ILLINOIS INSTITUTE OF TECHNOLOGY

OMB Circular A-133 Audit Report

Year ended May 31, 2010

(With Independent Auditors’ Reports 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, 2010 and 2009, 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 audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 audit provides 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, 2010 and 2009, 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.

As described in note 2 to the consolidated financial statements, the University adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Section 958, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*, effective June 30, 2009.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 12, 2010 on our consideration of 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 audit.

KPMG LLP

October 12, 2010

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statements of Financial Position

May 31, 2010 and 2009

(In thousands of dollars)

Assets		**2010**	**2009**
Cash	$	3,040	2,839
Bond proceeds held by trustees		16,130	2,174
Notes and accounts receivable:			
Grants and contracts, less allowance of $297 in 2010 and $347 in 2009		8,118	8,945
Students:			
Tuition, less allowance of $3,302 in 2010 and $654 in 2009		7,610	9,882
Notes, less allowance of $532 in 2010 and $373 in 2009		11,598	11,352
Pledges, less allowance of $218 in 2010 and $232 in 2009 (note 5)		20,047	14,226
Other		3,495	2,257
Inventories, prepaid expenses, and deferred charges		3,822	2,320
Investments (note 4)		176,609	177,424
Physical properties, less accumulated depreciation (note 6)		270,897	275,185
Beneficial interest in perpetual trusts (note 7)		18,688	17,213
Total assets	$	540,054	523,817
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued expenses	$	21,583	20,095
Accrued salaries and wages		14,719	17,165
Deferred revenue		17,932	15,531
Deposits by students and others		3,383	2,228
Accrued postretirement benefit obligation (note 9)		2,068	1,661
Obligation under split-interest agreements		1,408	1,308
Notes and bonds payable (note 8)		222,315	208,740
Advances from the U.S. government for student loans		8,117	8,094
Asset retirement obligation		6,778	9,243
Total liabilities		298,303	284,065
Net assets (note 12):			
Unrestricted		36,365	49,504
Temporarily restricted		33,539	18,855
Permanently restricted		171,847	171,393
Total net assets		241,751	239,752
Total liabilities and net assets	$	540,054	523,817

See accompanying notes to consolidated financial statements.

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statement of Activities

Year ended May 31, 2010

(In thousands of dollars)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Operating revenue:				
Tuition and fees, net of scholarships of $56,807	$ 112,312	—	—	112,312
Government grants and contracts	49,621	—	—	49,621
Private grants and contracts	6,149	—	—	6,149
Private gifts	6,224	10,606	—	16,830
Endowment spending distribution (note 13)	17,046	—	—	17,046
Sales and services of auxiliary enterprises	12,556	—	—	12,556
Other sources	12,977	—	—	12,977
Net assets released from restrictions	2,934	(2,934)	—	—
Total operating revenue	219,819	7,672	—	227,491
Operating expenses:				
Faculty salaries	48,573	—	—	48,573
Administrative salaries	43,663	—	—	43,663
Part-time salaries	14,860	—	—	14,860
Employee benefits	21,744	—	—	21,744
Operations and maintenance	22,315	—	—	22,315
Supplies and services	43,067	—	—	43,067
Professional fees and advertising	13,124	—	—	13,124
IITRI research	12,467	—	—	12,467
Interest on indebtedness	10,137	—	—	10,137
Depreciation	14,823	—	—	14,823
Total operating expenses	244,773	—	—	244,773
Increase (decrease) in net assets from operating activities	(24,954)	7,672	—	(17,282)
Nonoperating revenue and expenses:				
Private gifts	—	—	4,428	4,428
Release of net assets restricted for capital	954	(954)	—	—
Net asset reclassification (note 2)	5,428	—	(5,428)	—
Net gain on investments (note 4)	22,117	—	1,454	23,571
Endowment spending distribution (note 13)	(17,046)	—	—	(17,046)
Endowment income (note 4)	3,954	—	—	3,954
Net loss on disposal of assets	(237)	—	—	(237)
Asset retirement obligation	2,343	—	—	2,343
Other	2,268	—	—	2,268
Increase (decrease) in net assets from nonoperating activities	19,781	(954)	454	19,281
Increase (decrease) in net assets before endowment net asset reclassification	(5,173)	6,718	454	1,999
Endowment net asset reclassification (note 13)	(7,966)	7,966	—	—
Increase (decrease) in net assets	(13,139)	14,684	454	1,999
Net assets at beginning of year	49,504	18,855	171,393	239,752
Net assets at end of year	$ 36,365	33,539	171,847	241,751

See accompanying notes to consolidated financial statements.

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statement of Activities

Year ended May 31, 2009

(In thousands of dollars)

		Unrestricted	Temporarily restricted	Permanently restricted	Total
Operating revenue:					
Tuition and fees, net of scholarships of $52,708	$	102,456	—	—	102,456
Government grants and contracts		39,464	—	—	39,464
Private grants and contracts		13,218	—	—	13,218
Private gifts		7,353	1,251	—	8,604
Endowment spending distribution (note 13)		15,986	—	—	15,986
Sales and services of auxiliary enterprises		12,060	—	—	12,060
Other sources		16,006	—	—	16,006
Net assets released from restrictions		6,162	(6,162)	—	—
Total operating revenue		212,705	(4,911)	—	207,794
Operating expenses:					
Faculty salaries		49,309	—	—	49,309
Administrative salaries		44,016	—	—	44,016
Part-time salaries		14,751	—	—	14,751
Employee benefits		21,071	—	—	21,071
Operations and maintenance		23,193	—	—	23,193
Supplies and services		33,251	—	—	33,251
Professional fees and advertising		13,196	—	—	13,196
IITRI research		14,497	—	—	14,497
Interest on indebtedness		9,447	—	—	9,447
Depreciation		15,127	—	—	15,127
Total operating expenses		237,858	—	—	237,858
Decrease in net assets from operating activities		(25,153)	(4,911)	—	(30,064)
Nonoperating revenue and expenses:					
Private gifts		—	—	9,932	9,932
Net loss on investments (note 4)		(96,182)	—	(4,623)	(100,805)
Net loss on impairment of asset		(1,900)	—	—	(1,900)
Endowment spending distribution (note 13)		(15,986)	—	—	(15,986)
Endowment income (note 4)		4,813	—	—	4,813
Net loss on disposal of assets		(180)	—	—	(180)
Asset retirement obligation accretion		(248)	—	—	(248)
Other		108	—	—	108
Decrease in net assets from nonoperating activities		(109,575)	—	5,309	(104,266)
Decrease in net assets		(134,728)	(4,911)	5,309	(134,330)
Net assets at beginning of year		184,232	23,766	166,084	374,082
Net assets at end of year	$	49,504	18,855	171,393	239,752

See accompanying notes to consolidated financial statements.

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statements of Cash Flows

Years ended May 31, 2010 and 2009

(In thousands of dollars)

		2010	2009
Cash flows from operating activities:			
Increase (decrease) in net assets	$	1,999	(134,330)
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities:			
Private gifts restricted for long-term investment		(4,428)	(9,932)
Depreciation		14,823	15,127
(Gain) loss on beneficial interest in perpetual trusts		(1,475)	4,623
Contribution of fixed assets		(1,000)	—
Net loss on disposal of assets		237	180
Loss on impairment of asset		—	1,900
Net (gain) loss on investments		(22,096)	111,978
Accretion on asset retirement obligation		341	248
Changes in assets and liabilities:			
Receivables: tuition, grants, pledges, affiliate and other		(3,960)	575
Inventories, prepaid expenses, and deferred charges		(1,502)	(8)
Accounts payable and accrued expenses		1,488	(339)
Accrued salaries and wages		(2,446)	263
Deferred revenue		2,401	(4,526)
Deposits by students and others		1,155	(179)
Accrued postretirement benefit obligation		407	199
Obligations under split-interest agreements		100	209
Advances from U.S. government for student loans		23	—
Asset retirement obligation		(2,806)	(38)
Net cash used in operating activities		(16,739)	(14,050)
Cash flows from investing activities:			
Proceeds from sale of investments		169,683	133,505
Purchase of investments		(146,772)	(129,449)
Change in bond proceeds held by trustees		(13,956)	4,806
Purchase of physical properties		(9,772)	(24,002)
Issuance of notes receivable		(1,253)	(2,346)
Payments received on notes receivable		1,007	1,405
Net cash used in investing activities		(1,063)	(16,081)
Cash flows from financing activities:			
Private gifts restricted for long-term investment		4,428	9,932
Payments on notes and bonds payable		(925)	(1,151)
Payments on borrowings under line of credit		(15,500)	—
Proceeds from borrowings under line of credit		—	22,000
Proceeds from issuance of bonds payable		30,000	—
Net cash provided by financing activities		18,003	30,781
Increase in cash		201	650
Cash at:			
Beginning of year		2,839	2,189
End of year	$	3,040	2,839
Supplemental disclosure of cash flow information:			
Cash paid for interest	$	8,246	8,801

See accompanying notes to consolidated financial statements.

(1) Nature of Organization

(a) Illinois Institute of Technology

Illinois Institute of Technology (the University) is a private not-for-profit coeducational technical 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 entity headquartered in Bangalore, India. The entity has been created to facilitate IIT's ability to deliver long distance internet-based educational programs to residents of various cities in India.

IIT France is a private not-for-profit entity located in Paris, France. The entity has been created to promote French and European students to the programs of the University and to welcome visiting students from the University.

(b) IIT Research Institute

IIT Research Institute (IITRI) is a not-for-profit 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 are members of the IITRI corporation. Four officers of the University serve ex officio as members of the IITRI 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 consolidated 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.

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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 consolidated statements of activities reflect all transaction increasing or decreasing unrestricted net assets except those items associated with long-term investment, and other infrequent gains, losses, revenues, and expenses.

(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) is reported as reclassifications between applicable classes of net assets. During 2010, the University reclassified to unrestricted net assets, $5,428 of loan funds that were previously reported as permanently restricted 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 fund-raising activity.

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, are 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 is 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, 2010 and 2009, these governmental clients accounted for approximately 84% and 52%, respectively, of IITRI's operating revenue of $12,380 and $16,473, respectively. In addition, IITRI had one significant industrial customer, comprising of approximately 20%, respectively, of their contract revenue in 2009. During 2010, IITRI discontinued the research programs conducted for the significant customer. Included in IITRI's revenue for 2010 and 2009 and accounts receivable at May 31, 2010 and 2009 are unbilled receivables in the amounts of approximately $1,464 and $1,916, 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.

(e) Investments

Investments are reported at fair value. The fair values of investments in stocks, equity mutual funds, bonds and fixed income mutual funds are generally determined based on quoted market prices. 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 fund investments is determined based on net asset values 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.

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. During fiscal year 2010, the University received $25,000 from Alion for the outstanding notes receivable and detachable stock warrants.

(f) Notes Receivable

Student notes receivable consist primarily of Perkins loans, the Illinois Student Assistance Commission Federal Family Educational Loan program, and University loans. The University establishes valuation allowances for notes receivable based on estimates of future collectibility.

(g) Inventory

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

(h) Physical Properties

The University's and IITRI's fixed assets are recorded at cost of construction or acquisition. The University and IITRI depreciate their 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.

(i) Impairment of Long-Lived Assets

The University and IITRI account for long-lived assets in accordance with the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Section 360 Subtopic 10, *Impairment or Disposal of Long-lived Assets*. FASB ASC Section 360 Subtopic 10 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.

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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.

(j) Beneficial Interest in Perpetual Trusts

The University has a beneficial interest in certain perpetual trusts that 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.

(k) 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.

(l) 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.

Management has included a provision for income taxes on unrelated business income related to the University's interest in certain partnership investments. The unrelated business income liability at May 31, 2010 of $23,600 is reported in accounts payable and accrued expenses.

(m) Use of Estimates

The preparation of consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

(n) New Accounting Pronouncements

On June 1, 2009, the University adopted FASB ASC Section 855, *Subsequent Events*. FASB ASC 855 requires the University to establish general standards of accounting for the disclosure of events that occur after the balance sheet date but before consolidated financial statements are issued. This includes disclosing the date through which subsequent events have been evaluated, as well as whether that date is the date the consolidated financial statements were issued or the date the consolidated financial statements were available to be issued. The University has included this required disclosure within note 17.

On June 30, 2009, the University adopted the net asset classification for the FASB ASC Section 958, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*. The ASC 958 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). The University adopted the required FASB ASC 958 endowment disclosures fiscal year 2009 consolidated financial statements. The University has included this required disclosure within note 13.

(3) Fair Value Measurement

FASB ASC Section 820, *Fair Value Measurements and Disclosures*, defines fair value as the price that could be received for an asset or paid to transfer a liability in the University's principal or most advantageous market of the asset or liability in an orderly transaction between market participants on the measurement date.

FASB ASC Section 820 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private debt and equity instruments and alternative investments.

In many cases, a valuation technique used to measure fair value includes inputs from multiple levels of the fair value hierarchy. The lowest level of significant input determines the placement of the entire fair value measurement in the hierarchy. The University uses the following valuation techniques to measure the investments fair value:

Level 1 consists of financial instruments, such as cash and cash equivalents, bond proceeds, mutual funds, stocks and money market funds whose value is based on quoted market prices published by a financial institution, exchange fund, exchange-trade instruments and listed equities.

Level 3 consists of investments for which there are no active markets. The University has the real estate investments, equity mutual funds and private equity funds as Level 3. The real estate investment is valued at the net present value of the projected cash flow from the investment. The University's interests in alternative investment funds such as equity mutual funds and private equity funds, are generally reported at the net asset value (NAV), which is used as a practical expedient to estimate fair value, unless it is probably that all or a portion of the investment will be sold for an amount different from NAV. As of May 31, 2010 and 2009, the University had no plans to sell investments at amounts different from NAV. Beneficial interests in perpetual trusts are held by various financial institutions. These values are based on the University's proportionate share of the investments. The fair values are based on quoted market prices published by financial institutions.

The University has $18,970 of investments in alternative investment funds, which are reported at fair value. For $18,970 of those investments, the University has concluded that the net asset value reported by the underlying fund approximates the fair value of the investment. These investments are redeemable with the fund at net asset value under the original terms of the partnership agreements and/or subscription agreements and operations of the underlying funds. However, it is possible that these redemption rights may be restricted or eliminated by the funds in the future in accordance with the underlying fund agreements. Due to the nature of the investments held by the funds, changes in market conditions and the economic environment may significantly impact the net asset value of the funds and, consequently, the fair value of the University's interests in the funds. Furthermore, changes to the liquidity provisions of the funds may significantly impact the fair value of the University's interest in the funds.

Although a secondary market exists for these investments, it is not active and individual transactions are typically not observable. When transactions occur in this limited secondary market, they may occur at discounts to the reported net asset value. Therefore, if the redemption rights in the funds were restricted or eliminated and the University were to sell these investments in the secondary market, it is reasonably possible that a buyer in the secondary market may require a discount to the reported net asset value, and the discount could be significant.

(Continued)

(In thousands of dollars)

Assets Measured on a Recurring Basis

The following table presents information about the University's financial assets that are measured at the fair value of the recurring basis as of May 31, 2010 and 2009, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

	2010				Redemption	Days'
	Level 1	**Level 2**	**Level 3**	**Total**	**or liquidation**	**notice**
Investments:						
Cash and cash equivalents	33,633	—	—	33,633	Daily	One
Total	33,633	—	—	33,633		
Domestic equities:						
Fixed income	20,076	—	—	20,076	Daily	One
Large Cap Equity	36,217	—	—	36,217	Daily	One
Tactical opportunities	16,573	—	—	16,573	Daily	One
Small Cap	3,207	—	—	3,207	Daily	One
Total	76,073	—	—	76,073		
Global (ex-U.S.) equities:						
Developed international equity	35,683	—	—	35,683	Daily	One
Hedged equity funds of funds:						
Multiple strategies total return	—	—	8,117	8,117	Locked-up(1)	60
Multiple strategies – absolute return	—	—	3,106	3,106	Locked-up(1)	60
Total	—	—	11,223	11,223		
Private equity and venture capital funds:						
Commondfund Capital International	—	—	1,643	1,643	None	N/A
Commondfund Capital Venture	—	—	2,068	2,068	None	N/A
Commondfund Capital Private Equity	—	—	3,406	3,406	None	N/A
Roundtable			630	630	None	N/A
Total	—	—	7,747	7,747		
Real assets:						
IITRI Tower	—	—	4,227	4,227	Illiquid (2)	N/A
Total	—	—	4,227	4,227		
Other securities:						
Fixed income (IITRI)	7,774	—	—	7,774	Daily	One
Domestic equities	249	—	—	249	Daily	One
Total	8,023	—	—	8,023		
Other assets:						
Bond proceeds	16,130	—	—	16,130	Daily	One
Perpetual trusts	—	—	18,688	18,688	None	N/A
Total	16,130	—	18,688	34,818		
Total	$ 169,542	—	41,885	211,427		

(1) 1 year from the initial investment.
(2) Real Estate property owned by endowment

(In thousands of dollars)

	2009				Redemption	Days’
	Level 1	Level 2	Level 3	Total	or liquidation	notice
Investments:						
Cash and cash equivalents	27,640	—	—	27,640	Daily	One
Total	27,640	—	—	27,640		
Domestic equities:						
Fixed income	21,860	—	—	21,860	Daily	One
Large Cap Equity	45,889	—	—	45,889	Daily	One
Tactical opportunities	1,993	—	—	1,993	Daily	One
Small Cap	8,178	—	—	8,178	Daily	One
Total	77,920	—	—	77,920		
Global (ex-U.S.) equities:						
Developed international equity	19,362	—	—	19,362	Daily	One
Hedged equity funds of funds:						
Multiple strategies total return	—	—	11,608	11,608	Locked-up(1)	60
Multiple strategies – absolute return	—	—	4,912	4,912	Locked-up(1)	60
Total	—	—	16,520	16,520		
Private equity and venture capital funds:						
Commondfund Capital International	—	—	1,266	1,266	None	N/A
Commondfund Capital Venture	—	—	1,854	1,854	None	N/A
Commondfund Capital Private Equity	—	—	2,773	2,773	None	N/A
Roundtable			759	759	None	N/A
Total	—	—	6,652	6,652		
Real assets:						
IITRI Tower	—	—	8,348	8,348	Illiquid (2)	N/A
Alion notes and warrants	—	—	12,003	12,003	Illiquid (3)	N/A
Total	—	—	20,351	20,351		
Other securities:						
Fixed income (IIITRI)	8,834	—	—	8,834	Daily	One
Domestic equities	145	—	—	145	Daily	One
Total	8,979	—	—	8,979		
Other assets:						
Bond proceeds	2,174	—	—	2,174		
Perpetual trusts	—	—	17,213	17,213	None	N/A
Total	2,174	—	17,213	19,387		
Total	$ 136,075	—	60,736	196,811		

(1) 1 year from the initial investment.
(2) Real Estate property owned by endowment
(3) Investment redeemed in 2010

(In thousands of dollars)

Aggregate investment liquidity as of May 31, 2010 and 2009, is presented below based on redemption or sale period:

	2010	2009
Investment redemption or sale period:		
Daily	$ 153,412	133,901
Subject to rolling lock-ups	11,223	16,520
Illiquid	4,227	20,351
Redemptions not permitted	7,747	6,652
Totals	$ 176,609	177,424

The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended May 31, 2010 and 2009:

	Alion notes and warrants	Real estate	Equity mutual funds	Private equity funds	Beneficial interest in perpetual trusts	Total
Beginning balance, June 1, 2009	$ 12,003	8,348	16,520	6,652	17,213	60,736
Net realized and unrealized gains/(losses)	12,997	(4,121)	(5,297)	1,095	1,475	6,149
Purchases, issuances, and settlements	(25,000)	—	—	—	—	(25,000)
Transfers in (out) of Level 3	—	—	—	—	—	—
Ending balance, May 31, 2010	$ —	4,227	11,223	7,747	18,688	41,885
The amount of total gains or losses for the period included in net return on investments attributable to the change in unrealized gains or losses relating to assets still held at May 31, 2010	$ 12,997	(4,121)	(5,297)	1,095	1,475	6,149

(In thousands of dollars)

		Alion notes and warrants	Real estate	Equity mutual funds	Private equity funds	Beneficial interest in perpetual trusts	Total
Beginning balance, June 1, 2008	$	52,995	14,412	30,906	8,100	21,836	128,249
Net realized and unrealized losses		(40,992)	(6,064)	(14,386)	(1,448)	(4,623)	(67,513)
Purchases, issuances, and settlements		—	—	—	—	—	—
Transfers in (out) of Level 3		—	—	—	—	—	—
Ending balance, May 31, 2009	$	12,003	8,348	16,520	6,652	17,213	60,736
The amount of total gains or losses for the period included in net return on investments attributable to the change in unrealized gains or losses relating to assets still held at May 31, 2009	$	(40,992)	(6,064)	(1,759)	(1,693)	(4,623)	(55,131)

(4) Investments

Investments consist of the following at May 31:

		2010		2009	
		Cost	Fair value	Cost	Fair value
Cash equivalents	$	33,632	33,633	27,636	27,640
Stocks		219	249	131	145
Equity mutual funds		96,190	87,296	133,585	94,440
Bonds (IITRI)		7,498	7,774	8,682	8,834
Fixed income mutual funds		35,430	35,683	21,691	19,362
Private equity funds		6,418	7,747	6,450	6,652
Real estate		13,803	4,227	13,803	8,348
Alion notes and warrants		—	—	32,202	12,003
Total investments	$	193,190	176,609	244,180	177,424

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.

(In thousands of dollars)

Return on investments consists of the following for the years ended May 31:

		2010	2009
Return on investments:			
Interest and dividends	$	3,954	4,813
Net realized loss on sale of investments		74,096	(54,384)
Net unrealized loss on investments		(50,525)	(46,421)
Net return on investments	$	27,525	(95,992)

The return on investments reflects income from investments held by IITRI of $475 and $505 for 2010 and 2009, respectively.

(5) Pledges Receivable

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

		2010	2009
Pledges receivable	$	23,077	17,325
Allowance for uncollectible pledges		(218)	(232)
Discount to present value future cash flows		(2,812)	(2,867)
Net pledges receivable	$	20,047	14,226

The following is a summary showing the expected timing of collection of total gross unconditional pledges receivable outstanding as of May 31, 2010:

Fiscal year(s)		Amount
2011	$	12,512
2012 through 2016		10,179
2017 and thereafter		386
	$	23,077

(In thousands of dollars)

(6) Physical Properties

The University's consolidated physical properties consisted of the following as of May 31:

		2010	2009
Land and land improvements	$	30,039	30,039
Building and building improvements		349,047	342,587
Equipment and library collection		89,801	90,904
Construction in progress		10,406	9,173
Total physical properties		479,293	472,703
Less accumulated depreciation		208,396	197,518
Physical properties, net	$	270,897	275,185

During 2009, in accordance with FASB ASC Section 360 Subtopic 10, *Impairment or Disposal of Long Lived Assets*, the University recorded an impairment of the land parcel for $1,900 and an expense on the consolidated statement of activities in nonoperating revenue and expenses. At May 31, 2010, the land parcel was valued at $5,900.

(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, 2010 and 2009, the share of these trusts from which the University derives income had a combined fair value of $18,688 and $17,213, respectively. These trusts provided unrestricted income of $400 and $459 in fiscal 2010 and 2009, respectively.

(8) Notes and Bonds Payable

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

	Interest rate		2010	2009
University:				
IFA Bonds, Series 2006, payable in varying installments through 2036	5.0% and 6.10%	$	160,000	160,000
IFA Bonds, Series 2009, payable in varying installments through 2034	4.75% to 7.125%		30,000	—
City of Chicago Energy Loan	Interest free		—	150
IITRI – IFA Series 2004, payable in varying installments through 2034	Variable		15,315	16,090
Short-term line of credit	Various		17,000	32,500
Total notes and bonds payable		$	222,315	208,740

(In thousands of dollars)

The following is a summary of required principal payments on outstanding secured obligations as of May 31, 2010:

Fiscal year ending:		
2011	$	17,810
2012		845
2013		1,545
2014		4,695
2015		4,960
2016 and beyond		192,460
Total notes and bonds payable	$	222,315

In March 2006, the University issued $160,000 in fixed rate revenue bonds through the Illinois Finance Authority consisting of $153,600 (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 and 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.

In July 2009, The University issued $30,000 in fixed rate revenue bonds through the Illinois Finance Authority consisting of $30,000 (IFA Series 2009). Proceeds from the bonds were used to finance a portion of the costs of the renovation of the educational facilities of the University, establish a debt service reserve fund and pay certain costs incurred in connection with the bond issue. The fixed rates on the Series 2009 Bonds are 4.75% and 5.52% serial bonds maturing in February 2013 and 2014 and 6.25%, 6.50% and 7.125% term bonds maturing in February 1, 2019, 2023 and 2034.

In August 2004, IITRI sold an $18,820 bond issue of adjustable rate demand debt under the tax-exempt authority of the Illinois Finance Authority (IFA). The proceeds from the sale were used to (i) renovate and construct lab and office space; (ii) establish a debt service reserve fund; and (iii) pay certain costs incurred in connection with the bond issue. Additionally, IITRI has obtained an irrevocable letter of credit issued by Fifth Third Bank through August 4, 2010, which is renewable annually upon mutual consent of the parties. IITRI renewed the letter of credit on July 7, 2010 through April 4, 2011. In the event that the agent is unable to remarket the bonds, the bonds become a demand note under the irrevocable letter of credit issued by Fifth Third Bank. If the letter of credit is not renewed and an alternate credit facility is not in place, IITRI's bonds are subject to mandatory redemption. Although the loan agreement between IITRI and IFA is for a 30-year period, the terms of the letter of credit between IITRI and Fifth Third Bank require the bonds to be amortized over a 20-year life carrying interest rate of 1%; accordingly, the current amortization schedule results in final payment in year 2023, which does not violate the terms of IITRI's loan agreement.

The University maintains line-of-credit agreements that allow borrowings up to $20,150. Borrowings under the line will bear interest at the prime commercial rate or adjusted LIBOR with interest being payable on a quarterly basis. The borrowing under the line of credit will be payable on demand, but if no demand is made, borrowing shall automatically mature on the interest payable date next following the date the loan is made. In August 2009, the University paid in full the $7,500 line of credit that allowed borrowings up to $8,000. Amounts outstanding under these agreements were $0 and $17,000 as of May 31, 2010 and $7,500 and $25,000 as of May 31, 2009.

IITRI maintains a line-of-credit agreement that allows borrowings of up to $250. Borrowings under this line will bear interest at the prime commercial rate with interest payable on a monthly basis. 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. No amounts were outstanding under this agreement as of May 31, 2010 and 2009.

The University and IITRI are subject to certain debt covenants. As of May 31, 2010, those covenants have been met.

The carrying value of long-term debt does not differ materially from its estimated fair value as of May 31, 2010 and 2009 based on quoted market prices for the same or similar issues.

(In thousands of dollars)

(9) Accrued Postretirement Benefit Obligation

The University created a retirement incentive program for tenured faculty in November 2006. As part of the incentive program, certain medical benefits are offered to participants. A reconciliation of the plan's funded status with the accrued benefit cost reported on the consolidated statements of financial position at May 31, 2010 and 2009 is presented below. The accumulated postretirement benefit obligation disclosed below is the actuarial value of future benefits used on employees' service rendered through the measurement date.

		2010	2009
Change in accumulated postretirement benefit obligation at beginning of the period	$	1,662	1,462
Service cost		10	13
Interest cost		103	91
Plan amendments		—	—
Actuarial gain		315	119
Actuarial benefit payments net contributions		(22)	(24)
Accumulated postretirement benefit obligation at end of the period		2,068	1,661
Change in fair value of plan assets:			
Fair value of plan assets at beginning of period		—	—
Employer contribution		29	24
Participant contributions		34	39
Total benefit payments		(63)	(63)
Fair value of plan assets at end of the period		—	—
Funded status	$	(2,068)	(1,661)
Amounts recognized in the statement of financial position consist of:			
Accrued postretirement benefit obligation	$	2,068	1,661

In fiscal year 2008, the University adopted FASB ASC Section 715 Subtopic 60, *Defined Benefit Plans – Other Postretirement*. In fiscal year 2010, the accumulated charge to unrestricted net assets consists of amounts that have not yet been recognized in net periodic benefit cost as follows: unrecognized actuarial loss of $61 and unrecognized prior service costs of $61. These amounts will be subsequently recognized in future years as components of net periodic pension cost.

(In thousands of dollars)

The components of net periodic postretirement benefit cost for the years ended May 31 are as follows:

		2010	2009
Service cost	$	10	13
Interest cost		103	91
Amortization of net gain		(16)	(28)
Amortization of prior service cost		11	11
Net periodic postretirement benefit cost	$	108	87

(a) Actuarial Assumptions

The weighted average assumptions used in the accounting for the postretirement plan for the years ended May 31 are shown below:

	2010	2009
Discount rate (expense)	5.52%	6.00%
Discount rate (obligation)	5.52	6.00
Health care cost trend rates:		
Next two fiscal years	11.00	10.0 – 11.0
Next seven fiscal years	5.00	5.0 – 9.0
Thereafter	5.00	5.00

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage point change in assumed health care cost trend rates would have the following effects for the fiscal years ended May 31:

		2010	2009
Effect on total service cost and interest cost:			
One-percentage point increase	$	13	117
One-percentage point decrease		(12)	93
Effect on year-end postretirement benefit obligation:			
One-percentage point increase		231	189
One-percentage point decrease		(200)	(163)

(In thousands of dollars)

(b) Estimated Future Benefits Payments

The following benefit payments, which reflect expected future service, are expected to be paid for each of the fiscal years ending May 31:

Fiscal year:		
2011	$	82
2012		96
2013		115
2014		129
2015		133
2016 – 2019		831

(c) Plan Amendment

Effective August 1, 2007, the plan was amended to eliminate post-65 benefits for all retirees, both current and future. There was also a group of faculty participants who were offered a special option under which the University would reimburse their premiums for post-65 retiree coverage. This special benefit option was only available through May 31, 2008. Participants had to sign up by this date in order to participate.

(10) Employee Benefit Plans

(a) 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, 2010 and 2009 were $5,806 and $5,700 by the University and $351 and $362 by IITRI, respectively.

(b) 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.

(11) Functional Classification of Expenses

Operating and nonoperating expenses are reported in the consolidated 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.

(In thousands of dollars)

Consolidated expenses by functional classification are as follows for the years ended May 31:

		2010	2009
Instruction	$	83,187	85,786
Research and other grant activities		58,668	56,564
Academic support		24,382	25,841
Student services		15,135	15,568
Institutional support		50,358	40,501
Auxiliary enterprises		13,043	13,598
Total	$	244,773	237,858

(12) 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:

		2010	2009
Funds designated by the board of trustees for endowment	$	69,866	68,990
Undesignated		(33,501)	(19,486)
Total	$	36,365	49,504

Donor restrictions on temporarily restricted net assets consist of the following at May 31:

		2010	2009
Scholarships	$	3,484	1,319
Instruction and academic departments		7,124	8,374
General operations		21,999	8,230
Split-interest annuity agreements		932	932
Total	$	33,539	18,855

(In thousands of dollars)

Permanently restricted net assets consist of the following at May 31:

		2010	2009
Endowment investments	$	146,966	146,525
Donor-restricted revolving loans funds		4,051	5,426
Split-interest annuity agreements		2,142	2,229
Beneficial interest in perpetual trusts		18,688	17,213
Total	$	171,847	171,393

The amount of outstanding loans from quasi-endowments to unrestricted funds is $11,790 and $5,232 at May 31, 2010 and 2009, respectively.

(13) Endowments

The University endowments include both donor-restricted endowment funds and funds designated by the board of trustees to function as endowments. As required by applicable standards, nets assets associated with endowment funds, including funds designated by the board of trustees to function as endowment, are classified and reported based on the existence or absence of donor-imposed restrictions.

The board of trustees of the University has interpreted the State of Illinois Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gifts as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. Notwithstanding the foregoing, this determination is not intended to, and shall not; affect the University's authority under UPMIFA to spend any amounts from an endowment fund on a short-term basis even if the market value of the endowment fund is below the original value of the gifts by the donor. As the result of this interpretation, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of the subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time of accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets unless there are specific purpose restrictions that have not been met by the University.

Endowment net assets consist of the following as of May 31, 2010:

		Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	$	(2,291)	7,966	146,966	152,641
Board-designated funds		27,398	—	—	27,398
Total	$	25,107	7,966	146,966	180,039

(In thousands of dollars)

Endowment net assets consist of the following as of May 31, 2009:

		Unrestricted	Permanently restricted	Total
Donor-restricted endowment funds	$	(8,589)	146,525	137,936
Board-designated funds		36,975	—	36,975
Total	$	28,386	146,525	174,911

Changes in endowment net assets for year ended May 31, 2010:

		Unrestricted	Temporarily restricted	Permanently restricted	Total
Net assets, beginning of year	$	28,386	—	146,525	174,911
Endowment-related investment return:					
Endowment-related investment income, net		4,127	—	—	4,127
Endowment-related net realized and unrealized losses		22,338	—	—	22,338
Total endowment-related investment return		26,465	—	—	26,465
Contributions and pledges		3,521	—	4,493	8,014
Appropriation		(25,300)	—	—	(25,300)
Reclassifications		(7,965)	7,966	(4,052)	(4,051)
Net assets, end of year	$	25,107	7,966	146,966	180,039

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

		Unrestricted	Permanently restricted	Total
Net assets, beginning of year	$	159,082	134,990	294,072
Endowment-related investment return:				
Endowment-related investment income, net		3,245	—	3,245
Endowment-related net realized and unrealized losses		(96,402)	—	(96,402)
Total endowment-related investment return		(93,157)	—	(93,157)
Contributions		1,041	6,492	7,533
Appropriation		(33,537)	—	(33,537)
Reclassifications		(5,043)	5,043	—
Net assets, end of year	$	28,386	146,525	174,911

(Continued)

(a) Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the Act requires the University to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were $2,291 and $8,589 as of May 31, 2010 and 2009. These deficiencies are the result of unfavorable investments results experienced over the past two fiscal years, which overwhelmed the earnings accumulations on recent permanently restricted contributions, as well as some instances of continued spending appropriations for certain programs that were deemed prudent by the board of trustees. Subsequent gains that restore the fair value of such funds to the required level will be classified as increases in unrestricted net assets.

(b) Spending Policy and Strategies Employed for Achieving Objectives

The University has adopted investment policy to provide a stable source of funds to help and support the ongoing operations and activities of the University. Pursuant to this objective, the University seeks to earn a long-term total rate of return sufficient to produce growth of endowment assets, net of spending requirements of 5%, inflation, and investment expenses.

The purpose of the endowment funds is to facilitate donors' desires to make substantial long-term gifts to the community and to develop a new and significant source of revenue of the University. In doing so, the endowment fund will provide a secure, long-term source of funds to: (a) fund special programs; (b) ensure long-term growth; (c) enhance the University's ability to meet changing community needs; and (d) support the administrative expenses of the University as deemed appropriate

To achieve these goals, the University's spending policy 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. The University's total endowment fund spending is based upon a target percentage of a subset of investments. The target percentage set by the board of trustees is 5% of the average endowment balance over the prior 12 quarters. The board of trustees set endowment distribution is $17,046 for fiscal year 2010 and $15,986 for fiscal year 2009. The board of trustees budgeted endowment distribution is $15,573 for fiscal year 2011.

(14) 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 these payments.

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 consolidated 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.

In January 2006, the University entered into a 55-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 18 years. The University is required to pay $788, $808, $828, $849, $870, respectively, over each of the next five years and $9,991 in years thereafter.

In January 2007, the University entered into a five-year space rental lease with 350 LLC. The lease agreement requires the University to pay $994, $1,027, and $1,060 over the next three years for rent. The lease expires on August 31, 2012. The lease involves occupying space in the building located at 350 North LaSalle.

(15) 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.

(16) Participation in Federal Financial Assistance Program

On May 20, 2010, the University received a letter from the United States Department of Education (USDE) stating that the University had failed to meet the financial responsibility standards in 34 CFR 668.171. As a result, the University is participating in the USDE's Student Financial Assistance programs under the Provisional Certification Alternative (Zone Alternative) for the next three award years. As a condition of participating under the Zone Alternative, the University was required to obtain an irrevocable letter of credit in the amount of $5,270 payable to the USDE. The letter of credit was issued on August 6, 2010 and expires on June 30, 2011 with provisions to renew annually.

(17) Subsequent Events

In connection with the preparation of the consolidated financial statements and in accordance with recently issued FASB ASC Section 855 – *Subsequent Events*, management evaluated subsequent events after the balance sheet date of May 31, 2010 through October 12, 2010, which was the date the consolidated financial statements were issued.

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2010

Program title	Award number	CFDA number	Federal expenditures
Major Programs:			
Research and Development Cluster – Direct Awards:			
Department of Agriculture:			
Food and Drug Administration:			
USDA Research Grants		10.xxx	$ 996,612
Integrated Programs (B)	USDA 2008-51110-04345	10.303	194,728
Agriculture and Foot Research Initiative (AFRI)	USDA 2010-65201-20593	10.310	10,984
International Agricultural Research Program	US-EGYPT JOINT SCI & TECH BOARD	10.961	915
			1,203,240
National Institute of Standards and Technology:			
Measurement and Engineering Research and Standards	NIST-60NANB9D9177	11.609	5,290
Department of Defense:			
Basic Scientific Research	ARO W911NF-09-2-0051	12.431	548,093
Air Force Defense Research Sciences Program	AFOSR FA9550-07-10241	12.800	430,519
			978,612
Department of Transportation:			
Department of Transportation programs	FHWA Dtfh61-06-G0005	20.xxx	157,767
Aviation Research Grants	GNSS FAA 07-G-012	20.108	194,795
			352,562
Department of Treasury:			
Low-Income Taxpayer Clinics		21.008	90,785
National Aeronautics and Space Administration:			
Aerospace Education Services Program		43.001	93,638
National Science Foundation:			
National Science Foundation research programs		47.xxx	283,510
Engineering Grants	GOALI:ECCS-0936849 supplement	47.041	1,459,520
Mathematical and Physical Sciences	NSF Phy-031737	47.049	470,314
Geosciences	NSF Oce-0620539	47.050	24,274
Computer and Information Science and Engineering	NSF Eia-0224377	47.070	1,406,098
Biological Sciences	NSF MCB-0644015	47.074	181,748
Social, Behavioral, and Economic Sciences	NSF SES-0933810	47.075	10,890
Education and Human Resources		47.076	88,803
ARRA Trans-NSF Recovery Act Research Support	NSF/DMS-0914923	47.082	179,495
			4,104,652
U.S. Small Business Administration:			
SBA Small Business Programs		59.xxx	177,771
Economic Injury Disaster Loans	SBA SBAHQ-08-I-0052	59.002	330,415
			508,186
Department of Energy:			
Department of Energy Programs	DE-F0007758 US DOE/NETL	81.xxx	166,422
Office of Science Financial Assistance Program	DOE ER-41159	81.049	442,639
Renewable Energy Research and Development		81.087	1,544,288
ARRA Renewable Energy Research and Development		81.087	612,233
			2,765,582
Department of Health and Human Resources:			
Health and Human Services programs	FDA HHSF2230100003C	93.xxx	151,597
Food and Drug Administration – Research	FDA 223039902	93.103	5,867,972
Alcohol Research Programs		93.273	(4,422)
Discovery and Applied Research for Technological Innovations to Improve Human Health	NIH 1R21Eb005273-1A2	93.286	452,689
National Center for Research Resources	NIH YR 13 5P41RR008630-13	93.389	1,168,382
ARRA National Center for Research Resources	NIH 3P41RR006303S1	93.389	160,010
Cancer Detection and Diagnosis Research		93.394	159,023
Cancer Treatment Research	NIH 1Ro1 Ca112503-1A	93.395	285,983
Cancer Biology Research	NIH 1R01CA128114-01A1	93.396	342,962
Cancer Research Manpower	NCI/NIH 1F31CA1326190-01	93.398	73,032
ARRA Trans-NIH Recovery Act Research Support	1 R21 HL094916-01 A1	93.701	160,590
Heart and Vascular Diseases Research	NIH 5R01Hl065425-06	93.837	598,960
Arthritis, Musculoskeletal and Skin Diseases Research	NIH/Niams Ar053970-1	93.846	93,095
ARRA Arthritis, Musculoskeletal and Skin Diseases Research	NIH/Niams Ar053970-03S1	93.846	15,000
Diabetes Endocrinology and Metabolism Research	NIH 1 R01 DK085611-01	93.847	26,230
Allergy Immunology and Transplantation Research	NIH 1R01AI073892-01A1	93.855	385,730
Research Treatment and Education Programs on Lyme	NIH 1P20MH085981-01	93.942	432,490
			10,369,323

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2010

Program title	Award number	CFDA number	Federal expenditures
US Agency for International Development:			
Agency for International Development Programs	Alo Hne-A-00-97-59-0	98.xxx	$ 33,763
Research and Development Cluster – Direct Awards			20,505,633
Research and Development Cluster – Indirect Awards:			
Department of Agriculture:			
Integrated Programs:			
Passed through:			
Michigan Research Institute		10.200	146,978
University of Georgia		10.303	89,675
Department of Defense:			236,653
Department of Defense Contracts – passed through:			
Jacobs Technology Inc		12.xxx	14,152
Mound Laser & Photonics Center, Inc		12.xxx	14,920
EPIR Technologies		12.xxx	11,141
University of Illinois At Chicago		12.xxx	42,946
Basic Science Research – passed through:			
Michigan Research Institute		12.431	94,418
Basic, Applied, and Advanced Research in Science and Engineering passed through:			
California Institute of Technology		12.630	180,192
Boeing		12.630	176,413
			534,182
Department of Transportation:			
Highway planning and construction – passed through:			
University of Illinois at Chicago – Urbana Champaign		20.205	82,470
University of Illinois at Chicago		20.205	34,348
University Transportation Centers Program – passed through:			
University of Illinois at Chicago		20.701	30,957
			147,775
National Aeronautics and Space Administration:			
Aerospace Education Services Program – passed through:			
University of Illinois – Champaign		43.001	58,774
National Science Foundation:			
National Science Foundation Contracts – passed through:			
Harvard University		47.xxx	27,527
University of Chicago		47.xxx	34,976
Geosciences – passed through:			
University of Notre Dame		47.050	112,847
Computer and Information Science and Engineering – passed through:			
Florida International University		47.070	11,894
Education and Human Resources – passed through:			
Chicago State University		47.076	20,016
National Academy of Engineering		47.076	43,219
			250,479
Department of Veteran Affairs:			
Department of Veteran Affairs – passed through:			
Hines VA Hospital		64.xxx	117,358
Environmental Protection Agency:			
Great Lakes Program – passed through:			
Indiana University		66.469	8,446
Department of Energy Contracts – passed through:			
Lawrence Berely Lab		81.xxx	29,211
Argonne National Laboratory		81.xxx	419,885
URS Energy and Construction INC		81.xxx	32,293
University of Puerto Rico		81.xxx	34,225
Brookhaven National Lab		81.xxx	65,213
Los Alamos National Lab		81.xxx	50,594
Muons Inc.		81.xxx	55,654
Fermi National Laboratory		81.xxx	153,449
Office of Science Financial Assistance Program – passed through:			
Fermilab		81.049	36,338
Argonne National Laboratory		81.049	287,578
ARRA Argonne National Laboratory		81.049	909
Office of Scientific and Technical Information – passed through:			
Argonne National Laboratory		81.064	161,519
Nuclear Energy Research, Development and Demonstration (B)			
Battelle Energy Alliance		81.121	187,035
			1,513,903

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2010

Program title	Award number	CFDA number	Federal expenditures
Department of Health and Human Services:			
Food and Drug Administration Programs – passed through:			
Micro Probe Incorporated		93.xxx	$ 95,457
CARES		93.xxx	64,147
University of Illinois at Chicago		93.xxx	115,635
National Institute for Pharmaceutical Technology and Education		93.xxx	1,448
Food and Drug Administration Research – passed through:			
National Institute for Pharmaceutical Technology and Education		93.103	48,985
Oral Diseases and Disorders Research – passed through:			
University of Illinois at Chicago – Urbana Champaign		93.121	50,935
Discovery and Applied Research for Technological Innovations to Improve Human Health – passed through:			
Rehabilitation Institute Corporation		93.286	5,021
Cancer Detection and Diagnosis Research – passed through:			
Fairway Medical Technologies		93.394	13,394
Washington University		93.394	81,826
ARRA Trans-NIH Recovery Act Research Support:			
Northwestern University		93.701	30,652
University of Chicago		93.701	30,689
University of Wisconsin		93.701	113
Heart and Vascular Diseases Research – passed through:			
University of Arizona		93.837	9,039
Loyola University – Chicago		93.837	71,238
University of Wisconsin		93.837	95,239
Lung Diseases Research – passed through:			
Lovelace Inc.		93.838	27,087
Diabetes Endocrinology and Metabolism Research – passed through:			
University of Chicago		93.847	19,121
Wake Forest University Health Sciences		93.847	31,841
Kidney Diseases Urology and Hematology Research:			
CARES		93.849	46,988
Extramural Research Programs in the Neurosciences and Neurological Disorders – passed through:			
Rehabilitation Institute Corporation		93.853	80,253
Pharmacology Physiology and Biological Chemistry – passed through:			
University of Utah		93.859	69,199
Child Health and Human Development Extramural Research passed through:			
Rehabilitation Institute Corporation		93.865	54,716
University of Chicago		93.865	11,470
			1,054,493
Research and Development Cluster – Indirect Awards			3,922,063
Total Research and Development Cluster			24,427,696
Student Financial Aid Cluster:			
Department of Education:			
Federal Supplemental Educational Opportunity Grants		84.007	677,334
Federal Family Education Loans		84.032	57,090,157
ARRA Federal Work-Study Program		84.033	326,989
Federal Work-Study Program		84.033	845,740
Federal Perkins Loan Program		84.038	1,348,346
Federal Pell Grant Program		84.063	3,098,191
Academic Competitiveness Grants		84.375	122,847
National Science and Mathematics Access to Retain Talent (SMART) Grants		84.376	387,000
Total Student Financial Aid Cluster			63,896,604
Total Major Programs			88,324,300

(Continued)

ILLINOIS INSTITUTE OF TECHNOLOGY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2010

Program title	Award number	CFDA number	Federal expenditures
Nonmajor Programs:			
Direct Awards:			
Department of Education:			
Rehabilitation Long-Term Training		84.129	$ 644,312
Criminal Justice System		84.xxx	70,509
Mathematics and Science Partnerships (B)		84.366	81,598
Department of Commerce:			
ARRA Special Economic Development and Adjustment Assistance		11.307	128,075
Other – Direct Awards			924,494
Indirect Awards:			
Fund for the Improvement of Postsecondary Education – passed through			
Biotechnology Institute		84.116	97,026
Chicago Public Schools		84.xxx	283,469
Other – Indirect Awards			380,495
Total Nonmajor Programs			1,304,989
Total Federal Awards			$ 89,629,289

See accompanying independent auditors' report and notes to schedule of expenditures of federal awards.

(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, 2010. 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, *Audits of Institutions of States, Local Governments, and Non-Profit Organizations.*

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 subawards 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. Such categories are as follows:

Major Programs

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

Student Financial Assistance Cluster – Includes certain awards to provide financial assistance to students, primarily under the Federal Pell Grant (Pell), Federal Work-Study (FWS), Federal Supplemental Educational Opportunity Grant (FSEOG), Academic Competitiveness Grant (ACG), and the National Science and Mathematics Access to Retain Talent Grant (SMART) programs of the U.S. Department of Education. Also, the University receives awards to make loans to eligible students under the Federal Perkins Loan 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 in the Schedule do not directly agree to the revenue line items on the University's May 31, 2010 consolidated statement of activities. The federal expenditures are classified in the accompanying consolidated statement of activities as government grants and contracts revenue, totaling approximately $39,272,000. The remaining government grants and contracts consist of approximately $4,118,000 of awards received from states and other sources, with the balance of approximately $8,620,000 related to IIT Research Institute, a consolidated separate legal entity.

(b) Expenditure Recognition

Expenditures are recognized as incurred. 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.

(Continued)

(2) Indirect Costs

The University has four-year predetermined fixed indirect cost rates, effective June 1, 2009 through May 31, 2012, which have been negotiated with its cognizant agency, the U.S. Department of Health and Human Services. The predetermined fixed rates were based on the University's financial information for fiscal year 2008. The base rates for on- and off-campus and FDA research were 51%, 24%, and 8% of modified total direct costs, respectively. Approximately $5,518,327 of indirect costs were reimbursed to the University for the year ended May 31, 2010.

(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, 2010 are summarized as follows:

Direct loan programs – Perkins	$	1,348,346
Federal Family Education Loans (FFEL)		57,090,157
Total federal student loan programs	$	58,438,503

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 $8,319,785 at May 31, 2010. The University received an administrative cost allowance of $152,091 under the Perkins program during the fiscal year ended May 31, 2010.

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, 2010.

(4) Summary of Subrecipient Payments

Expenditures made to subrecipients under federal awards for the year ended May 31, 2010, were as follows:

Research and Development Cluster:		
Department of Health and Human Services	$	763,955
Department of Education		10,714
Department of Defense		99,669
Department of Energy		699,547
Department of Transportation		36,692
National Science Foundation		106,910
U.S. Small Business Administration		93,776
Total	$	1,811,263

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303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' 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 year ended May 31, 2010, and have issued our report thereon dated October 12, 2010. Our report was modified to include an emphasis paragraph stating that the University adopted the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Section 958, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*, effective June 30, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the University's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency and that is described in the accompanying schedule of findings and questioned costs, as finding 10-01. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

KPMG

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 audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the University in a separate letter dated October 12, 2010.

The University's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the University's response, and accordingly, we express no opinion on it.

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

Chicago, Illinois
October 12, 2010

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

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

The Board of Trustees
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* (Compliance Supplement) that are applicable to each of its major federal programs for the year ended May 31, 2010, except those requirements discussed in the third paragraph of this report. 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 the University's compliance based on our audit.

The University's consolidated financial statements include the operations of IIT Research Institute, which received $5,050,754 in federal awards that are not included in the University's schedule of expenditures of federal awards for the year ended May 31, 2010. Our audit, described below, did not include the operations of IIT Research Institute because those awards will be audited separately.

We did not audit the University's compliance with the requirements governing the billing, collection, and due diligence functions in accordance with the requirements of the Student Financial Assistance Cluster: Federal Perkins Loan Program as described in the Compliance Supplement. 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 for the year ended June 30, 2010 was examined by other accountants in accordance with the U.S. Department of Education's Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers*. Our report does not include the results of the other accountants' examination of ACS' compliance with such requirements.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements described in the Compliance Supplement 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 in the first paragraph above that are applicable to each of its major federal programs for the year ended May 31, 2010. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as findings 10-02 through 10-05.

Internal Control over Compliance

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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over compliance.

Requirements governing billing, collection, and due diligence functions in the Student Financial Assistance Cluster: Federal Perkins Loan Program as described in the Compliance Supplement are performed by ACS. Internal control over compliance relating to such functions for the year ended June 30, 2010 was reported on by other accountants in accordance with the U.S. Department of Education's Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers*. Our report does not include the results of the other accountants' testing of ACS' internal control over compliance related to such functions.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the University's internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying schedule of findings and questioned costs as findings 10-02 through 10-05. A *significant deficiency in internal control over compliance* is a deficiency or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance with a type of compliance, yet important enough to merit attention by those charged with governance.

Schedule of Expenditure of Federal Awards

We have audited the basic financial statements of the University as of and for the year ended May 31, 2010 and have issued our report thereon dated October 12, 2010. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The University's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the University's responses, and accordingly, we express no opinion on the responses.

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

Chicago, Illinois
February 28, 2010,
except with respect to the opinion related to
the schedule of expenditures of federal awards
in paragraph ten, as to which the date is
October 12, 2010

(1) Summary of Auditors' Results:

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

(b) Significant deficiencies in internal control disclosed by the audit of the consolidated financial statements: **Yes**

Material weaknesses: **No**

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

(d) Significant deficiencies 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:

- Federal Supplemental Educational Opportunity Grant Program – 84.007
- Federal Family Education Loan Program – 84.032
- Federal Work Study Program – 84.033
- Federal Work Study Program (ARRA) – 84.033
- Federal Perkins Loan Program – 84.038
- Federal Pell Grant Program – 84.063
- Academic Competitiveness Grant – 84.375
- National Science and Mathematics Access to Retain Talent (SMART) Grants – 84.376

Research & Development Cluster – various CFDA numbers

(h) Dollar threshold used to distinguish between Type A and Type B programs: $935,724

(i) Auditee qualified as a low-risk auditee under Section. 530 of OMB Circular A-133: **No**

(2) Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards*

Finding 10-01 *Controls over User Access Rights*

During our review of the University's procedures for removing access rights for terminated users, we identified 33 terminated users whose system access was not removed upon termination from the University. Of the 33 terminated users, 17 accessed the University's network; however, only two had access to perform transactions within the University's information systems (one had access to the general ledger and one had access to the human resource module). Upon further review, the University was able to determine the individual with access to the human resource module had not made changes within the module. The University was not able to determine whether the individual with access to the general ledger had performed any transactions subsequent to termination because the audit trail function was not activated for the general ledger. Management represented a review was performed of transactions recorded in the general ledger subsequent to identifying the inappropriate access.

We also noted during our testwork that the University did not perform periodic reviews of the access rights of its users to verify the appropriateness of system access. Management performed an access review in connection with our audit and identified certain individuals had access to the human resource module which was no longer necessary with respect to their job functions. Management was able to ascertain these individuals had not made changes within the human resource module during the year.

Recommendation

We recommend the University review its procedures for monitoring user access rights and implement procedures to ensure terminated users are removed in a timely manner and periodic reviews of user access are performed. We would also recommend the University activate the audit trail function within the general ledger to document the user performing and reviewing each transaction recorded in the general ledger. Implementation of these controls will assist the University in mitigating the risk of unauthorized transactions being recorded within the University's financial systems and not being detected in a timely manner.

View of Responsible Officials

The University will review the ERP security access policies and procedures to ensure all system users are terminated on a timely basis. In addition, Management will periodically review and document user access to ensure users have the appropriate access.

(Continued)

(3) Findings and questioned costs relating to federal awards

Federal Agency: U.S. Department of Health and Human Services (USDHHS)

U.S. Department of Commerce (USDOC)
U.S. Department of Defense (USDOD)
U.S. Department of Transportation (USDOT)
U.S. Department of Treasury (USTD)
National Aeronautics and Space Administration (NASA)
National Science Foundation (NSF)
Small Business Administration (SBA)
U.S. Department of Energy (USDOE)
Environmental Protection Agency (USEPA)
U.S. Department of Education (USDE)
Department of Veterans Affairs (USDVA)
U.S. Department of Agriculture (USDA)
U.S. Agency for International Development (USAID)

Program Name: Research and Development Cluster

CFDA # and Program Expenditures: Various ($24,427,695)

Award Numbers: Various

Questioned Costs: None

Finding 10-02 *Subrecipient Monitoring*

Requirement

In accordance with OMB Circular A-133, the University is responsible for, among other things, (1) ensuring that subrecipients expending $500,000 or more in federal awards during the subrecipient's fiscal year have met the audit requirements of OMB Circular A-133 and that the required audits are completed within nine months of the end of the subrecipient's audit period and (2) identifying to the subrecipient the federal award information (i.e., CFDA title and number; award name and number; if the award is research and development; and name of federal awarding agency) and applicable compliance requirements at the time of the award.

Additionally, OMB Circular A-110 requires nonfederal entities receiving federal awards to establish and maintain internal control designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements. Effective internal control should include establishing a supervisor review to ensure information submitted to the COD system is accurate and is updated within required timeframes as federally prescribed.

Condition Found

During our testwork over subrecipient expenditures for the Research and Development Cluster, we noted the University is not adequately documenting reviews of OMB Circular A-133 reports received from its subrecipient and does not have a system to track and follow up with subrecipients when reports have not been received. Specifically, in our testwork over 10 subrecipients with expenditures of $1,012,667 during the fiscal year ended May 31, 2010, we noted the University did not use a checklist to document whether the reports received met the audit requirements of OMB Circular A-133. We also noted 4 audit reports (for subrecipients expending $595,002) had not been received as of the date of our testwork and the University could not provide evidence that follow-up procedures had been performed.

In addition, we noted the University had not provided all of its subrecipients with the CFDA number for the federal programs under which awards were made. Specifically, we noted the award agreements for two subrecipients (out of 10 award agreements tested) did not contain the CFDA number and the University could not provide any other documentation supporting the CFDA number had been provided to these subrecipients. Expenditures paid to these subrecipients totaled $309,925 for the year ended May 31, 2010.

Effect

Failure to obtain and adequately review subrecipient OMB A-133 audit reports and communicate required information to subrecipients may result in federal funds being expended for unallowable purposes and subrecipients not properly administering federal programs in accordance with laws, regulations, and the grant agreement.

Recommendation

We recommend the University establish procedures to ensure all subrecipients receiving federal awards have audits performed in accordance with OMB Circular A-133. Reviews of OMB Circular A-133 reports should be formally documented using a checklist and documentation of procedures performed to follow up on delinquent audit reports should be retained. In addition, the University should verify all required information is communicated to its subrecipients.

Views of Responsible Officials

Management agrees with the finding and has developed procedures to ensure all subrecipient agreements reference federal award information in the language of the agreement including the CFDA number. In addition due to staff changes, the desk review was not completed on a timely basis. The University will develop procedures to ensure staff changes will not affect future monitor and tracking processes. In addition, the University will continue to utilize the checklist developed prior to FY10 finding for monitoring, tracking, and reviewing subrecipient A-133 reports.

(Continued)

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

Program Name: Student Financial Aid Cluster

CFDA # and Program Expenditures: 84.007/84.032/84.033/84.038/84.063/84.375/84.376 ($63,896,604)

Award Numbers: Various

Questioned Costs: $6,250 (P063P091349)

Finding 10-03 *Verification – Special Test and Provision*

Requirement

An institution shall require each applicant whose application is selected by the central processor, based on edits specified by the USDE, to verify the items specified in 34 CFR Section 668.56. The institution shall also require applicants to verify any information used to calculate the expected family contribution (EFC) it has reason to believe is inaccurate.

Additionally, OMB Circular A-110, *Uniform Administrative Requirements for Grant and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, requires nonfederal entities receiving federal awards to establish and maintain internal control designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements. Effective internal control should include ensuring corrections are made as required by federal regulations and supporting documentation is obtained and maintained in the verification file.

Condition Found

During our testwork over 60 students selected for verification by the USDE Central Processor, we noted the following exceptions:

- Information (including the household size, number in college, adjusted gross income, or U.S. taxes paid) reported on the Institutional Student Information Records (ISIR) for seven students was not consistent with information reported on the student's verification worksheet or other supporting documentation. Upon further investigation and discussions with management, we noted the verified information was not properly reported to the USDE for correction on the ISIR, and as a result, these students were overawarded Pell grants in the amount $1,600. In response to this exception, the University reviewed the population of students selected for verification and identified an additional 17 students for which corrections were not processed and for which Pell grants were overawarded in the amount of $4,650.
- Untaxed benefits reported on the verification worksheet for one student were not supported by a W-2 or other forms of acceptable documentation.

Effect

Failure to properly perform verification procedures and correct ISIR information in accordance with federal regulations may result in students receiving awards for which they are not eligible and an unallowable costs being charged to the federal programs.

Recommendation

We recommend the University review its process to ensure all corrections required as the result of verification procedures are properly reported to the USDE in a timely manner and awards are adjusted for changes in the EFC as appropriate. In addition, the University should ensure all required supporting documentation is obtained and maintained.

Views of Responsible Officials

Management agrees with the finding. The University has implemented procedures to ensure that the verification sent to COD system has been received by COD and the verification back from COD has been loaded into the Banner Student System.

(Continued)

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

Program Name: Student Financial Aid Cluster

CFDA # and Program Expenditures: 84.007/84.033/84.038 ($3,198,409)

Award Numbers: Various

Questioned Costs: None

Finding 10-04 *Reporting – Fiscal Operations Report and Application to Participate (FISAP)*

Requirement

According to 34 CFR 673.3, an institution is required to file an application to participate in the Federal Perkins Loan, Federal Work-Study, and Federal Supplemental Educational Opportunity Grants programs, which includes all information required by the USDE. In addition, OMB Circular A-110, *Uniform Administrative Requirements for Grant and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations* 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 procedures to ensure amounts reported on the FISAP are accurate.

Additionally, OMB Circular A-110 requires nonfederal entities receiving federal awards to establish and maintain internal control designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements. Effective internal control should include establishing a supervisor review to ensure information submitted on the FISAP is accurate and is updated within required timeframes as federally prescribed.

(Continued)

Condition Found

During our testwork over the FISAP for the program year ended June 30, 2009 (submitted in 2010), we noted the amounts reported for the community work study program did not agree to supporting schedules or system generated data as follows:

		Amounts		
Line item		**Actual**	**Reported**	**Difference**
Number of Students in Community Service Employment		49	41	8
Federal Share of Community Service	$	117,719	96,825	20,894
Number of FWS students employed as reading tutors		8	3	5
Federal Share of earned compensation for FWS students employed as reading tutors	$	14,270	8,101	6,169
Number of FWS Students employed as math tutors		13	7	6
Federal Share of earned compensation for FWS students employed as math tutors	$	21,037	9,675	11,362

Effect

Failure to prepare accurate reports inhibits the ability of the USDE to properly monitor and evaluate the performance of the programs.

Recommendation

We recommend the University implement procedures to ensure the information reports in its FISAP is accurate.

Views of Responsible Officials

Management agrees with the finding. The University will implement new procedures to ensure the data reported on the FISAP report reconciles with internal documentation and support. The Office of Financial Aid will monitor and document the students participating in the community service projects on a monthly basis.

(Continued)

Federal Agency: U.S. Department of Health and Human Services (USDHHS)

U.S. Department of Commerce (USDOC)
U.S. Department of Defense (USDOD)
U.S. Department of Transportation (USDOT)
U.S. Department of Treasury (USTD)
National Aeronautics and Space Administration (NASA)
National Science Foundation (NSF)
Small Business Administration (SBA)
U.S. Department of Energy (USDOE)
Environmental Protection Agency (EPA)
U.S. Department of Education (USDE)
Department of Veterans Affairs (USDVA)
U.S. Department of Agriculture (USDA)
U.S. Agency for International Development (USAID)

Program Name: Research and Development Cluster

CFDA # and Program Expenditures: Various ($24,427,695)

Award Numbers: Various

Questioned Costs: None

Finding 10-05 *Time and Effort Confirmations – Activities Allowed or Unallowed*

Requirement

OMB Circular A-21, *Cost Principles for Higher Education Institutions*, establishes principles and standards for determining costs for federal awards carried out through grants, cost reimbursements contracts, and other agreements with higher education institutions. To be allowable under federal awards, costs must meet certain general criteria. Those criteria, among other things, require that the expenditures must be allocable, reasonable, and supported by adequate documentation. OMB Circular A-21 requires that the distribution of salaries and wages for professorial and professional personnel be supported by semiannual or monthly effort certifications under the after the fact activity report method.

Additionally, OMB Circular A-110, *Uniform Administrative Requirements for Grant and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, 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 procedures to ensure payroll expenditures are properly supported in accordance with OMB Circular A-21.

Condition Found

During our testwork, we noted one employee who had certified the incorrect amount of time and effort that he had worked on a grant for the month of February 2010. This error was a result of the University's time and effort certification system incorrectly calculating the effort by including a pay code that should have been excluded. The University had identified and corrected this issue in their system, but failed to have this Principal Investigator recertify the correct Time and Effort once the system had been corrected.

Effect

Inadequate documentation and lack of accurate and correct effort certifications may result in the federal funds being expended for unallowable purposes.

Recommendation

We recommend the University implement procedures to ensure effort certifications are properly completed by individuals whose time is charged to federal awards or used to meet cost sharing requirements in accordance with federal regulations and University policies and procedures.

Views of Responsible Officials

Management agrees with the finding and has identified the error within the effort reporting system. The University will be implementing manual internal controls to monitor the output of the system to ensure accuracy. In addition, the University is implementing the Banner Time and Effort system to record and track research employees' effort.