Change in Accounting Principle

In fiscal year 2006 the University adopted Financial Accounting Standards Board Interpretation No. 47 (FIN 47), "*Accounting for Conditional Asset Retirement Obligations*." FIN 47 requires that a liability be recognized for the fair value of a legal obligation to perform asset retirement activities that are conditional on a future event if the amount can be reasonably estimated. Upon recognition of a liability, the asset retirement cost is recorded as an increase in the carrying value of the related long-lived asset and then depreciated over the life of the asset. The University's asset retirement obligations arise primarily from regulations that specify how to dispose of asbestos if facilities are demolished or undergo major renovations or repairs. The University's obligations to remove asbestos was estimated using a per square foot estimate.

As a result of an evaluation of available asbestos remediation estimates, the University recorded a liability of $9,330 for the asset retirement obligations. Accumulated depreciation was measured from fiscal year 1973, the date the liability and capitalized asset would have been recognized if FIN 47 were in effect when the University incurred the liability. Accordingly, the capitalized asset associated with the asset retirement obligation is considered to be fully depreciated. As a result, the cumulative effect of this change in accounting principle was recorded as a cumulative effect of a change in accounting principle in unrestricted net assets in fiscal year 2006.

(Continued)

(In thousands of dollars)

(4) Investments and Investments from the Sale of IITRI Net Assets

Investments at May 31, 2006 and 2005 consist of the following:

		2006		2005	
		Cost	**Fair Value**	**Cost**	**Fair Value**
Cash equivalents	$	27,589	27,589	8,758	8,758
Real estate		13,931	14,483	14,261	16,027
Stocks		141,178	168,117	137,310	153,177
Bonds		41,048	40,236	23,013	23,420
Total investments	$	223,746	250,425	183,342	201,382

For investment purposes, the University pools substantially all assets of its endowment accounts. Each account owns "units" of the consolidated investment pool. The pooled assets are valued on a monthly basis and a fair value per unit is determined which is used to calculate the number of units purchased by accounts entering the pool and redeemed by accounts withdrawing from the pool. Income (interest, dividends, and rents) earned by the investment pool is distributed to the individual accounts on the basis of average units owned by each account in the pool during the year.

The University utilizes the total return concept of endowment spending. Under the method adopted by the University, interest, dividends, and rents, as well as appreciation on investments held by the investment pool, are made available for spending. Endowment payouts for operations of $12,600 for fiscal year 2006 and $11,700 for fiscal year 2005 were set by the University's board of trustees.

Investments from sale of IITRI net assets at May 31, 2006 and 2005 consist of the following:

		2006		2005	
		Cost	**Fair value**	**Cost**	**Fair value**
Alion notes and warrants	$	25,020	58,932	29,518	60,051
Cash equivalents		1,075	1,075	21,737	21,737
Total investments from sale of IITRI net assets	$	26,095	60,007	51,255	81,788

On March 27, 2006, the University redeemed all outstanding mezzanine warrants from Alion. The mezzanine warrants represented options to purchase 504,901.9 shares of Alion's common stock. The University received cash of $13,072 and recorded a realized gain of $8,574 in connection with the redemption. The proceeds from the redemption are invested with the University's short term investments.

(In thousands of dollars)

On October 1, 2004, Alion prepaid the mezzanine note payable to the University. The total cash transmitted by Alion to the University on October 1, 2004 was $21,400, consisting of payment of principal, accrued interest, and a prepayment premium.

Return on investments for the years ended May 31, 2006 and 2005 consists of the following:

		2006	2005
Return on investments:			
Interest and dividends (endowment income)	$	4,915	4,218
Interest from Alion investments		2,394	2,394
Net realized gain on sale of investments		9,341	1,749
Net unrealized gain on investments		12,018	34,381
Realized gain on sale of Alion mezzanine note		—	7,161
Realized gain on sale of Alion mezzanine warrants		8,574	—
Net return on investments	$	37,242	49,903

(5) Pledges Receivable

Pledges receivable consist of unconditional promises to give and are summarized as follows at May 31, 2006 and 2005:

		2006	2005
Pledges receivable	$	12,184	18,675
Allowance for uncollectible pledges		(283)	(1,200)
Discount to present value future cash flows		(2,525)	(4,230)
Net pledges receivable	$	9,376	13,245

The following is a summary showing the expected timing of collection of total unconditional pledges receivable outstanding as of May 31, 2006:

Fiscal year(s)		Amount
2007	$	2,797
2008 through 2012		9,012
2013 and thereafter		375
	$	12,184

(Continued)

(In thousands of dollars)

(6) Physical Properties

The University's consolidated physical properties consisted of the following as of May 31, 2006 and 2005:

	2006	2005
Land and land improvements	$ 23,813	20,801
Building and building improvements	229,916	225,895
Equipment and library collection	88,674	82,345
Construction in-progress	42,198	27,979
Total physical properties	384,601	357,020
Less accumulated depreciation	167,494	156,090
Physical properties, net	$ 217,107	200,930

(7) Beneficial Interest in Perpetual Trusts

The University is an income beneficiary of certain irrevocable trusts that are held and controlled by independent trustees. The University has no equity interest in the principal of these trusts. At May 31, 2006 and 2005, the share of these trusts from which the University derives income had a combined fair value of $20,853 and $19,553, respectively. These trusts provided unrestricted income of $383 and $344 in fiscal 2006 and 2005, respectively.

(In thousands of dollars)

(8) Notes and Bonds Payable

Notes and bonds payable at May 31, 2006 and 2005 consist of the following:

	Interest rate	2006	2005
University:			
IEFA Bonds, Series 1999, payable in varying installments through 2025	4.0%	—	51,245
IEFA Bonds, Series 2000, payable in varying installments through 2026	Variable	—	38,000
IEFA Bonds, Series 2004, payable in varying installments through 2025	Variable	—	20,000
IFA Bonds, Series 2006, payable in varying installments through 2036	Variable	160,000	—
Note payable to ISAC for student lender program	Various	382	229
City of Chicago Energy Loan	Interest free	600	750
IITRI - IFA Series 2004, payable in varying installments through 2034	Variable	18,220	18,820
Total notes and bonds payable		$ 179,202	129,044

The following is a summary of required principal payments, excluding amounts due under the note payable to ISAC, on outstanding secured obligations as of May 31, 2006:

	IIT
Fiscal year ending:	
2006	$ 830
2007	860
2008	890
2009	925
2010	810
After 2010	174,505
Total notes and bonds payable	$ 178,820

During the year ended May 31, 2006, the University issued $160,000 in fixed rate revenue bonds through the Illinois Finance Authority consisting of $153,660 (IFA Series 2006A) and $6,340 (IFA Series 2006B). Proceeds from the bonds were used to advance refund the IEFA Series 1999 Bonds, refund the outstanding IEFA Series 2000 Bonds, refund the outstanding IEFA Series 2004 Bonds,

(Continued)

finance a portion of the costs of the construction, renovation and equipping of certain of the educational facilities of the University, and pay for certain expenses incurred in conjunction with the issuance of the Series 2006A and 2006B Bonds. The fixed rate on the Series 2006A Bonds is 5% with serial bonds maturing from April 2016 through 2026 and term bonds due April 1, 2031 and April 1, 2036. The Series 2006B term bond bears a 6.10% rate maturing April 1, 2015.

The University has also been designated a lender by the U.S. Department of Education for the Federal Stafford Loan program. As a lender the University participates in the Federal Family Education Loan Program (FFELP) and offers loans to University graduate students. In order to provide funding to support the lender program, the University has contracted with the Illinois Student Assistance Commission (ISAC). The arrangement with ISAC provides that once the University approves a loan to a student, ISAC will loan the funds to the University to forward to the student. After the student separates from the University, ISAC, or one of its designated agencies, will purchase the loan from the University, at which time the University will liquidate its debt to ISAC, and ISAC will then service the loan through the repayment process.

The University maintains a line of credit agreement that allows borrowings of up to $5,000. Borrowings under this line will bear interest at the prime commercial rate with interest being payable monthly. The borrowings under this line of credit will be payable on demand, but if no demand is made, borrowings shall automatically mature on the interest payment date next following the date the loan is made. The line of credit agreement expired on November 30, 2003. Management has received written communication from the bank indicating that the line of credit continues to be in effect and available. No amounts were outstanding under this agreement as of May 31, 2006 and 2005.

The University is subject to certain debt covenants. As of May 31, 2006, management believes it has met those covenants.

IITRI maintains a line of credit agreement that allows borrowings of up to $350. Borrowings under this line will bear interest at the prime commercial rate with interest payable monthly. IITRI may make principal payments at any time and in any amount, or on demand of the lender. The line of credit does not have a termination date. The line of credit is supported by an unconditional guaranty issued by the University. In August 2004, IITRI terminated this line of credit and established a new line of credit with Fifth Third Bank. The line of credit with Fifth Third bank does not require a University guaranty.

The carrying value of long-term debt does not differ materially from its estimated fair value as of May 31, 2006 and 2005, based on quoted market prices for the same or similar issues.

(9) Employee Benefit Plans

Pension Plan

Substantially all full time employees of the University and IITRI are participants in defined contribution retirement plans that are funded by contributions from the University, IITRI, and participating employees. Total contributions made under the plans for the years ended May 31, 2006 and 2005 were $4,528 and $4,253 by the University and $104 and $195 by IITRI, respectively.

(In thousands of dollars)

Health Care Benefit Plans

The University maintains a health care benefits plan (the Plan) that provides for certain major medical, surgical, and other benefits for all eligible employees and dependents. The Plan is partially self-funded by the University, subject to stop loss arrangements. Under this Plan, the University makes contributions to cover benefits not funded by employees, limited by stop loss amounts.

IITRI offers a health care benefits plan (the Plan) that provides for certain medical and dental expense coverage including certain vision discounts for all eligible employees and dependents. The Plan is fully insured and underwritten by the Aetna Life Insurance Company. Under this Plan, premium contributions are shared by both IITRI and plan participants.

(10) Functional Classification of Expenses

Expenses are reported in the statements of activities by natural business category. The University's primary program services are instruction and research. Expenses reported as academic support, student services, institutional support, and auxiliary enterprises are incurred in support of these primary program services.

Consolidated expenses by functional classification for the years ended May 31, 2006 and 2005 are as follows:

		2006	2005
Instruction	$	65,925	61,484
Research and other grant activities		50,619	47,397
Academic support		24,040	22,890
Student services		15,027	14,608
Institutional support		33,429	31,056
Auxiliary enterprises		11,217	11,284
Total	$	200,257	188,719

(Continued)

(In thousands of dollars)

(11) Net Assets

Certain unrestricted net assets are designated for specific purposes by the board of trustees of the University and are summarized as follows at May 31, 2006 and 2005:

		2006	2005
Net investment in land, buildings, and equipment	$	72,843	65,314
Funds designated by the board of trustees for endowment		17,933	18,418
Undesignated		131,893	142,878
Total	$	222,669	226,610

Included in the net investment in land, buildings, and equipment amount above are $6,380 and $5,945 of IITRI net assets at May 31, 2006 and 2005, respectively.

Donor restrictions on temporarily restricted net assets consist of the following at May 31, 2006 and 2005:

		2006	2005
Net investment in land, buildings, and equipment	$	7,227	9,000
Scholarships		2,779	1,824
Instruction and academic departments		7,276	5,938
Library		521	501
General operations		4,825	4,039
Split-interest annuity agreements		1,581	1,592
Total	$	24,209	22,894

Permanently restricted net assets consist of the following at May 31, 2006 and 2005:

		2006	2005
Endowment investments	$	107,219	97,694
Endowments restricted for plant		9,898	9,898
Donor-restricted revolving loans funds		6,844	6,667
Split-interest annuity agreements		2,117	3,008
Beneficial interest in perpetual trusts		20,853	19,553
Total	$	146,931	136,820

The amount of outstanding loans from quasi-endowments to unrestricted funds is $7,700 and $8,500 at May 31, 2006 and 2005, respectively.

(12) Leases

In December 1999, the University leased its undeveloped property located at 32nd Street between Michigan Avenue and Indiana Avenue, to Michigan Place LLC for a term of 100 years. The agreement requires Michigan Place LLC to pay the University $815 in total lease payments. The University has received a final payment of $285 in fiscal year 2004.

In May 2002, the University entered into a 40 year ground lease agreement with IIT State Street, NFP, to lease property on the University's campus for the purpose of building housing to lease to students, faculty, and staff of the University or employees of other not-for-profit educational institutions in the area. Under this agreement, the University will receive annual lease payments of $5 over the term of the lease.

IIT State Street, NFP is a 501(c)(3) corporation that is affiliated with, but not controlled by the University, and accordingly, is not included in the University's financial statements. IIT State Street, NFP, has borrowed $28,800 from IEFA to construct the dorms and $1,000 from the University for a supplemental reserve fund. The University has no obligation for the corporation's liabilities or debts. However, the University has provided $1,000 loan to State Street to establish the supplemental reserve fund, which was subsequently used to fund construction costs of the housing complex.

In August 2003, the University entered into a five year operating lease with IIT State Street, NFP. If there are vacancies in the IIT State Street housing complex, the lease obligates the University to lease unoccupied beds from IIT State Street to the extent necessary to permit IIT State Street to pay its annual debt service.

IIT State Street, NFP had assets, liabilities, and net assets of $29,431, $30,310, and $(880), respectively for the year ended May 31, 2006. Additionally, IIT State Street, NFP had operating revenue and expenses of $3,223 and $3,217, respectively for the year ended May 31, 2006.

In January 2006, the University entered into a fifty-five year ground lease agreement with Townsend Chicago, LLC. The ground lease agreement requires Townsend Chicago, LLC to pay the University an initial rent payment of $1.9 million for the first 10 years and $11 million through 2031. Townsend purchased from IIT the building known as the Technology Business Center for $2,600 resulting in a gain of approximately $2,400 which is being amortized over the life of the building lease. IIT is leasing approximately 21% of the building back from Townsend for an initial term of eighteen years. The University is required to pay $756, $762, $782, $800, $821 in minimum lease payments over the next five years.

(13) Contingencies

The University is a defendant in legal proceedings arising in the ordinary course of its business. Although the outcome of these proceedings cannot presently be determined, in the opinion of management, disposition of these proceedings will not have a material adverse effect on the financial position of the University.

KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' Report on Supplemental Information

The Board of Trustees
Illinois Institute of Technology:

We have audited and reported separately herein on the consolidated financial statements of Illinois Institute of Technology (the University) as of and for the years ended May 31, 2006 and 2005.

Our 2006 audit was made for the purpose of forming an opinion on the consolidated financial statements of the University taken as a whole. The accompanying supplementary information included in schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements of the University. The supplementary information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2006 consolidated financial statements taken as a whole.

KPMG LLP

November 1, 2006

Schedule 1

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidating Statement of Financial Position

May 31, 2006

(In thousands of dollars)

Assets		**University**	**IITRI**	**Eliminations**		**Total**
Cash	$	1,432	2,385	—		3,817
Bond proceeds held by trustees		48,481	3,200	—		51,681
Investments		239,006	11,419	—		250,425
Investments from sale of IITRI net assets		60,007	—	—		60,007
Notes and accounts receivable:						
Grants and contracts, less allowance of $105		9,928	5,749	—		15,677
Students:						
Tuition, less allowance of $7,563		6,492	—	—		6,492
Notes, less allowance of $373		9,213	91	—		9,304
Pledges, less allowance of $1,200		9,376	—	—		9,376
Other		8,215	—	—		8,215
Affiliated organizations, net		1,041	—	(1,041)	(a)	—
Inventories, prepaid expenses, and deferred charges		2,409	129	—		2,538
Equity interest in IITRI		13,249	—	(13,249)	(b)	—
Physical properties, less accumulated depreciation		195,707	21,400	—		217,107
Beneficial interest in perpetual trusts		20,853	—	—		20,853
Total assets	$	625,409	44,373	(14,290)		655,492
Liabilities and Net Assets						
Liabilities:						
Accounts payable and accrued expenses	$	18,219	2,772	(468)	(a)	20,523
Accrued salaries and wages		13,635	1,346	(573)	(a)	14,408
Deferred revenue		16,546	8,786	—		25,332
Deposits by students and others		2,899	—	—		2,899
Obligation under split-interest agreements		1,295	—	—		1,295
Notes and bonds payable		160,982	18,220	—		179,202
Advances from U.S. Government for student loans		8,094	—	—		8,094
Other long term liabilities		9,930	—	—		9,930
Total liabilities		231,600	31,124	(1,041)		261,683
Net assets:						
Unrestricted		222,669	13,249	(13,249)	(b)	222,669
Temporarily restricted		24,209	—	—		24,209
Permanently restricted		146,931	—	—		146,931
Total net assets		393,809	13,249	(13,249)		393,809
Total liabilities and net assets	$	625,409	44,373	(14,290)		655,492

(a) Elimination of interentity accounts payable/receivable.

(b) Elimination of equity interest in IITRI.

See accompanying independent auditors' report on supplemental information.

Schedule 2

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidating Statement of Activities

Year ended May 31, 2006

(In thousands of dollars)

	Unrestricted				Temporarily restricted – University	Permanently restricted – University	Total
	University	IITRI	Interentity eliminations	Total			
Operating revenue:							
Tuition and fees, net of scholarships of $35,037	$ 77,035	—	—	77,035	—	—	77,035
Government grants and contracts	28,774	8,406	—	37,180	—	—	37,180
Private grants and contracts	2,519	15,621	—	18,140	—	—	18,140
Private gifts	11,453	—	—	11,453	6,601	—	18,054
Endowment spending distribution	12,600	—	—	12,600	—	—	12,600
Interest from Alion investments	2,394	—	—	2,394	—	—	2,394
Sales and services of auxiliary enterprises	11,388	—	—	11,388	—	—	11,388
Other sources	13,046	511	(1,491) (a)	12,066	664	—	12,730
Net assets released from restrictions	6,177	—	—	6,177	(6,177)	—	—
Total operating revenue	165,386	24,538	(1,491)	188,433	1,088	—	189,521
Operating expenses:							
Faculty salaries	40,458	—	—	40,458	—	—	40,458
Administrative salaries	33,998	—	—	33,998	—	—	33,998
Part-time salaries	10,919	—	—	10,919	—	—	10,919
Employee benefits	14,566	—	—	14,566	—	—	14,566
Operations and maintenance	19,475	—	—	19,475	—	—	19,475
Supplies and services	34,625	—	—	34,625	—	—	34,625
Professional fees and advertising	8,996	—	—	8,996	—	—	8,996
IITRI research	—	20,645	(1,491) (a)	19,154	—	—	19,154
Depreciation	10,770	1,318	—	12,088	—	—	12,088
Total operating expenses	173,807	21,963	(1,491)	194,279	—	—	194,279
Increase (decrease) in net assets from operating activities	(8,421)	2,575	—	(5,846)	1,088	—	(4,758)
Nonoperating revenue and expenses:			—				
Private gifts	—	—	—	—	—	7,021	7,021
Change in donor restriction	—	—	—	—	(1,284)	1,284	—
Interest on indebtedness	(5,622)	(356)	—	(5,978)	—	—	(5,978)
Net gain on investments	8,561	—	—	8,561	49	1,449	10,059
Endowment income	4,915	—	—	4,915	—	—	4,915
Net loss on disposal of assets	(283)	(58)	—	(341)	—	—	(341)
Early retirements	—	—	—	—	—	—	—
Loss on refunding of bond issue	(2,750)	—	—	(2,750)	—	—	(2,750)
Gain on call of mezz note	8,574	—	—	8,574	—	—	8,574
Other	(1,146)	—	—	(1,146)	1,462	357	673
Equity income from IITRI	2,161	—	(2,161) (b)	—	—	—	—
Increase (decrease) in net assets from nonoperating activities	14,410	(414)	(2,161)	11,835	227	10,111	22,173
Increase in net assets before cumulative effect of change in accounting principle	5,989	2,161	(2,161)	5,989	1,315	10,111	17,415
Cumulative effect of change in accounting principle	(9,930)	—	—	(9,930)	—	—	(9,930)
Increase (decrease) in net assets	(3,941)	2,161	(2,161)	(3,941)	1,315	10,111	7,485
Net assets at beginning of year	226,610	11,088	(11,088)	226,610	22,894	136,820	386,324
Net assets end of year	$ 222,669	13,249	(13,249)	222,669	24,209	146,931	393,809

(a) Elimination of interentity utility income and expense.

(b) Elimination of equity interest in IITRI earnings and contribution to IIT.

See accompanying independent auditors' report on supplemental information.

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidating Statement of Cash Flows

Year ended May 31, 2006

(In thousands of dollars)

	University	IITRI	Eliminations		Total
Cash flows from operating activities:					
Increase in net assets	$ 7,485	2,161	(2,161)	(a)	7,485
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:					
Cumulative effect of change in accounting principle	9,930	—	—		9,930
Private gifts restricted for long-term investment	(8,305)	—	—		(8,305)
Depreciation	10,770	1,318	—		12,088
Amortization of bond issue costs and goodwill	—	—	—		—
(Gain) loss on beneficial interest in perpetual trusts	(1,300)	—	—		(1,300)
Contribution of fixed assets	(169)	—	—		(169)
Net gain on disposal of assets	283	58	—		341
Net gain on Alion notes and warrants	(8,574)	—	—		(8,574)
Net (gain) loss on investments	(21,358)	—	—		(21,358)
Changes in assets and liabilities:					
Receivables: tuition, grants, pledges, affiliate and other	(4,447)	(1,650)	165	(b)	(5,932)
Inventories, prepaid expenses, and deferred charges	942	419	—		1,361
Equity interest in IITRI	(2,161)	—	2,161	(a)	—
Accounts payable and accrued expenses	3,782	(522)	(166)	(b)	3,094
Accrued salaries and wages	1,364	315	1	(b)	1,680
Deferred revenue	1,865	(694)	—		1,171
Deposits by students and others	190	—	—		190
Obligations under split-interest agreements	23	—	—		23
Net cash provided by (used in) operating activities	(9,680)	1,405	—		(8,275)
Cash flows from investing activities:					
Proceeds from sale of investments	50,215	—	—		50,215
Purchase of investments	(36,126)	(11,419)	—		(47,545)
Bond proceeds held by trustees	(44,931)	5,347	—		(39,584)
Purchase of physical properties	(21,879)	(6,558)	—		(28,437)
Proceeds from the sales-leaseback of physical properties	2,600	—	—		2,600
Issuance of notes receivable	(1,215)	(91)	—		(1,306)
Payments received on notes receivable	1,951	—	—		1,951
Net cash used in investing activities	(49,385)	(12,721)	—		(62,106)
Cash flows from financing activities:					
Private gifts restricted for long-term investment	8,305	—	—		8,305
Payments on notes and bonds payable	(109,395)	(600)	—		(109,995)
Proceeds from borrowings under notes and bonds payable	160,153	—	—		160,153
Advances of refundable grants	—	—	—		—
Net cash provided by (used in) financing activities	59,063	(600)	—		58,463
Decrease in cash	(2)	(11,916)	—		(11,918)
Cash at:					
Beginning of year	1,434	14,301	—		15,735
End of year	$ 1,432	2,385	—		3,817
Supplemental disclosure of cash flow information:					
Cash paid for interest	$ 3,556	525	—		4,081

(a) Elimination of change in equity interest in IITRI.

(b) Elimination of change in interentity accounts payable/receivable.

See accompanying independent auditors' report on supplemental information.