McGladrey & Pullen
Certified Public Accountants

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Financial Audit
For the Year Ended June 30, 2006

Performed as Special Assistant Auditors for the
Auditor General, State of Illinois

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

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State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Agency Officials

Executive Director	Larry E. Matejka
Deputy Executive Director	Kathleen T. Rooney
Chief Operating and Administrative Officer (8/16/05-6/19/06)	Marcia Thompson
Chief Financial Officer (8/16/05 – current)	Theresa Morgan
Chief Financial Officer (7/1/05 – 8/15/05)	Marcia Thompson
General Counsel	Karen Salas
Director of Internal Audit (7/1/05 – 7/31/05)	Wendy Funk

Agency offices are located at:

1755 Lake Cook Road
Deerfield, IL 60015-5209

Financial Statement Report

Summary

The audit of the accompanying financial statements of the Illinois Prepaid Tuition Program of the State of Illinois, Illinois Student Assistance Commission (Program) was performed by McGladrey and Pullen, LLP.

Based on their audit, the auditors expressed an unqualified opinion on the Program's financial statements.

McGladrey & Pullen
Certified Public Accountants

Independent Auditors' Report

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Illinois Prepaid Tuition Program of the State of Illinois, Illinois Student Assistance Commission as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the State of Illinois, Illinois Student Assistance Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the 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.

As discussed in Note 2, the financial statements present only the Illinois Prepaid Tuition Program, a fund of the State of Illinois, Illinois Student Assistance Commission and do not purport to, and do not, present fairly the financial position of the State of Illinois, Illinois Student Assistance Commission as of June 30, 2006, and its changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Illinois Prepaid Tuition Program of the State of Illinois, Illinois Student Assistance Commission, as of June 30, 2006, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The State of Illinois, Illinois Student Assistance Commission has not presented a management's discussion and analysis for the Illinois Prepaid Tuition Program that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the financial statements.

In accordance with *Government Auditing Standards*, our report dated November 15, 2006 on our consideration of the State of Illinois, Illinois Student Assistance Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements and other matters will be issued under a separate cover. 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, upon issuance, 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.

McGladrey & Pullen, LLP

Schaumburg, Illinois
November 15, 2006

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Statement of Net Assets
June 30, 2006

Assets	
Current	
Cash and cash equivalents	$ 10,745,602
Receivables:	
Accrued interest on investments	63,609
Total current assets	10,809,211
Noncurrent	
Investments	777,302,000
Total assets	788,111,211
Liabilities	
Current	
Accounts payable and accrued expenses	846,963
Tuition payable	24,757,664
Accreted tuition payable	1,863,480
Due to other State funds	64,658
Compensated absences	8,604
Total current liabilities	27,541,369
Noncurrent	
Tuition payable	633,067,768
Accreted tuition payable	156,559,962
Compensated absences	77,434
Total noncurrent liabilities	789,705,164
Total liabilities	817,246,533
Net assets, unrestricted (deficit)	$ (29,135,322)

See Notes to Financial Statements.

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Statement of Revenues, Expenses, and Changes in Net Assets
Year Ended June 30, 2006

Operating revenues:	
Income from investment securities	$ 49,328,993
Interest revenue - other	419,156
Application and other fees	2,341,666
Total operating revenues	52,089,815
Operating expenses:	
Salaries and employee benefits	739,745
Accreted tuition expenses	44,367,125
Management and professional services	3,002,229
Investment management fees	2,620,729
Total operating expenses	50,729,828
Operating income	1,359,987
Transfer - out	(25,000)
Change in net assets	1,334,987
Net assets (deficit), July 1, 2005	(30,470,309)
Net assets (deficit), June 30, 2006	$ (29,135,322)

See Notes to Financial Statements.

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Statement of Cash Flows
Year Ended June 30, 2006

Cash flows from operating activities	
Cash receipts from prepaid tuition contracts	$ 117,170,221
Cash received from application and other fees	2,341,666
Cash paid for refund of contracts	(4,696,984)
Cash paid for tuition and accretion	(18,194,735)
Cash payments to suppliers for goods and services	(2,809,816)
Cash payments to employees for services	(733,051)
Net cash provided by operating activities	93,077,301
Cash flows from noncapital financing activities	
Transfer Out	(25,000)
Cash flows from investing activities	
Purchase of investment securities	(203,589,410)
Sales and maturities of investment securities	101,643,127
Interest and dividends on investments	15,332,058
Cash paid to investment managers	(2,620,729)
Net cash used in investing activities	(89,234,954)
Net increase in cash and cash equivalents	3,817,347
Cash and cash equivalents, July 1, 2005	6,928,255
Cash and cash equivalents, June 30, 2006	$ 10,745,602

(Continued)

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Statement of Cash Flows (Continued)
Year Ended June 30, 2006

Reconciliation of operating income to net cash provided by operating activities:

Operating income	$ 1,359,987
Adjustments to reconcile operating income to net cash provided by operating activities:	
Investment and other interest income	(49,748,149)
Accreted tuition expense	44,367,125
Investment management fees	2,620,729
Increase (decrease) in liabilities:	
Accounts payable and accrued expenses	165,525
Due to other State funds	26,888
Tuition payable	94,278,502
Compensated absences	6,694
Total adjustments	91,717,314
Net cash provided by operating activities	$ 93,077,301

Supplemental disclosure of noncash transactions:	
Net appreciation in fair value of investments	$ 34,382,710

See Notes to Financial Statements.

Note 1. Description of Program

The Illinois Student Assistance Commission (ISAC) administers the nonshared proprietary fund, Illinois Prepaid Tuition Program (*College Illinois!*) described below. A nonshared fund is a fund in which a single State agency is responsible for administering substantially all financial transactions of the fund.

Legislation authorizing ISAC to administer an Illinois Prepaid Tuition Program was passed in November 1997. The Illinois Prepaid Tuition Program is administered by ISAC with advice and counsel from an investment advisory panel consisting of seven members appointed by ISAC. The purpose of this program is to provide Illinois families with an affordable tax-advantaged method to pay for college. Illinois Prepaid Tuition contracts will allow participants to prepay the cost of tuition and mandatory fees at Illinois public universities and community colleges at current program prices which are significantly less than projected future college costs. Benefits of the contracts can also be used at private and out-of-state colleges and universities. Contracts can be purchased in a lump sum payment or in installments.

The first contracts were offered for sale in 1998. After eight enrollment periods, as of June 30, 2006, the Illinois Prepaid Tuition Program had 46,709 contracts in force with a purchased value of $938 million. As of June 30, 2006, the fund has received cash collections of $708,128,235.

The Illinois Prepaid Tuition Program Fund is a non-appropriated fund.

Note 2. Summary of Significant Accounting Policies

The financial statements of the Illinois Prepaid Tuition Program administered by ISAC have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

A. Reporting Entity

As defined by GAAP, the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

1) Appointment of a voting majority of the component unit's board and either (a) the primary government's ability to impose its will, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or

2) Fiscal dependency on the primary government.

Based upon the required criteria, the Illinois Prepaid Tuition Program does not have component units, nor is it a component unit of any other entity. However, because the Illinois Prepaid Tuition Program is not legally separate from the State of Illinois, it is included in the financial statements of the State as a proprietary fund. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois 62704-1871.

Note 2. Summary of Significant Accounting Policies - Continued

A. Reporting Entity - Continued

The financial statements present only the Illinois Prepaid Tuition Program administered by the State of Illinois, Illinois Student Assistance Commission (ISAC) and do not purport to, and do not, present fairly the financial position of the State of Illinois or ISAC as of June 30, 2006, and changes in financial positions and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

B. Basis of Presentation

In government, the basic accounting and reporting entity is a fund. A fund is defined as an independent fiscal and accounting entity with a self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves, and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. A statement of net assets, statement of revenues, expenses, and changes in net assets, and statement of cash flows have been presented for the Illinois Prepaid Tuition Program administered by ISAC.

Operating revenues result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Due to the nature of the Illinois Prepaid Tuition Program activities, income from investments is considered an operating activity in the Statement of Revenues, Expenses and Changes in Net Assets. Nonoperating revenues and expenses result from nonexchange transactions or ancillary activities.

C. Basis of Accounting

The Illinois Prepaid Tuition Program is reported using the economic resources measurement focus and the accrual basis of accounting.

Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place. The fund accounts for resources received and used for financing self-supporting activities of the Illinois Prepaid Tuition Program that offers services on a user-charge basis to the general public.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The State also has the option of following subsequent private-sector guidance for their enterprise funds, subject to this same limitation. The State has elected not to follow subsequent private-sector guidance as it relates to the Program's operations.

D. Cash and Cash Equivalents

Cash and cash equivalents consist principally of deposits held in the State Treasury. Cash and cash equivalents include cash on hand, cash in banks, interest bearing deposits with banks, and securities with maturities at the date of purchase of 90 days or less.

Note 2. Summary of Significant Accounting Policies - Continued

E. Investments

The Illinois Prepaid Tuition Program presents investments on its Statement of Net Assets at fair value. The net appreciation or depreciation in the fair value of investments is included in income from investment securities in the Statement of Revenues, Expenses and Changes in Net Assets. The investments are classified as noncurrent, as current cash flows cover current payouts for the program and the program has no plans to withdraw investments in the near future.

F. Interfund Transactions

The Illinois Prepaid Tuition Program has the following type of interfund transactions with other funds of the State:

Loans - amounts provided with a requirement for repayment. Interfund loans are reported as interfund receivables (i.e. due from other funds) in lender funds and interfund payables (i.e. due to other funds) in borrower funds.

Reimbursements—repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursements are reported as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

Transfers—flows of assets (such as cash or goods) without equivalent flow of assets in return and without a requirement for repayment. Transfers are reported after nonoperating revenues and expenses.

G. Compensated Absences

The liability for compensated absences reported in the Illinois Prepaid Tuition Program consists of unpaid, accumulated vacation and sick leave balances for Illinois Prepaid Tuition Program employees. The liability has been calculated using the vesting method in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary-related costs (e.g., Social Security and Medicare tax).

Legislation that became effective January 1, 1998 capped the paid sick leave for all State Employees' Retirement System members at December 31, 1997. Employees continue to accrue twelve sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between 1984 and December 31, 1997 (with a 50% cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997 will be converted to service time for purposes of calculating employee pension benefits.

H. Tuition Payable

Tuition payable in the Illinois Prepaid Tuition Program represents the net principal payments received for the 46,709 contracts held by the fund as of June 30, 2006.

Note 2. Summary of Significant Accounting Policies - Continued

I. Net Assets, Unrestricted (Deficit)

Net assets, unrestricted (deficit) consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

J. Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

K. Funding and Actuarial Assumptions

Program funding is derived entirely from payments received from contract purchasers and the investment income earned by the Fund. The Commission has obtained actuarial assistance in order to establish, maintain and certify assets sufficient to meet the Fund's obligations. The assets of the fund are to be preserved, invested and expended solely pursuant to and for the purposes of the Fund and may not be loaned or otherwise transferred or used by the State of Illinois for any other purpose.

In the event the Commission, with the concurrence of the State of Illinois, determines the Illinois Prepaid Tuition Program to be financially infeasible, the Commission may discontinue, prospectively, the operation of the Illinois Prepaid Tuition Program. Any beneficiary who has been accepted by and is enrolled, or will within five years enroll, at an eligible institution shall be entitled to exercise the complete benefits of his/her contract. All other contract holders shall receive an appropriate refund of all contributions and accrued interest up to the time the Illinois Prepaid Tuition Program is discontinued.

Note 3. Deposits and Investments

A. Investment Authority and Legal Compliance

The State Treasury is the custodian of the State's cash and cash equivalents for the Illinois Prepaid Tuition Program maintained in the State Treasury. The investment authority for the State Treasury is found in the State Treasurer Act (15 ILCS 505), which authorizes the State of Illinois primary government and its component units to engage in a wide variety of investment activities. For further details please refer to the State of Illinois CAFR, available in the Office of the Treasurer, Fiscal Officer Responsibilities Audit Report. A copy of the report can be obtained from the State Treasurer at 300 West Jefferson, Springfield, Illinois, 62701.

The Illinois Prepaid Tuition Program independently manages cash and cash equivalents maintained outside the State Treasury. The Commission by statute (Illinois Prepaid Tuition Act, 110 ILCS 979) is required to appoint an investment advisory panel to offer advice and counseling regarding the investments of the Illinois Prepaid Tuition Program. The panel is required to annually review and advise the Commission on provisions of the strategic investment plan, which will specify the investment policies to be utilized by the Commission in the administration of the Illinois Prepaid Tuition Program.

Note 3. Deposits and Investments - Continued

A. Investment Authority and Legal Compliance - Continued

The Commission may direct that assets of those Funds be placed in savings accounts or may use the same to purchase fixed or variable life insurance or annuity contracts, securities, evidence of indebtedness, or other investment products pursuant to the comprehensive investment plan and in such proportions as may be designated or approved under that plan.

Investment managers are hired who, by their record and experience have demonstrated their fiduciary responsibility, their investment expertise, their investment experience, and their capacity to undertake the mandate for which they are being considered. Investment managers retained for the Illinois Prepaid Tuition Program acknowledge in writing, a fiduciary relationship with respect to the Illinois Prepaid Tuition Program and need to be currently registered and maintain registration as an investment advisor under the Investment Advisors Act of 1940, a bank (as defined in the Act), or an insurance company qualified to perform investment management services under the law of more than one state unless otherwise approved on an exception basis. The Commission has established investment guidelines for the investment managers and conducts thorough due diligence before the appointment of all investment managers.

A qualified investment consultant, on an ongoing basis, evaluates the Illinois Prepaid Tuition Program. Written reports are provided to the Commission by the investment consultant no later than 45 days after the end of each calendar quarter. The investment consultant meets with the various investment managers on a regular basis to review the investment guidelines and analyzes the general liability structure of the Illinois Prepaid Tuition Program. They also assist the Commission and the Investment Advisory Panel with the selection of investment managers and custodians. The qualified investment consultant retained by the Commission is required to exercise discretion within the parameters set forth in the investment policy guidelines for the portfolio(s) they manage. Additionally, the program has contracted with Marquette Associates to evaluate the investment performance of the Illinois Prepaid Tuition Program on a quarterly basis.

The Illinois Prepaid Tuition Program investment policy dictates certain guidelines and restrictions that apply to investments in domestic equities by the investment managers. The manager may only hold up to 5% of its portfolio in a money market and/or cash. The only exception to this rule is during trading activity, which can only be maintained for very short time periods, i.e. less than 30 days. Further, options, financial futures, private placements, restricted stock, issues related to the investment manager, or venture capital may not be purchased. The policy also prohibits the purchase of securities on margin and short selling. Also, investments cannot be made in securities not traded on a U.S. exchange or traded in U.S. dollars.

The investment policy authorizes the Commission to utilize a third party custodian to safe-keep the assets of the fund and to provide reports on a monthly basis to all necessary parties. The custodian is responsible for sweeping all interest and dividend payments and any other un-invested cash into a short-term money market fund for re-deployment. The custodian retained by the Commission is required to exercise discretion within the parameters set forth in the investment policy guidelines for the portfolio(s) they manage on behalf of the fund.

Note 3. Deposits and Investments - Continued

B. Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Illinois Prepaid Tuition Program's deposits may not be returned to it. State law (30 ILCS 230/2C) requires that all deposits of public funds be covered by FDIC insurance or eligible collateral. The Illinois Prepaid Tuition Program has no policy that would further limit the requirements under State law. As of June 30, 2006, the Illinois Prepaid Tuition Program's locally held deposits were not exposed to custodial credit risk.

The State Treasurer is the custodian of the State's cash and cash equivalents for the Illinois Prepaid Tuition Program maintained in the State Treasury. Deposits in the custody of the State Treasurer totaled $9,723,227 at June 30, 2006. These deposits are pooled and invested with other State funds in accordance with the Deposits of State Moneys Act of the Illinois Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been addressed as to custodial credit risk because the Illinois Prepaid Tuition Program does not own individual securities. Details on the nature of these deposits and investments are available within the State of Illinois' Comprehensive Annual Financial Report.

C. Investments

ISAC is required annually to adopt a comprehensive investment plan to invest the funds received through contract payments. The Commission approved the Illinois Prepaid Tuition Program's most recent revision to the investment plan on November 18, 2005. The comprehensive investment plan specifies the investment policies to be utilized by the Commission in its administration of the Illinois Prepaid Tuition Program. The Commission may direct that assets of those funds be invested in a manner which will provide the investment return and risk level consistent with the actuarial return requirements and risk levels and cash flow demands of the Fund. The investments should be in compliance with all applicable federal and state laws and other statutes governing the investment of Illinois Prepaid Tuition Program resources.

ISAC has retained State Street Global Advisors, J P Morgan Investment Advisors, William Blair & Company, Richmond Capital Management, LSV Asset Management, Holland Capital, New Amsterdam Partners, Kenwood Capital, Nicholas Applegate, and Denver Investment Advisors as investment managers to assist with the investment of the fund assets for the Illinois Prepaid Tuition Program. Approximately $87,000,000 of additional contract payments received have been invested as of the end of the fiscal year June 30, 2006. The program has contracted with Marquette Associates to evaluate the investment performance of the Program on a quarterly basis. Use of funds invested on behalf of the Illinois Prepaid Tuition Program by the investment managers is restricted to the payout of tuition and fee benefits for program beneficiaries.

As of June 30, 2006, 60% of the funds were invested in Domestic Equities, 34% in Domestic Fixed Income, 5% in International Equity and 1% as Cash and Equivalents. Investments of the Fund are recorded at fair value based on quoted market prices.

Note 3. Deposits and Investments - Continued

C. Investments - Continued

The Illinois Prepaid Tuition Program's cash and investments at June 30, 2006 are presented below at fair value by investment type and by investment manager:

Investment Managers
Asset Allocation
June 30, 2006

Asset Class	Investment Manager	Fair Value	Actual Allocation
Fixed Income-Core	J P Morgan	$ 99,777,347	12.66%
Fixed Income-Intermediate	Richmond Capital Management	123,523,673	15.67%
Fixed Income-Core	SSgA Passive Bonds	38,731,089	4.91%
Total Fixed Income Portfolio		262,032,109	33.25%
Large-Cap Core Equity	SSgA S&P 500 Index	117,402,688	14.90%
Large-Cap Value Equity	LSV Asset Management	65,817,902	8.35%
Large-Cap Value Equity	SSgA	67,670,016	8.59%
Large-Cap Growth Equity	William Blair & Company	33,876,277	4.30%
Large-Cap Growth Equity	Holland Capital	32,977,189	4.18%
Large-Cap Growth Equity	New Amsterdam Partners	34,495,477	4.38%
Small-Cap Core Equity	Nicholas Applegate	43,972,573	5.58%
Small-Cap Core Equity	Denver Investment Advisors	34,984,815	4.44%
Small-Cap Value Equity	Nicholas Applegate	21,324,997	2.71%
Small-Cap Value Equity	Kenwood Capital	20,534,704	2.61%
Total Domestic Equity		473,056,638	60.03%
International Equity	LSV Asset Management	42,213,253	5.36%
Total International Equity		42,213,253	5.36%
Total Investments		777,302,000	98.64%
Cash and Equivalents	N/A	10,745,602	1.36%
Total Cash Equivalents		10,745,602	1.36%
TOTAL PORTFOLIO		$ 788,047,602	100%

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Illinois Prepaid Tuition Program's policy for managing interest rate risk is to ensure that the investment managers comply with its investment policy guidelines.

As per the investment policy, the operational guidelines for the Fixed Income Securities Managers require that the average duration of the manager's portfolio not vary more than +/- 30% of the duration of the Lehman Brothers (LB) Intermediate Government/Credit Index and the LB Aggregate Index respectively (see schedule of investments on previous page).

The duration of the portfolios, by Manager, for the fixed income securities, compared to the benchmark index(s) is as follows:

Fixed Income Portfolio Manager	Portfolio Average Duration	LB Aggregate Index	LB Intermediate Government/ Credit Index
JP Morgan	4.3 years	4.8 years	N/A
Richmond Capital Management	3.6 years	N/A	3.6 years
SSgA	4.8 years	4.8 years	N/A

As of June 30, 2006, all portfolios are within the guidelines permitted by the investment policy.

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Interest Rate Risk –Continued

Portfolio Weighted Average Maturity

Investment Type	Fair Value	Weighted Average Maturity (in Years)
U.S. treasury notes	$ 16,401,818	3.8
U.S. treasury bonds	7,266,937	11.9
U.S. treasury strips	9,212,531	9.1
U.S. agency obligations	27,626,810	4.3
Federal agencies bonds and notes	45,139,878	5.5
U.S. agency asset-backed securities	6,709,497	4.3
Corporate debt securities	91,037,181	4.5
Money market mutual funds	8,155,908	0.1
Corporate asset-backed securities	3,792,665	1.5
Foreign debt securities	327,642	6.3
Corporate mortgage backed securities	7,630,153	3.8
Passive bond index fund	38,731,089	5.8
Total Fair Value	$ 262,032,109	
Portfolio Weighted Average Maturity		4.1

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Commission is authorized to hire competent registered professional investment managers to manage the assets of the Illinois Prepaid Tuition Program.

The operational guidelines as set forth in the Illinois Prepaid Tuition Program investment policy for fixed income investments dictate that no securities with a credit rating below BBB- by Standard & Poor's or Ba3 by Moody's may be purchased. In the case of a split rating, the higher rating shall apply. Securities, which are downgraded below the policy minimum, may only be held at the manager's discretion for up to 6 months.

The following table indicates credit ratings, as of June 30, 2006, for the Program's debt security investments (other than obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government which are not considered to have credit risk). Ratings for debt security investments that have multiple ratings are on the following page:

		Credit Rating		
Investment Type	Total Fair Value	Moody's	Standard & Poor's	Fitch
U.S. agency obligations	$ 27,626,810	Aaa	AAA	AAA
Federal agencies bonds and notes	45,139,878	Aaa	AAA	AAA
U.S. agency asset-backed securities	6,709,497	Aaa	AAA	AAA
Money market mutual funds	8,155,908	Aaa	AAA	AAA
Corporate asset-backed securities	3,792,665	Aaa	AAA	AAA
Foreign debt securities	327,642	Baa	BBB	BBB
Passive bond index fund	38,731,089	Aa2	AA	AA

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Credit Risk – Continued

The following table indicates credit ratings, as of June 30, 2006, for debt security investments that received multiple ratings:

Rating Agency	Investment Type	Credit Rating*	Fair Value
Moody's:	Corporate debt securities	Aaa	$ 3,636,792
	Corporate debt securities	Aa	19,749,630
	Corporate debt securities	A	62,589,800
	Corporate debt securities	Baa	4,635,190
	Corporate debt securities	NR	425,769
			91,037,181
Standard and Poor's:	Corporate debt securities	AAA	3,636,792
	Corporate debt securities	AA	11,384,644
	Corporate debt securities	A	68,111,280
	Corporate debt securities	BBB	7,904,465
			91,037,181
Fitch:	Corporate debt securities	AAA	1,191,969
	Corporate debt securities	AA	19,271,387
	Corporate debt securities	A	60,125,918
	Corporate debt securities	BBB	3,778,717
	Corporate debt securities	NR	6,669,190
			91,037,181
Moody's:	Corporate mortgage-backed securities	AAA	6,354,780
	Corporate mortgage-backed securities	NR	1,275,373
			7,630,153
Standard and Poor's:	Corporate mortgage-backed securities	AAA	6,221,566
	Corporate mortgage-backed securities	NR	1,408,587
			7,630,153
Fitch:	Corporate mortgage-backed securities	AAA	3,506,463
	Corporate mortgage-backed securities	NR	4,123,690
			7,630,153

* NR - not rated

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the Illinois Prepaid Tuition Program will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The Program does not have an investment policy for custodial credit risk for investments.

As of June 30, 2006, all investments were held by the Program's agent in the Program's name.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

The operational guidelines as set forth in the Illinois Prepaid Tuition Program's investment policy for fixed income investments dictate that no single security should comprise more than 10% of the portfolio's overall allocation after accounting for price appreciation, except for any U.S. Treasury or U.S. agency security, which may comprise no more than 15% of the portfolio's overall allocation after accounting for price appreciation. In the case of investments in domestic equities the policy states that no single security in the manager's portfolio will comprise more than 5% of its equity allocation at the time of purchase, nor will it be more than 10% of the equity allocation of the portfolio after accounting for price appreciation. Additionally, in the case of the small-cap investment managers at no point in time should the portfolio hold a security such that the investment management firm's aggregate position in that company exceeds 20% of the fair value of the outstanding stock of the Company.

There were no investments in any single issuer (other than U.S. Treasury or securities explicitly guaranteed by the U.S. government) which exceeded 5% or more of the total investment portfolio as of June 30, 2006.

Foreign Currency Risk

Foreign currency risk is the risk that changes in currency exchange rates will adversely affect the fair value of an investment.

The Commission's investment policy authorizes a maximum of 10% of the portfolio for investments in international equities. As of June 30, 2006, 5% is invested in international equities, however, none of these investments are denominated in foreign currencies.

Note 4. Balances Due to Other State Funds and Transfers

As of June 30, 2006, the Illinois Prepaid Tuition Program owed the Audit Fund $51,021 for the cost of the fiscal year 2005 audit. In addition, the Illinois Prepaid Tuition Program owed $13,637 to state universities for tuition and fees for benefits under *College Illinois!*. During the year, $25,000 was transferred to the ISAC COP Debt Service Fund for lease payments.

Note 5. Compensated Absences Payable

Changes in compensated absences for the year ended June 30, 2006, were as follows:

	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006	Amounts Due Within One Year
Compensated absences	$ 79,344	$ 34,757	$ 28,063	$ 86,038	$ 8,604

Note 6. Tuition Payable

Tuition payable activity for the year ended June 30, 2006 is as follows:

Balance July 1, 2005	$ 562,274,039
Add:	
Contributions	117,170,221
Less:	
Return of contributions	(4,696,984)
Tuition payments	(16,921,844)
Balance June 30, 2006	$ 657,825,432
Reported as:	
Current	$ 24,757,664
Noncurrent	633,067,768
	$ 657,825,432

Note 7. Accretion Payable

Accretion payable is management's estimate of the present value of the estimated tuition payment to be made in excess of principal payments received and is expected to be financed from investments of prepaid tuition contracts. The accretion expense for fiscal year 2006 is estimated as a percentage of net tuition contracts paid to date. The rate is 7.75% and is based on the average increase in tuition for Illinois colleges.

Note 7. Accretion Payable - Continued

Average monthly tuition payable over the year	$ 578,261,644
Estimate of 7.75% increase of tuition payable	$ 44,815,277
Present value	$ 44,367,125
Beginning balance accretion payable as of July 1, 2005	$ 115,329,209
Accretion expense	44,367,124
Accretion payments	(1,272,891)
Ending balance accretion payable as of June 30, 2006	$ 158,423,442
Reported as:	
Current	$ 1,863,480
Noncurrent	156,559,962
	$ 158,423,442

The accretion expense is calculated on a monthly basis on the balance in the tuition payable account. Accretion expense is reflected as an expense in the Statement of Revenues, Expenses and Changes in Net Assets and as an increase to liabilities on the Statement of Net Assets.

Note 8. Pension Plan

Substantially all of ISAC's full-time employees who are not eligible for participation in another state-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. The SERS is a single-employer defined/benefit public employee retirement system (PERS) in which State employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems. The financial position and results of operations of the SERS for fiscal year 2006 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2006. The SERS issues a separate CAFR that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois 62794-9255.

A summary of SERS benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

The Commission pays employer retirement contributions for the Illinois Prepaid Tuition Program based upon an actuarially determined percentage of its payroll. For fiscal year 2006, the employer contribution rate was 7.8%. The required and actual contribution was $41,922.

Note 9. Post-employment Benefits

The State provides health, dental, and life insurance benefits for certain retirees and their dependents. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State-sponsored pension plans. Health and dental benefits include basic benefits for annuitants under the State's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to $5,000 per annuitant age 60 and older.

Costs incurred for health, dental, and life insurance for annuitants and their dependents were not separated from benefits provided to active employees and their dependents for the year ended June 30, 2006.

Post-employment costs for the State as a whole for all State agencies/departments for dependent health, dental and life insurance for annuitants and their dependents are disclosed in the Illinois Comprehensive Annual Financial Report for the State. Cost information for retirees by individual fund or State agency is not available. Payments are made on a "pay-as-you-go" basis.

Note 10. Fund Deficits

College Illinois!, the State's section 529 prepaid tuition program, has taken action to reduce and ultimately eliminate its $147 million current actuarially determined deficit over time. The Illinois Student Assistance Commission (ISAC), administrator of the *College Illinois!* program, has added a premium to contract prices during each of the past five enrollment periods (2001-02 through 2005-06) to partially amortize the current actuarial deficit, and the Commission could perpetuate these or similar actions in subsequent years until any deficit is fully amortized.

In terms of the program's actuarially determined deficit, actual investment performance is only one influencing factor. Expected future investment performance is another factor, as is the level of actual tuition and fee increases at Illinois public universities, new contracts for each <u>future</u> enrollment period, as well as <u>future</u> expectations for tuition and fee increases at those institutions. A large proportion of the program's actuarial deficit is related to increasing the Illinois public universities' tuition growth expectation to between 9% and 10% for fiscal years 2003 through 2008 and 7.75% long-term rather than 7.5%. Beginning with fiscal year 2007, the assumption regarding future contract sales is lowered from between 5,000 and 6,000 to 5,000 per year. A factor contributing to a decrease in the actuarial deficit is that the program's long-range investment returns assumption was recently raised by 25 basis points from 7.75% to 8%.

Each year when setting plan prices, the Commission reviews the assumptions that influence the actuarial deficit. Since 2002, recognizing that the State's budget has provided minimal increases for the state's institutions of higher education and tuition and fee increases have as a result been higher than anticipated, the assumption concerning tuition increases has been adjusted higher on a temporary basis. Also in 2002, the Commission reduced the program's long-term investment return assumption temporarily, in recognition that the economy was recovering more slowly than expected due to external shocks that have adversely affected financial markets during the past several years. With current economic trends, it was decided to return to the original long-term investment performance assumption of 8% in FY2007.

Implementation of the Truth-in-Tuition law (in 2004) has impacted and will continue to impact future tuition increases for classes of new students entering the State's public universities. Another significant fact that only became evident after the law was implemented, was that while tuition rates charged to students who remain enrolled for continuous academic years must remain level, the universities continue to increase fees annually for all students, not just new enrollees.

Note 10. Fund Deficits - Continued

Beginning with fiscal year 2006, fee increase assumptions separate from tuition increase assumptions were developed. For FY2006 they were 8% for one year and 6% long-term. Those assumptions were recently reconsidered and based on the current State budget situation and the recent history of fee increases at the public universities, the fee increase assumptions were raised to 10% for the FY2007 and 8% long-term. Considering the potential impact of fee increases, as well as a refinement made in the calculation of weighted average tuition and fees for students impacted by Truth-in-Tuition, the actuarial deficit has been impacted significantly.

ISAC is required by State statute to prepare a report describing the financial condition of the program. Included in this report shall be an actuarial evaluation on the financial viability of the program. An Actuary's Report on Soundness was prepared for the *College Illinois!* Prepaid Tuition Program. According to the actuarial evaluation report, there is a deficit of $146,929,478 in the program.

	Actuarial Evaluation
Net assets, before tuition/accretion payable	$ 787,113,553
Actuarial present value of future payments expected to be made by contract purchasers	186,468,090
Subtotal	973,581,643
Actuarial present value of future payments expected to be made by the program	1,120,511,121
Actuarial deficit as of June 30, 2006	$ (146,929,478)

Actuarial projections indicate that the program's cash flow (contributions received less tuition benefits and expenses) is expected to remain positive through FY2009 even without reflecting the expected proceeds from contracts sold after June 30, 2006. Moreover, on this basis, total program assets are projected to cover benefit payments through FY2020.

Note 11. Risk Management

The Commission is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; workers compensation and natural disasters. The State retains the risk of loss (i.e., self insured) for these risks except for insurance purchased by the Commission for the building and EDP equipment. There has been no reduction in insurance coverage from coverage in the prior year. Settlement amounts have not exceeded coverage for the current or prior two years. The Commission's risk management activities for workers compensation are financed through appropriations to the Illinois Department of Central Management Services and are accounted for in the general fund of the State. The claims are not considered to be a liability of the Commission and, accordingly, have not been reported in the Commission's financial statements for the year ended June 30, 2006.

Note 12. New Governmental Accounting Standards

The Governmental Accounting Standards Board (GASB) has issued the following statements:

Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and if applicable, required supplementary information. The Commission is required to implement this Statement for the year ending June 30, 2008.

Statement No. 47, *Accounting for Termination Benefits*, establishes accounting standards for voluntary and involuntary termination benefits, including termination benefits provided through a defined benefit other post employment benefit plan (OPEB). For those termination benefits provided through a defined benefit OPEB plan, this Statement must be implemented concurrently with Statement No. 45.

Statement No. 48*, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, establishes criteria that governments will use to ascertain whether the proceeds received in exchange for an interest in their expected cash flows from collecting specific receivables or specific future revenues should be reported as revenue or as a liability. This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions. This Statement also requires disclosures pertaining to future revenues that have been pledged or sold and is intended to provide financial statement users with information about which revenues will be unavailable for other purposes and how long they will continue to be so. The Commission is required to implement this Statement for the year ending June 30, 2008.

Management has not yet completed their assessment of these Statements, however, they are not expected to have a material effect on the overall financial statement presentation.