ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Financial Statements and Supplemental Information

May 31, 2006 and 2005

(With Independent Auditors’ Report Thereon)

ILLINOIS INSTITUTE OF TECHNOLOGY

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Independent Auditors' Report

The Board of Trustees
Illinois Institute of Technology:

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

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Illinois Institute of Technology as of May 31, 2006 and 2005, and the changes in its net assets and its cash flows for the y

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statements of Financial Position

May 31, 2006 and 2005

(In thousands of dollars)

Assets		**2006**	**2005**
Cash	$	3,817	15,735
Bond proceeds held by trustees		51,681	12,097
Investments (note 4)		250,425	201,382
Investments from sale of IITRI net assets (note 4)		60,007	81,788
Notes and accounts receivable:			
Grants and contracts, less allowance of $105 in 2006 and 2005		15,677	10,486
Students:			
Tuition receivable , less allowance of $7,775 in 2006 and $7,563 in 2005		6,492	5,708
Notes receivable, less allowance of $373 in 2006 and 2005		9,304	9,949
Pledges receivable, less allowance of $283 in 2006 and $1,200 in 2005 (note 5)		9,376	13,245
Other		8,215	4,389
Inventories, prepaid expenses, and deferred charges		2,538	3,899
Physical properties, less accumulated depreciation (note 6)		217,107	200,930

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statement of Activities

Year ended May 31, 2006

(In thousands of dollars)

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

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statement of Activities

Year ended May 31, 2005

(In thousands of dollars)

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

See accompanying notes to consolidated financial statements.

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidated Statements of Cash Flows

Years ended May 31, 2006 and 2005

(In thousands of dollars)

		2006	2005
Cash flows from operating activities:			
Increase in net assets	$	7,485	29,243
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:			
Cumulative effect of change in accounting principle		9,930	—
Private gifts restricted for long-term investment		(8,305)	(891)
Depreciation		12,088	11,964
Amortization of bond issue costs		—	176
Gain on beneficial interest in perpetual trusts		(1,300)	(510)
Contribution of fixed assets		(169)	(175)
Net (gain) loss on disposal of assets		341	260
Net gain on Alion notes and warrants		(8,574)	(22,606)
Gain on investments		(21,358)	(13,525)
Changes in assets and liabilities:			
Receivables: tuition, grants, pledges, affiliate and other		(5,932)	1,822
Inventories, prepaid expenses, and deferred charges		1,361	(947)
Accounts payable and accrued expenses		3,094	3,404
Accrued salaries and wages		1,680	391
Deferred revenue		1,171	(2,260)
Deposits by students and others		190	(1,464)

Obligations under split-q1 i 9ep7 T0 D,sdiret asset6,D34.6,D34) 8.2 86Amortization of bond issue cost

(1) Nature of Organization

Illinois Institute of Technology

Illinois Institute of Technology (the University) is a private not-for-profit coeducational technical engineering institution that is dedicated to superi

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

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

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

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

(c) Operations

Operating results in the statements of activities

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

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

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

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

Historically, governmental clients have been a major source of revenue for IITRI. For the fiscal years ended May 31, 2006 and 2005, these governmental clients accounted for approximately 35% and 42%, respectively, of IITRI's operating revenue of $24,538 and $21,201, respectively. In addition, IITRI has one significant industrial customer, which comprised approximately 51%

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(e) Investments

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

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

(f) Investments from the Sale of IITRI Net Assets

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

(Continued)

Upon sale or retirement of an asset, cost and the related accumulated depreciation are deducted5

(m) Income Taxes

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

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

(n) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

(o) Reclassifications

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

(3) Change in Accounting Principle

In fiscal year 2006 the University adopted Financial Accounting Standards Board Interpretation No. 47 (FIN 47), "*Accounting for Conditional Asset Retirement Obligations*." FIN 47 requires that a liability be recognized for the fair value of a legal obligation to perform asset retirement activities that are conditional on a future event if the amount can be reasonably estimated. Upon recognition of a liability, the asset retirement cost is recorded as an incl onl80aTJS0.00aTJS0.w(Acc) Reclaecsen36 cost is

(In thousands of dollars)

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

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

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

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

The University utilizes the total re

redemption. The proceeds from the redemption are invested with the University's short term investments.

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

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

	2006	**2005**
Return on investments:		

(In thousands of dollars)

(6) Physical Properties

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

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

(7) Beneficial Interest in Perpetual Trusts

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

(In thousands of dollars)

(8) Notes and Bonds Payable

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

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

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

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

The University maintains a line of credit agreement that allows borrowings of up to $5,000. Borrowings under this line will bear interest at the prime commercial rate with interest being payable monthly. The borrowings under this line of credit will be payabl

(Continued)

(In thousands of dollars)

(11) Net Assets

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

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

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

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

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

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

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

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

(13) Contingencies

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Independent Auditors' Report on Supplemental Information

The Board of Trustees
Illinois Institute of Technology:

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

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

KPMG LLP

November 1, 2006

Schedule 1

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidating Statement of Financial Position

May 31, 2006

(In thousands of dollars)

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

(a) Elimination of interentity accounts payable/receivable.

(b) Elimination of equity interest in IITRI.

See accompanying independent auditors' report on supplemental information.

Schedule 3

ILLINOIS INSTITUTE OF TECHNOLOGY

Consolidating Statement of Cash Flows

Year ended May 31, 2006

(In thousands of dollars)

	University	IITRI	Eliminations	Total
Cash flows from operating activities:				
Increase in net assets	$ 7,485	2,161		