ILLINOIS INSTITUTE OF TECHNOLOGY

OMB Circular A-133 Audit Report

Year ended May 31, 2006

(With Independent Auditors' Report Thereon)

ILLINOIS INSTITUTE OF TECHNOLOGY

Table of Contents

	Page
Independent Auditors' Report	1
Consolidated Financial Statements	2
Schedule of Expenditures of Federal Awards	21
Notes to Schedule of Expenditures of Federal Awards	27
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*	30
Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133	32
Schedule of Findings and Questioned Costs	35

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 and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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.

In accordance with *Government Auditing Standards,* we have also issued our report dated November 1, 2006 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Our 2006 audit was made for the purpose of forming an opinion on the basic consolidated financial statements of the University taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* and is not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly presented in all material respects in relation to the consolidated financial statements taken as a whole.

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.

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, 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.

(Continued)

(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.

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2006

Program title	CFDA number	Federal expenditures
Major Programs:		
Research and Development Cluster – Direct awards:		
Department of Agriculture:		
Integrated Programs	10.303	$ 55,073
International Training – Foreign Participant	10.962	5,502
		60,575
Department of Defense:		
Procurement Technical Assistance for Business Firms	12.002	8,434
Basic and Applied Scientific Research	12.300	1,592,754
Military Medical Research and Development	12.420	452,553
Basic Scientific Research	12.431	(520)
Air Force Defense Research Sciences Program	12.800	10,030
Research and Technology Development	12.910	8,741
		2,071,992
Department of Labor:		
Workforce Investment Act Cluster – WIA Youth Activities	17.259	119,572
Department of State:		
Professional Development International Educators/Administrators	19.404	42,210
Department of Treasury:		
Low-income Taxpayers Clinic	21.008	93,000
National Aeronautics and Space Administration:		
Contract NNC04AAA68A	43.xxx	22,030
Contract NNC05GA64G	43.xxx	78,530
Contract NNC05GM96G	43.xxx	28,115
		128,675
National Science Foundation:		
Engineering Grants	47.041	1,012,187
Mathematical and Physical Sciences	47.049	698,100
Computer and Information Science and Engineering	47.070	599,007
Social, Behavioral, and Economic Sciences	47.075	105,567
Education and Human Resources	47.076	74,773
		2,489,634
Small Business Administration:		
Internet-Based Technical Assistance	59.005	487,431
Environmental Protection Agency:		
P3 Award: National Student Design Competition for Sustainability	66.516	7,787
Contract X3-83220401-0	66.xxx	74,043
		81,830
Department of Energy:		
Office of Science Financial Assistance Program	81.049	501,107
University Coal Research	81.057	(42,088)
Nuclear Energy Research, Development, and Demonstration	81.121	197,203
		656,222

(Continued)

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2006

Program title	CFDA number	Federal expenditures
Department of Health and Human Services:		
Food and Drug Administration Research	93.103	$ 5,099,956
Research Related to Deafness and Communication Disorders	93.173	37,815
Alcohol Research Programs	93.273	312,881
Discovery and Applied Research	93.286	782,936
National Center for Research Resources	93.389	1,563,624
Cancer Treatment Research	93.395	415,154
Cancer Research Manpower	93.398	141,040
Heart and Vascular Diseases Research	93.837	700,005
Biomedical Research and Research Training	93.859	93,105
		9,146,516
Corporation for National and Community Service:		
Volunteers in Service to America	94.013	20,804
Research and Development Cluster – Direct awards		15,398,461
Research and Development Cluster – Indirect awards:		
Department of Agriculture:		
Grants for Agricultural Research, Special Research Grants – Passed through Medical Research Institute	10.200	95,384
Department of Defense:		
Basic and Applied Scientific Research – Passed through:	12.300	
BIT Systems		43,866
Honeywell		27,213
Innovative Technology Application Company		4
Lockheed Martin		15,802
Stanford University		22,970
University of Minnesota		48,006
University of Tulsa		77,395
		235,256
Basic Scientific Research – Passed through Avure	12.431	207
Basic Applied and Advanced Research in Science and Engineering – Passed through California Institute of Technology	12.630	91,893
Research and Technology Development – Passed through Rush	12.910	10,676
Department of Defense Contracts – Passed through:	12.xxx	
ARINC		19,333
Aspen Systems		34,408
Arizona State University		32,722
High Performance Technologies, Inc.		68,159
Stanford University		(206)
		154,416
		492,448

(Continued)

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2006

Program title	CFDA number	Federal expenditures
Department of Transportation:		
Aviation Research Grants – Passed through Stanford University	20.108	$ 124,703
National Aeronautics and Space Administration:		
Aeronautics Education Services Program – Passed through:	43.001	
University of Illinois at Chicago		68,701
University of Illinois at Urbana-Champaign		2,246
		70,947
Technology Transfer – Passed through ASRC	43.002	930
National Aeronautics and Space Administration Contracts – Passed through:	43.xxx	
ARSC – Aerospace Corporation – NAS1003006		(4,012)
ARSC – Aerospace Corporation – NNC04CB08C		37,491
		33,479
		105,356
National Science Foundation:		
Engineering Grants – Passed through:	47.041	
Arizona State University		22,054
Cornell University		2,447
New Jersey Institute of Technology		76,970
Polytechnic		3,266
		104,737
Mathematical and Physical Sciences – Passed through:	47.049	
Cornell University		71,277
Northeastern Illinois University		2,922
University of Tennessee		3,900
		78,099
Education and Human Resources – Passed through:	47.076	
Western Michigan University		233,326
Chicago State University		8,097
		241,423
International Science and Engineering – Passed through CRDF	47.079	3,000
		427,259
Environmental Protection Agency:		
Air Information Center – Passed through University of Arizona	66.009	487
Great Lakes Program – Passed through Indiana University	66.469	6,644
		7,131
Department of Energy:		
Inventions and Innovations – Passed through Argonne National Laboratory	81.036	27,034

(Continued)

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2006

Program title	CFDA number	Federal expenditures
Office of Science Financial Assistance Program – Passed through:	81.049	
Argonne National Laboratory		$ 824,501
Fermi National Laboratory		82,615
Honeywell		155,335
Muons Inc.		21,831
Sandia National Laboratory		9,904
University of Missouri		23,008
United Technologies Company		75,965
		1,193,159
Office of Scientific and Technical Information – Passed through Argonne National Laboratory	81.064	166,350
Fossil Energy Research and Development – Passed through Gas Technology Institute	81.089	(6)
Department of Energy Contracts – Passed through:	81.xxx	
Fermi National Laboratory		35,036
Battelle		489,053
Brookhaven National Laboratory		1,500
		525,589
		1,912,126
Department of Health and Human Services:		
Food and Drug Administration Research – Passed through:	93.103	
Oak Ridge Associated Universities		21,535
University of Maryland		10,597
Bont in Liquid Food		409
		32,541
Oral Diseases and Disorders Research – Passed through University of Illinois at Chicago	93.121	92,415
Research Related to Deafness and Communications Disorders – Passed through University of Chicago	93.173	14,090
Mental Health Research Grants – Passed through Children's Hospital	93.242	21,137
Discovery and Applied Research – Passed through Northwestern University	93.286	209,954
Biomedical Technology – Passed through:	93.371	
AJ Medical		17,936
Quercus X-Ray Technologies		260
		18,196
National Center for Research Resources – Passed through University of Florence	93.389	5,532
Cell Biology and Biophysics Research – Passed through University of Maryland	93.821	74,270

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2006

Program title	CFDA number	Federal expenditures
Heart and Vascular Diseases Research – Passed through:	93.837	
University of Illinois at Chicago		$ 18,993
University of Chicago		27,421
University of Vermont		35,938
Washington State University		26,329
		108,681
Arthritis, Musculoskeletal, and Skin Disease Research – Passed through:	93.846	
Duke University		9,000
Rush		229,617
		238,617
Kidney Diseases, Urology, and Hematology Research – Passed through:	93.849	
Loyola University		34,785
Extramural Research Programs in the Neurosciences and Neurological Disorders: Passed through Argonne National Laboratory	93.853	102,632
Vision Research – Passed through University of Illinois at Urbana-Champaign	93.867	6,536
Aging Research – Passed through University of Rhode Isle BCC	93.866	8,538
Department of Health and Human Services – Passed through:		
Nesch LLC	93.xxx	25,272
University of Georgia		142,570
		167,842
		1,135,766
U.S. Agency for International Development:		
U.S. Agency for International Development Contract A-00-97-59-0	98.xxx	
Passed through Association Liaison Office for University Cooperation in Development		7,722
Research and Development Cluster – Indirect awards		4,307,895
Total Research and Development Cluster		19,706,356
Student Financial Aid Cluster:		
Department of Education:		
Federal Supplemental Educational Opportunity Grants	84.007	458,397
Federal Family Education Loans	84.032	31,022,676
Federal Work – Study Program	84.033	801,539
Federal Perkins Loan Program – Federal Capital Contributions	84.038	1,264,405
Federal Pell Grant Program	84.063	1,311,532
Total Student Financial Aid Cluster		34,858,549
Total Major Programs		54,564,905
Nonmajor Programs:		
Direct awards:		
Department of Agriculture:		
Grants for Agricultural Research Competitive Research Grants	10.206	59,862
National Science Foundation:		
Engineering Grants	47.041	43,479
Social, Behavioral, and Economic Sciences	47.075	924
Education and Human Resources	47.076	44,460
		88,863

(Continued)

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2006

Program title	CFDA number	Federal expenditures
Department of Energy:		
Nuclear Energy Research, Development, and Demonstration	81.121	$ 15,500
Department of Education:		
Rehabilitation Long-term Training	84.129	403,944
Byrd Honors Scholarships	84.185	13,500
		417,444
Department of Health and Human Services:		
Alcohol National Research Service Awards for Research Training	93.272	27,191
Corporation for National and Community Service:		
Volunteers in Service to America	94.013	15,041
Other – Direct awards		623,901
Indirect Awards:		
Department of Defense:		
Contract N66001-05-C-8001 – Passed through Science Application International Corporation	12.xxx	69,608
National Science Foundation:		
Education and Human Resources – Passed through Chicago State University	47.076	33,533
Department of Energy:		
Office of Science Financial Assistance – Passed through University of Pittsburgh	81.049	(4,495)
Department of Education:		
Fund for the Improvement of Postsecondary Education – Passed through:	84.116	
North Central Regional Educational Laboratory		(48)
Other – Indirect awards		98,598
Total Nonmajor Programs		722,499
Total Federal Awards		$ 55,287,404

ILLINOIS INSTITUTE OF TECHNOLOGY

Notes to Schedule of Expenditure of Federal Awards

Year ended May 31, 2006

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) summarizes the federal awards received by the Illinois Institute of Technology (the University) under programs of the federal government for the fiscal year ended May 31, 2006. The Schedule excludes expenditures of federal awards of IIT Research Institute, a subsidiary of the University. Expenditures of federal awards for IIT Research Institute will be separately audited in accordance with Office of Management and Budget (OMB) Circular A-133.

For purposes of the Schedule, federal awards include all grants, contracts, and similar agreements entered into directly between the University and agencies and departments of the federal government and all sub-awards to the University by nonfederal organizations pursuant to federal grants, contracts, and similar agreements. The awards are classified into major program and nonmajor program categories in accordance with the provisions of OMB Circular A-133, *Audits of Institutions of States, Local Governments, and Non-Profit Organizations.* Such categories are as follows:

Major Programs

Research and Development – Includes awards for research and development activities at the University sponsored by various agencies of the federal government.

Student Financial Assistance – Includes certain awards to provide financial assistance to students, primarily under the Federal Work Study (FWS), Federal Pell Grant (Pell), and Federal Supplemental Educational Opportunity Grant (FSEOG) programs of the U.S. Department of Education. Also, the University receives awards to make loans to eligible students under the Federal Perkins Loan (Perkins) Program, and federally guaranteed loans are issued to students by the University under the Federal Family Education Loan Program (FFEL).

Nonmajor Programs

Other Federal Awards – Includes awards for program activities at the University sponsored by various agencies of the federal government.

Total expenditures per the Schedule do not directly agree to the revenue line items on the University's May 31, 2005 consolidated statement of activities. The federal expenditures are classified in the accompanying consolidated statement of activities as government grants and contracts revenue, totaling approximately $37,180,000. The remaining government grants and contracts consist of approximately $2,598,000 of awards received from states and other sources, with the balance of approximately $8,406,000 related to IIT Research Institute, a consolidated separate legal entity.

(b) Expenditure and Revenue Recognition

Expenditures are recognized as incurred and related revenue is recognized up to award amounts for financial statement and program reporting. Award reporting periods do not necessarily coincide with the fiscal reporting period of the University. The existence of certain credit balances on the Schedule is primarily due to the reclassification of expenditures incurred and related revenue recorded in the University's prior fiscal reporting period.

(c) Subrecipients

Certain funds are passed through to subrecipient organizations by the University. Expenditures reimbursed by the University are presented in the Schedule. See note 4 for a summary of payments made to subrecipients during the year ended May 31, 2006.

(d) Pass-Through Funds

The University is the subrecipient of federal funds from nonfederal organizations, which are reported on the Schedule as pass-through funds.

(2) Indirect Costs

The University has four-year predetermined fixed indirect cost rates, effective June 1, 2003 through May 31, 2007, which have been negotiated with its cognizant agency, the U.S. Department of Health and Human Services. The predetermined fixed rates were based on University financial information for fiscal year 2003. The base rates for on- and off-campus research were 50% and 24% of modified total direct costs, respectively. Approximately $2.9 million of indirect costs were reimbursed to the University for the year ended May 31, 2006.

(3) Federal Student Loan Programs

Loans made by the University to eligible students under federal student loan programs and federally guaranteed loans issued to students of the University by financial institutions during the fiscal year ended May 31, 2006, are summarized as follows:

Direct loan programs – Perkins	$	1,264,405
Guaranteed loan programs – Stafford and other		31,022,676
Total federal student loan programs	$	32,287,081

The Perkins program is administered directly by the University and balances and transactions relating to this program are included in the University's consolidated financial statements. The balance of loans outstanding under the Perkins program was $6,812,470 at May 31, 2006. The University received an administrative cost allowance of $132,559 under the Perkins program during the fiscal year ended May 31, 2006.

The University is responsible only for the performance of certain administrative duties with respect to the FFEL and, accordingly, these loans are not included in its financial statements, and it is not practical to determine the balance of loans outstanding to students and former students of the University under these programs at May 31, 2006.

(4) Summary of Subrecipient Payments

Expenditures made to subrecipients under federal awards for the year ended May 31, 2006, were as follows:

Major program – research and development cluster:		
Department of Defense	$	418,829
National Science Foundation		217,125
Environmental Protection Agency		1,145
Department of Energy		152,721
Department of Health and Human Services		994,222
Total major program		1,784,042
Nonmajor programs		695
Total	$	1,784,737

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

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
Illinois Institute of Technology:

We have audited the consolidated financial statements of Illinois Institute of Technology (the University) as of and for the years ended May 31, 2006 and 2005, and have issued our report thereon dated November 1, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

We noted certain matters that we reported to University management in separate letters dated November 1, 2006 and September 9, 2005.

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

KPMG LLP

November 1, 2006

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

Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133

The Board of Trustees
Illinois Institute of Technology:

Compliance

We have audited the compliance of Illinois Institute of Technology (the University) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement,* that are applicable to each of its major federal programs for the year ended May 31, 2006, except those requirements discussed in the fourth following paragraph. The University's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the University's management. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

The University's consolidated financial statements include the operations of IIT Research Institute, which received $8,406,000 in federal awards that are not included in the University's schedule of expenditures of federal awards for the year ended May 31, 2006. Our audit, described below, did not include the operations of IIT Research Institute because those awards will be audited separately.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial statement audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the University's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the University's compliance with those requirements.

In our opinion, the University complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended May 31, 2006, other than those requirements discussed in the following paragraph. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as findings 06-01, 06-02, 06-04, 06-05, and 06-06.

We did not audit the University's compliance with the requirements governing the billing, collection, and due diligence functions of the Federal Perkins Loan Program. Those requirements govern functions performed by Affiliated Computer Services, Inc. Education Services (ACS). Since we did not apply auditing procedures to satisfy ourselves as to compliance with those requirements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on compliance with those requirements.

ACS' compliance with the requirements governing the functions that it performs for the University was examined by other accountants whose report has been furnished to us. The report of the other accountants indicates that compliance with those requirements was examined in accordance with the Department of Education's Audit Guide, *Compliance Audits (Attestation Engagements) of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers.* Based on our review of the service organization accountants' report, we have determined that all of the compliance requirements included in the *OMB Circular A-133 Compliance Supplement* that are applicable to the major program in which the University participates are addressed in either our report or the report of the service organization accountants. Further, based on our review of the service organization accountants' report, we have determined that it does not contain any findings of noncompliance that would have a direct and material effect on the University's major programs.

Internal Control Over Compliance

The management of the University is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the University's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Requirements governing billing, collection, and due diligence functions of the Federal Perkins Loan Program are performed by ACS. Internal control over compliance relating to such functions was reported on by other accountants in accordance with the Department of Education's Audit Guide, *Compliance Audits (Attestation Engagements) of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers.* A copy of the service organization accountants' report has been furnished to us. However, the scope of our work did not extend to internal control maintained at ACS.

We noted certain matters involving internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over compliance that, in our judgment, could adversely affect the University's ability to administer a major program in accordance with the applicable laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-01, 06-02, 06-03, 06-04, 06-05, and 06-06.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

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

KPMG LLP

January 25, 2007

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Findings and Questioned Costs

Year ended May 31, 2006

(1) Summary of Auditors' Results

(a) The type of opinion issued on the consolidated financial statements:
Unqualified opinion

(b) Reportable conditions in internal control disclosed by the audit of the consolidated financial statements: **None reported**

Material weaknesses: **No**

(c) Noncompliance which is material to the consolidated financial statements: **No**

(d) Reportable conditions in internal control over major programs: **Yes**

Material weaknesses: **No**

(e) The type of report issued on compliance for major programs: **Unqualified opinion**

(f) Any audit findings which are required to be reported under Section 510(a) of OMB Circular A-133: **Yes**

(g) Major programs:
Student Financial Assistance Cluster – various CFDA numbers
Research and Development Cluster – various CFDA numbers

(h) Dollar threshold used to distinguish between Type A and Type B programs: **$690,010**

(i) Auditee qualified as a low-risk auditee under Section 530 of OMB Circular A-133: **Yes**

(2) Findings relating to the financial statements reported in accordance with *Government Auditing Standards:* None

(3) Findings and questioned costs relating to federal awards

Federal Agency: U.S. Department of Agriculture (USDA)
U.S. Department of Defense (USDOD)
U.S. Department of Labor (USDOL)
U.S. Department of Transportation (USDOT)
U.S. Department of State (USDOS)
U.S. Department of the Treasury (UST)
National Aeronautics and Space Administration (NASA)
National Science Foundation (NSF)
U.S. Small Business Administration (SBA)
U.S. Environmental Protection Agency (USEPA)
U.S. Department of Energy (USDOE)
U.S. Department of Health and Human Services (USDHHS)
Corporation for National and Community Service (CNCS)
U.S. Agency for International Development (USAID)

Program Name: Research and Development Cluster

CFDA Numbers and Program Expenditures: Various ($19,706,356)

Award Numbers: Various

Questioned Costs: None

Finding 06-01 – ***Allowable Costs – Effort Reporting***

Requirement

OMB Circular A-21, *Cost Principles for Educational Institutions,* requires that the allocation of salaries and wages to federal contracts be supported by personnel activity reports which include the following:

1. Personnel activity reports will reflect the distribution of activity expended by each employee covered by the system.

2. The reports will reflect an after-the-fact reporting of the percentage of activity of each employee. Charges may be made initially on the basis of estimates made before services are performed, provided that such charges are promptly adjusted if significant differences are indicated by activity reports.

3. Each report will account for 100% of the activity which is required in fulfillment of the employee's obligations to the institution for which the employee is compensated. The report will reasonably reflect the percentage of activity applicable to each sponsored agreement, each indirect cost category, and each major function of the institution.

4. To confirm that the distribution of activity represents a reasonable estimate of the work performed by the employee during the period, each report will be signed by the employee or by a responsible official having first-hand knowledge of the work performed.

For professional staff, the reports will be prepared each academic term, but no less frequently than every six months. For other individuals, the reports will be prepared not less frequently than monthly and will coincide with one or more pay periods. The salary and wage costs allocated are required to be based on payrolls documented in accordance with generally accepted practices of colleges and universities.

Additionally, OMB Circular A-110 requires nonfederal entities receiving federal awards establish and maintain internal control designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements. Effective internal controls should include establishing procedures to ensure payroll and fringe benefit expenditures charged to federal programs are adequately supported.

Condition Found

During our testwork over 50 payroll and fringe benefit expenditures (totaling $228,736) charged to research and development grants during the year ended May 31, 2006, we identified signed effort reports for two employees could not be located for our testwork, and as a result, an after-the-fact activity report did not exist to support these payroll expenditures. However, subsequent to our testwork, a signed effort report was obtained. Amounts claimed for reimbursement for these individuals in the affected period totaled $9,390.

Effect

Failure to properly document expenditures in accordance with the applicable cost principles may result in unallowable costs being charged to federal programs.

Recommendation

We recommend the University review its process for documenting payroll and fringe benefit expenditures and implement any procedures necessary to ensure adequate supporting documentation exists for all federal expenditures.

Management's Response

The University will review the process for documenting payroll and fringe benefit expenditures and implement necessary procedures to ensure adequate supporting documentation exists.

(Continued)

Federal Agency:	U.S. Department of Agriculture (USDA) U.S. Department of Defense (USDOD) U.S. Department of Labor (USDOL) U.S. Department of Transportation (USDOT) U.S. Department of State (USDOS) U.S. Department of the Treasury (UST) National Aeronautics and Space Administration (NASA) National Science Foundation (NSF) U.S. Small Business Administration (SBA) U.S. Environmental Protection Agency (USEPA) U.S. Department of Energy (USDOE) U.S. Department of Health and Human Services (USDHHS) Corporation for National and Community Service (CNCS) U.S. Agency for International Development (USAID)
Program Name:	Research and Development Cluster

CFDA Numbers and Program Expenditures: Various ($19,706,356)

Award Numbers:	FD-U-000431-17-2 FD-U-00431-18-1

Questioned Costs: $2,357

Finding 06-02 – ***Allowable Costs – Car Rental***

Requirement

OMB Circular A-21, *Cost Principles for Educational Institutions*, Section J(8)(g) states that the portion of the cost of institution-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees.

Additionally, OMB Circular A-110 requires nonfederal entities receiving federal awards establish and maintain internal control designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements. Effective internal controls should include establishing procedures to ensure payroll and fringe benefit expenditures charged to federal programs are adequately supported.

Condition Found

During our testwork over 40 other than personal services expenditures (totaling $484,259) charged to research and development projects during the year ended May 31, 2006, we identified one expenditure for car rental charges for an employee that had relocated to the University and worked on the affected grant during the audit period. The car rental expenditure was incurred to provide the employee a means of transportation for the period from March 26, 2006 through May 1, 2006. As the rental car was for the employee's personal use and transportation to and from work, the cost is not an allowable cost under OMB Circular A-21. Car rental expenditures claimed for reimbursement relative to this individual totaled $2,357 during the year ended May 31, 2006.

Effect

Failure to properly determine the allowability of costs in accordance with program regulations may result in costs inconsistent with program objectives being claimed to federal programs.

Recommendation

We recommend the University implement procedures to ensure expenditures are allowable prior to requesting reimbursement from its federal programs.

Management's Response

The University will implement procedures to ensure expenditures are allowable prior to requesting reimbursement from its federal program. The car rental expense claimed for reimbursement was $2,357. The grant will be reimbursed that amount. The car rental expenditure was viewed mistakenly as an allowable relocation expense. The Grant and Contract Accounting staff have been educated to better monitor this type of expense in the future.

(Continued)

Federal Agency:	U.S. Department of Agriculture (USDA) U.S. Department of Defense (USDOD) U.S. Department of Labor (USDOL) U.S. Department of Transportation (USDOT) U.S. Department of State (USDOS) U.S. Department of the Treasury (UST) National Aeronautics and Space Administration (NASA) National Science Foundation (NSF) U.S. Small Business Administration (SBA) U.S. Environmental Protection Agency (USEPA) U.S. Department of Energy (USDOE) U.S. Department of Health and Human Services (USDHHS) Corporation for National and Community Service (CNCS) U.S. Agency for International Development (USAID)
Program Name:	Research and Development Cluster

CFDA Numbers and Program Expenditures: Various ($19,706,356)

Award Numbers: Various

Questioned Costs: None

Finding 06-03 – *Cash Management*

Requirement

OMB Circular A-110 requires nonfederal entities receiving federal awards establish and maintain internal control designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements. Effective internal controls should include formally documenting the review and approval of cash draws.

Condition Found

During our testwork over 10 of 38 cash draws (representing 45% of amounts drawn) performed for research and development grants and contracts during the year ended May 31, 2006, we noted three cash draws tested did not contain evidence that a supervisory review had been performed by Project Accounting personnel. Each of these draw calculations appear to have been accurately performed.

Effect

Failure to document supervisory reviews of cash draw calculations may result in unapproved and inaccurate cash draw calculations leading to noncompliance with cash management regulations.

Recommendation

We recommend the University ensure the review and approval of cash draw calculations is documented.

(Continued)

Management's Response

The University agrees that the cash draw calculations should be consistently reviewed by management. All three cash draws were reviewed but the evidence of the review could not be located. The filing system of all the cash draw documents has been reorganized to assist in document retrieval.

Federal Agency:	U.S. Department of Agriculture (USDA) U.S. Department of Defense (USDOD) U.S. Department of Labor (USDOL) U.S. Department of Transportation (USDOT) U.S. Department of State (USDOS) U.S. Department of the Treasury (UST) National Aeronautics and Space Administration (NASA) National Science Foundation (NSF) U.S. Small Business Administration (SBA) U.S. Environmental Protection Agency (USEPA) U.S. Department of Energy (USDOE) US Department of Health and Human Services (USDHHS) Corporation for National and Community Service (CNCS) U.S. Agency for International Development (USAID)
Program Name:	Research and Development Cluster

CFDA Numbers and Program Expenditures: Various ($19,706,356)

Award Numbers: Various

Questioned Costs: None

Finding 06-04 – *Financial Reporting*

Requirement

45 CFR 74.52(2) requires recipients of federal funds to submit Payment Management System Standard Form 272 (PMS-272) reports within 15 calendar days following the end of each quarter.

Condition Found

During our testwork over financial reports relative to the Research and Development Cluster, we noted the quarterly PMS-272 financial reports required for Research and Development grants from the United States Department of Health and Human Services (USDHHS) was not completed by the University for the March 31, 2006 quarter. Management indicated the reports are required to be filed electronically within a specified timeframe. As the financial reports were not completed within the required timeframe, the University reported the March 31, 2006 financial information on the next quarterly report. Management indicated USDHHS agreed to allow the University to report the March 31, 2006 financial information on the June 30, 2006 quarterly report; however, formal documentation supporting USDHHS' approval could not be provided.

Effect

Failure to complete and file required financial reports for the research and development grant prohibits the federal agency from monitoring the University's progress on its federal grants.

(Continued)

Recommendation

We recommend the University implement procedures to ensure required financial reports are completed and filed within the appropriate timeframe.

Management's Response

The University agrees that USDHHS financial reports are to be completed and filed within the appropriate timeframe. A verbal confirmation was granted by USDHHS in which the March 31, 2006 quarterly report was allowed to be included with the June 30, 2006 quarterly report. In order to ensure timely financial reporting additional staff have been added to the Grant and Contract Accounting office.

Federal Agency: U.S. Department of Education (USDE)

Program Name: Student Financial Assistance Cluster – Federal Family Education Program (FFEL)

CFDA Numbers and Program Expenditures: 84.032 ($31,022,676)

Award Numbers: None

Questioned Costs: None

Finding 06-05 – *Student Status Changes*

Requirement

In accordance with 34 CFR Section 682.10, the University is required to notify National Student Loan Data System (NSLDS) of changes in a student's status within 30 days of discovering the change, unless the University expects to complete its next roster file within 60 days.

Additionally, OMB Circular A-110 requires nonfederal entities receiving federal awards establish and maintain internal control designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements. Effective internal controls should include establishing a reporting schedule to ensure student status change submissions comply with federally prescribed timeframes.

Condition Found

During our testwork over 50 FFEL borrowers that graduated, withdrew, or dropped out during the fiscal year, we noted the following:

- Eight status changes were not submitted to NSLDS within the required timeframes. The delay in reporting these status changes ranged from 34 to 95 days.
- One status change for one of the 22 graduated students selected for testwork was inaccurately reported to NSLDS as withdrawn status (W) rather than as graduated status (G).

Effect

Failure to accurately report student status changes to NSLDS in a timely manner may result in FFEL borrowers not entering repayment status at the appropriate time.

Recommendation

We recommend the University revise its schedule for reporting student status changes to ensure status changes are submitted within the required timeframes. In addition, the University should implement procedures to ensure the status of graduated students is accurately reported.

(Continued)

Management's Response

Management has changed the timing on running reports for student status changes to ensure more timely recognition and reporting of changes. Special care is taken to ensure that the correct status – withdrawn status or graduation is noted. Management will continue efforts to improve this process.

Federal Agency: U.S. Department of Education (USDE)

Program Name: Student Financial Assistance Cluster – Federal Pell Grant Program

CFDA Numbers and Program Expenditures: 84.063 ($1,311,532)

Award Numbers: None

Questioned Costs: None

Finding 06-06 – *Pell Payment Data Reporting*

Requirement

According to Volume 3, Chapter 3 of the U.S. Department of Education's (USDE) Federal Student Aid Handbook, a school must submit a disbursement record within 30 days of the date the school becomes aware of a Pell change (i.e. a new recipient or an increased award). Schools may report once every 30 calendar days, or may set up their own system to ensure that changes are reported in a timely manner.

Additionally, OMB Circular A-110 requires nonfederal entities receiving federal awards establish and maintain internal control designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements. Effective internal controls should include establishing a reporting schedule to ensure student status change submissions comply with federally prescribed timeframes.

Condition Found

In our sample of 50 Pell recipients, we noted two disbursements of Pell funds selected for testwork were not reported to USDE via the Pell Payment Data report within 30 calendar days of disbursement. Based upon further investigation, it was determined that these two Pell disbursements were never reported to the USDE. Upon the reconciliation of Pell disbursements recorded in the general ledger during the year ended May 31, 2006 to the Pell Payment Data reports filed for that same period, we noted a total of ten Pell disbursements recorded in the general ledger were not reported to USDE.

Effect

Failure to report the required records may result in a reduction in the University's Pell allocation or a fine from the Department of Education.

Recommendation

We recommend the University review its current procedures for reporting Pell disbursements to the Department of Education and revise such procedures to ensure Pell Payment Data submitted to the USDE is complete and accurate.

Management's Response

We concur with the recommendation that we review current procedures for reporting Pell disbursements. An additional step in the review process was added to ensure all students are included in the Pell Payment Data file.