

ITT Educational Services, Inc.
Florida Single Audit Act and Additional Information
For the Year Ended December 31, 2011

ITT Educational Services, Inc.
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For the Year Ended December 31, 2011

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
ITT Educational Services, Inc.:

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of ITT Educational Services, Inc. and its subsidiaries (the "Company") at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting appearing on page 29. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 23, 2012 on 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 compliance and the results of that testing, and not to provide an opinion 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.



A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A deficiency in internal control 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, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The accompanying Note 15 on the Company's calculation of its Title IV 90/10 revenue test is required by the U.S. Department of Education and is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying Note 15 on the Company's calculation of its Title IV 90/10 revenue test is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

PricewaterhouseCoopers LLP

February 23, 2012

ITT EDUCATIONAL SERVICES, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

	As of December 31,	
	2011	2010
Assets		
Current assets:		
Cash and cash equivalents	\$228,993	\$163,779
Short-term investments	148,488	149,160
Restricted cash	2,128	255
Accounts receivable, less allowance for doubtful accounts of \$9,175 and \$7,526	48,106	68,937
Deferred income taxes	9,759	9,079
Prepaid expenses and other current assets	18,814	22,887
Total current assets	456,288	414,097
Property and equipment, net	201,257	198,213
Deferred income taxes	33,267	21,814
Other assets	38,006	40,656
Total assets	\$728,818	\$674,780
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$78,876	\$67,920
Accrued compensation and benefits	21,438	28,428
Other current liabilities	18,190	15,441
Deferred revenue	226,543	244,362
Total current liabilities	345,047	356,151
Long-term debt	150,000	150,000
Other liabilities	64,972	40,559
Total liabilities	560,019	546,710
Commitments and contingent liabilities (Note 14)		
Shareholders' equity:		
Preferred stock, \$.01 par value, 5,000,000 shares authorized, none issued	0	0
Common stock, \$.01 par value, 300,000,000 shares authorized, 37,068,904 issued	371	371
Capital surplus	189,573	173,935
Retained earnings	827,675	524,678
Accumulated other comprehensive (loss)	(9,479)	(4,509)
Treasury stock, 10,969,425 and 7,075,563 shares, at cost	(839,341)	(566,405)
Total shareholders' equity	168,799	128,070
Total liabilities and shareholders' equity	\$728,818	\$674,780

The accompanying notes are an integral part of the consolidated financial statements.

ITT EDUCATIONAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Amounts in thousands, except per share data)

	Year Ended December 31,		
	2011	2010	2009
Revenue	\$1,499,949	\$1,596,529	\$1,319,194
Costs and expenses:			
Cost of educational services	553,065	537,855	449,835
Student services and administrative expenses	439,808	445,125	380,567
Total costs and expenses	992,873	982,980	830,402
Operating income	507,076	613,549	488,792
Interest income	2,902	2,504	3,291
Interest (expense)	(1,825)	(1,918)	(726)
Income before provision for income taxes	508,153	614,135	491,357
Provision for income taxes	200,401	239,969	191,094
Net income	\$307,752	\$374,166	\$300,263
Earnings per share:			
Basic	\$11.22	\$11.28	\$8.01
Diluted	\$11.13	\$11.17	\$7.91
Weighted average shares outstanding:			
Basic	27,429	33,165	37,490
Diluted	27,655	33,501	37,942

The accompanying notes are an integral part of the consolidated financial statements.

ITT EDUCATIONAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

	Year Ended December 31,		
	2011	2010	2009
Cash flows from operating activities:			
Net income	\$307,752	\$374,166	\$300,263
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation and amortization	27,886	26,797	24,908
Provision for doubtful accounts	61,308	86,935	81,983
Deferred income taxes	(8,991)	(14,557)	(3,066)
Excess tax benefit from stock option exercises	(1,166)	(3,383)	(5,289)
Stock-based compensation expense	17,074	15,813	13,074
Other	(1,936)	468	(1,163)
Changes in operating assets and liabilities, net of acquisition:			
Restricted cash	(1,873)	1,636	5,775
Accounts receivable	(40,477)	(70,446)	(136,837)
Accounts payable	10,956	6,645	4,911
Other operating assets and liabilities	35,118	62,057	6,344
Deferred revenue	(17,819)	72,429	10,355
Net cash flows from operating activities	<u>387,832</u>	<u>558,560</u>	<u>301,258</u>
Cash flows from investing activities:			
Facility expenditures and land purchases	(4,053)	(6,118)	(4,236)
Capital expenditures, net	(26,847)	(26,811)	(23,992)
Acquisition of college, net of cash acquired	0	0	(20,792)
Proceeds from sales and maturities of investments and repayment of notes	337,032	385,306	247,701
Purchase of investments and note advances	(352,195)	(451,594)	(263,012)
Net cash flows from investing activities	<u>(46,063)</u>	<u>(99,217)</u>	<u>(64,331)</u>
Cash flows from financing activities:			
Excess tax benefit from stock option exercises	1,166	3,383	5,289
Proceeds from exercise of stock options	5,599	7,893	8,800
Repurchase of common stock and shares tendered for taxes	(283,320)	(435,628)	(348,483)
Net cash flows from financing activities	<u>(276,555)</u>	<u>(424,352)</u>	<u>(334,394)</u>
Net change in cash and cash equivalents	65,214	34,991	(97,467)
Cash and cash equivalents at beginning of period	163,779	128,788	226,255
Cash and cash equivalents at end of period	<u>\$228,993</u>	<u>\$163,779</u>	<u>\$128,788</u>
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Income taxes (net of refunds)	\$196,387	\$259,788	\$190,718
Interest	\$1,842	\$1,914	\$824
Non-cash financing activities:			
Issuance of treasury stock for Directors' compensation	\$30	\$ 30	\$30

The accompanying notes are an integral part of the consolidated financial statements.

ITT EDUCATIONAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Dollars and shares in thousands)

	<u>Common Stock</u>		<u>Capital Surplus</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Common Stock in Treasury</u>		<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				<u>Shares</u>	<u>Amount</u>	
Balance as of December 31, 2008	54,069	\$541	\$135,655	\$718,100	(\$13,384)	(15,352)	(\$667,068)	\$173,844
Net income				300,263				300,263
Other comprehensive income:								
Prior service costs, net of \$11 of income tax					17			17
Net actuarial pension loss, net of \$2,386 of income tax					3,697			3,697
Pension settlement loss, net of \$18 of income tax					28			28
Unrealized (loss)					(451)			(451)
Comprehensive income								303,554
Exercise of stock options and equity awards				(11,462)		210	20,262	8,800
Tax benefit from exercise of stock options and equity award vesting			5,766					5,766
Stock-based compensation			13,074					13,074
Common shares repurchased						(3,478)	(348,123)	(348,123)
Issuance of shares for Directors' compensation				2		1	28	30
Shares tendered for taxes						(4)	(360)	(360)
Balance as of December 31, 2009	54,069	541	154,495	1,006,903	(10,093)	(18,623)	(995,261)	156,585
Net income				374,166				374,166
Other comprehensive income:								
Prior service costs, net of \$4,058 of income tax					6,340			6,340
Net actuarial pension loss, net of \$551 of income tax					(860)			(860)
Unrealized gain					104			104
Comprehensive income								379,750
Exercise of stock options and equity awards				(13,631)		214	21,524	7,893
Tax benefit from exercise of stock options and equity award vesting			3,627					3,627
Stock-based compensation			15,813					15,813
Common shares repurchased						(5,658)	(434,656)	(434,656)
Issuance of shares for Directors' compensation				1		1	29	30
Shares tendered for taxes						(10)	(972)	(972)
Common shares retired	(17,000)	(170)		(842,761)		17,000	842,931	0
Balance as of December 31, 2010	37,069	371	173,935	524,678	(4,509)	(7,076)	(566,405)	128,070
Net income				307,752				307,752
Other comprehensive income:								
Prior service costs, net of \$607 of income tax					(948)			(948)
Net actuarial pension loss, net of \$3,005 of income tax					(4,696)			(4,696)
Pension settlement loss, net of \$470 of income tax					734			734
Unrealized (loss)					(60)			(60)
Comprehensive income								302,782
Exercise of stock options and equity awards				(4,756)		155	10,355	5,599
Tax benefit from exercise of stock options and equity award vesting			1,190					1,190
Stock-based compensation			14,448					14,448
Common shares repurchased						(4,040)	(282,701)	(282,701)
Issuance of shares for Directors' compensation				1		1	29	30
Shares tendered for taxes						(9)	(619)	(619)
Balance as of December 31, 2011	37,069	\$371	\$189,573	\$827,675	(\$9,479)	(10,969)	(\$839,341)	\$168,799

The accompanying notes are an integral part of the consolidated financial statements.

ITT EDUCATIONAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data and unless otherwise stated)

1. Business and Significant Accounting Policies

Business. We are a leading proprietary provider of postsecondary education in the United States based on revenue and student enrollment. As of December 31, 2011, we were offering master, bachelor and associate degree programs to approximately 73,000 students and had 144 locations (including 141 campuses and three learning sites) in 39 states. In addition, we offered one or more of our online programs to students who are located in 48 states. We have provided career-oriented education programs since 1969 under the “ITT Technical Institute” name and since June 2009 under the “Daniel Webster College” (“DWC”) name. Our corporate headquarters are located in Carmel, Indiana.

Basis of Presentation. The consolidated financial statements include our wholly-owned subsidiaries’ accounts and have been prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”). All significant intercompany balances and transactions are eliminated upon consolidation. Arrangements where we may have a variable interest in another party are evaluated in accordance with the provisions of Financial Accounting Standards Board (“FASB”) Accounting Standards CodificationTM (“ASC” or “Codification”) 810, “Consolidation” (“ASC 810”), to determine whether we would be required to include the financial results of the other party in our consolidated financial statements. As of December 31, 2011, we were not required to include the financial results of any variable interest entity in our consolidated financial statements. Certain reclassifications may have been made in the consolidated financial statements of prior years to conform to the current year presentation. These reclassifications would have no impact on previously reported net income, total shareholders’ equity or cash flows.

Use of Estimates. The preparation of these consolidated financial statements, in accordance with GAAP, includes estimates and assumptions that are determined by our management. Actual results could differ materially from the estimates. Significant accounting estimates and assumptions are used for, but not limited to:

- the allowance for doubtful accounts;
- useful lives of tangible and intangible assets;
- self insurance;
- pension liabilities;
- stock-based compensation;
- guarantees;
- unrecognized tax benefits; and
- litigation exposures.

Cash Equivalents. Highly liquid investments purchased with an original maturity of three months or less are considered cash equivalents.

Restricted Cash. The funds from the federal student financial aid programs under Title IV (“Title IV Programs”) of the Higher Education Act of 1965, as amended (“HEA”), and certain other monies transferred to us by electronic funds transfer, are subject to holding restrictions before they can be drawn into our cash account. The funds subject to these holding periods are identified as restricted cash until they are applied to the students’ accounts. We also maintain an escrow account for a guarantee obligation to an unaffiliated third party under a private education loan program for our students. The funds in this escrow account are considered restricted cash and classified as other assets. The balance in this escrow account as of December 31, 2011 and December 31, 2010 was not material.

Investments. We classify our investments in marketable securities as available-for-sale or held-to-maturity depending on our investment intentions with regard to those securities on the date of acquisition. Investments classified as available-for-sale are recorded at their market value. Investments are classified as either current or non-current based on the maturity date of each security.

The cost of securities sold is based on the specific identification method.

ITT EDUCATIONAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data and unless otherwise stated)

Accounts Receivable and Allowance for Doubtful Accounts. We extend unsecured credit to our students for tuition and fees and we record a receivable for the tuition and fees earned in excess of the payment received from or on behalf of a student. The individual student balances of these receivables are insignificant. We record an allowance for doubtful accounts with respect to accounts receivable based on the students' credit profiles and our historical collection experience related to amounts owed by our students with similar credit profiles. If our collection trends were to differ significantly from our historical collection experience, we would make a corresponding adjustment to our allowance for doubtful accounts.

When a student is no longer enrolled in a program of study at one of our campuses, we increase the allowance for doubtful accounts related to the former student's receivable balance to reflect the amount we estimate will not be collected. The amount that we estimate will not be collected is based on a review of the historical collection experience for each campus, adjusted as needed to reflect other facts and circumstances. We review the collection activity after a student withdraws or graduates from a campus and will write off the accounts receivable, if we conclude that collection of the balance is not probable.

Property and Equipment. Property and equipment is recorded on our consolidated financial statements at cost, less accumulated depreciation and amortization. Maintenance and repairs are expensed as incurred. Expenditures that extend the useful lives of our assets are capitalized.

Developed or purchased software is capitalized in accordance with ASC 350, "Intangibles – Goodwill and Other." Facility construction costs are capitalized as incurred, with depreciation commencing when the facility is placed in service. We capitalize interest on our real estate construction projects in accordance with ASC 835, "Interest."

Provisions for depreciation and amortization of property and equipment have generally been made using the straight-line method over the following ranges of useful lives:

<u>Type of Property and Equipment</u>	<u>Estimated Useful Life</u>
Furniture and equipment	3 to 10 years
Leasehold, building and land improvements	3 to 14 years
Buildings	20 to 40 years
Software	3 to 8 years

We amortize leasehold improvements using the straight-line method over the shorter of the life of the improvement or the term of the underlying lease. Land is not depreciated.

We regularly review our long-lived assets for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If we determine that the carrying amount of a long-lived asset exceeds the total amount of the estimated undiscounted future cash flows from that asset, we would determine the fair value of that asset. If the fair value is less than the net book value of the long-lived asset, we recognize an impairment loss in the amount of the difference. We base our impairment analyses of long-lived assets on our current business strategy, expected growth rates and estimates of future economic and regulatory conditions.

Insurance Liabilities. We record liabilities and related expenses for medical, workers compensation and other insurance in accordance with the contractual terms of the insurance policies. We record the total liabilities that are estimable and probable as of the reporting date for our insurance liabilities that we self-insure. The accounting for our self-insured arrangements involves estimates and judgments to determine the liability to be recorded for reported claims and claims incurred but not reported. We consider our historical experience in determining the appropriate insurance reserves to record. If our current insurance claim trends were to differ significantly from our historic claim experience, however, we would make a corresponding adjustment to our insurance reserves.

Contingent Liabilities. We are subject to various claims and contingencies in the ordinary course of our business, including those related to litigation, business transactions and employee-related matters, among others. When we are aware of a claim or potential claim, we assess the likelihood of any loss or exposure. If it is probable that a loss will result and the amount of the loss can be reasonably estimated, we record a liability for the loss. The liability recorded includes probable and estimable legal costs associated with the claim or potential claim. If the loss is not probable or the amount of the loss cannot be reasonably estimated, we disclose the claim if the likelihood of a potential loss is reasonably possible and the amount involved is material.

ITT EDUCATIONAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data and unless otherwise stated)

Guarantees. In accordance with ASC 460, “Guarantees,” we recognize a liability for the fair value of a guarantee obligation upon its issuance. We evaluate the fair value of our guarantee obligations periodically and adjust the liability as warranted. The fair market value of our guarantees related to certain private student loan programs were estimated based on historical charge off experience with respect to private loans made to our students and the present value of the expected cash flows, taking into consideration current economic conditions, that may result from the settlement of the guarantee obligations in the future.

Treasury Stock. Repurchases of outstanding shares of our common stock are recorded at cost. Treasury stock issued in fulfillment of stock-based compensation awards or other obligations is accounted for under the last in, first out method. We record “losses” from the sale of treasury stock that exceed previous net “gains” from the sale of treasury stock as a charge to retained earnings.

The retirement of shares of our common stock held in treasury are accounted for under the first in, first out method. We reduce common stock in the amount of the par value of the shares retired and we reduce retained earnings in the amount of the difference between the cost of the treasury shares and their par value.

Recognition of Revenue. Tuition revenue is recorded on a straight-line basis over the length of the applicable course to the extent that we consider the collectability of that revenue to be reasonably assured. If a student withdraws from an institution, the standards of most state education authorities that regulate our institutions, the accrediting commissions that accredit our institutions and our own internal policy limit a student’s obligation for tuition and fees to the institution depending on when a student withdraws during an academic term (“Refund Policies”). The terms of the Refund Policies vary by state, and the limitations imposed by the Refund Policies are generally based on the portion of the academic term that has elapsed at the time the student withdraws. Generally, the greater the portion of the academic term that has elapsed at the time the student withdraws, the greater the student’s obligation is to the institution for the tuition and fees related to that academic term. We record revenue net of any refunds that result from any applicable Refund Policy. On an individual student basis, tuition earned in excess of cash received is recorded as accounts receivable, and cash received in excess of tuition earned is recorded as deferred revenue.

We do not charge a separate fee for textbooks that students use in their programs of study. We record the cost of these textbooks in prepaid expenses and other current assets and amortize the cost of textbooks on a straight-line basis over the applicable course length. Tool kit sales, and the related cost, are recognized when the student receives the tool kit. Academic fees (which are charged only one time to students on their first day of class attendance) are recognized as revenue on a straight-line basis over the average program length. If a student withdraws from an institution, all unrecognized revenue relating to his or her fees, net of any refunds that result from any applicable Refund Policy, is recognized upon the student’s departure. An administrative fee is charged to a student and recognized as revenue when the student withdraws or graduates from a program of study at an institution.

We report 12 weeks of tuition revenue in each of our four fiscal quarters. We standardized the number of weeks of revenue reported in each fiscal quarter, because the timing of student breaks in a calendar quarter can fluctuate from quarter to quarter each year. The total number of weeks of school during each year is 48.

Advertising Costs. We expense all advertising costs as incurred.

Equity-Based Compensation. Stock-based compensation cost for our equity instruments exchanged for employee and director services is measured at the date of grant, based on the calculated fair value of the grant and is recognized as an expense on a straight-line basis over the period of time that the grantee must provide services to us before the stock-based compensation is fully vested. The vesting period is generally the period set forth in the agreement granting the stock-based compensation. Under the terms of our stock-based compensation plans, some grants immediately vest in full when the grantee’s employment or service terminates, and, for grants made prior to November 24, 2010, when he or she retires. As a result, in certain circumstances, the period of time that the grantee must provide services to us in order for that stock-based compensation to fully vest may be less than the vesting period set forth in the agreement granting the stock-based compensation. In these instances, compensation expense will be recognized over this shorter period.

ITT EDUCATIONAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data and unless otherwise stated)

We use a binomial option pricing model to determine the fair value of stock options granted and we use the market price of our common stock to determine the fair value of restricted stock and restricted stock units (“RSUs”) granted. The binomial option pricing model takes into account the variables defined below:

- “Volatility” is a statistical measure of the extent to which the stock price is expected to fluctuate during a period and combines our historical stock price volatility and the implied volatility as measured by actively traded stock options.
- “Expected life” is the weighted average period that those stock options are expected to remain outstanding, based on the historical patterns of our stock option exercises, as adjusted to reflect the current position-level demographics of the stock option grantees.
- “Risk-free interest rate” is based on interest rates for terms that are similar to the expected life of the stock options.
- “Dividend yield” is based on our historical and expected future dividend payment practices.

We generally issue shares of our common stock from treasury shares upon the exercise of stock options or vesting of RSUs. As of December 31, 2011, 10,969,425 shares of our common stock were held in treasury. Our Board of Directors has authorized us to repurchase outstanding shares of our common stock, but we are unable to determine at this point how many shares we will repurchase over the next 12 months. See Note 5 for additional disclosures regarding our stock repurchases.

Operating Leases. We lease our non-owned facilities under operating lease agreements. Common provisions within our operating lease agreements include:

- renewal options, which can be exercised after the initial lease term;
- rent escalation clauses;
- tenant improvement allowances; and
- rent holidays.

We record the rent expense associated with each operating lease agreement evenly over the term of the lease. The difference between the amount of rent expense recorded and the amount of rent actually paid is recorded as accrued rent, which is included in Other liabilities, on our Consolidated Balance Sheets.

Income Taxes. We account for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for expected future tax consequences of temporary differences that currently exist between the tax bases and financial reporting bases of our assets and liabilities.

We follow the guidance under ASC 740, “Income Taxes,” which prescribes a single, comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on its tax returns. This guidance requires us to evaluate whether it is more likely than not, based on the technical merits of a tax position, that the benefits resulting from the position will be realized by us.

We record interest and penalties related to unrecognized tax benefits in income tax expense.

2. New Accounting Guidance

In December 2011, the FASB issued Accounting Standards Update (“ASU”) No. 2011-12, which is included in the Codification under ASC 220, “Comprehensive Income” (“ASC 220”). This update defers the effective date of ASU No. 2011-05 for changes that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. None of the other requirements in ASU 2011-05 are affected by this update. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. The adoption of this guidance will not have a material impact on our consolidated financial statements.

Also in December 2011, the FASB issued ASU No. 2011-11, which is included in the Codification under ASC 210, “Balance Sheet.” This update provides for enhanced disclosures to help users of financial statements evaluate the effect or potential effect of netting arrangements on an entity’s financial position. This guidance is effective for interim and annual reporting periods beginning January 1, 2013. We have not yet determined the effect that the adoption of this guidance will have on our financial statements.

ITT EDUCATIONAL SERVICES, INC.
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(Dollars in thousands, except per share data and unless otherwise stated)

In September 2011, the FASB issued ASU No. 2011-08, which is included in the Codification under ASC 350, “Intangibles – Goodwill and Other” (“ASC 350”). This update allows an entity to assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. The adoption of this guidance will not have a material impact on our consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, which is included in the Codification under ASC 220. This update requires total comprehensive income, the components of net income and the components of other comprehensive income to be presented either in a single continuous statement or in two separate but consecutive statements. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. Prior to January 1, 2012, we presented total Comprehensive income and the components of Other comprehensive income in our Consolidated Statements of Shareholders’ Equity. The adoption of this guidance will require us to present Comprehensive income on a different statement.

In May 2011, the FASB issued ASU No. 2011-04, which is included in the Codification under ASC 820, “Fair Value Measurements” (“ASC 820”). This update provides guidance and clarification about the application of existing fair value measurements and disclosure requirements. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. The adoption of this guidance will not have a material impact on our consolidated financial statements.

In December 2010, the FASB issued ASU No. 2010-29, which is included in the Codification under ASC 805, “Business Combinations.” This update provides guidance on the disclosure of supplemental pro forma information for business combinations. This guidance became effective for our interim and annual reporting periods beginning January 1, 2011. The adoption of this guidance did not have a material impact on our consolidated financial statements.

Also in December 2010, the FASB issued ASU No. 2010-28, which is included in the Codification under ASC 350. This update provides guidance on applying the goodwill impairment test for reporting units with zero or negative carrying amounts. This guidance became effective for our interim and annual reporting periods beginning January 1, 2011. The adoption of this guidance did not have a material impact on our consolidated financial statements.

3. Fair Value and Credit Risk of Financial Instruments

ASC 820 defines fair value for financial reporting as the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants at the measurement date. The fair value measurement of our financial assets utilized assumptions categorized as observable inputs under ASC 820. Observable inputs are assumptions based on independent market data sources.

The following table sets forth information regarding the fair value measurement of our financial assets as of December 31, 2011:

Description	As of December 31, 2011	Fair Value Measurements at Reporting Date Using		
		(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Cash equivalents:				
Money market funds	\$228,287	\$228,287	\$0	\$0
Short-term investments:				
U.S. Treasury obligations	100,517	100,517	0	0
Government agency obligations	31,351	0	31,351	0
Corporate obligations	16,620	0	16,620	0
Other assets:				
Money market fund	7,576	7,576	0	0
	<u>\$384,351</u>	<u>\$336,380</u>	<u>\$47,971</u>	<u>\$0</u>

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The following table sets forth information regarding the fair value measurement of our financial assets as of December 31, 2010:

Description	As of December 31, 2010	Fair Value Measurements at Reporting Date Using		
		(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Cash equivalents:				
Money market funds	\$163,165	\$163,165	\$0	\$0
Short-term investments:				
U.S. Treasury obligations	110,560	110,560	0	0
Government agency obligations	24,394	0	24,394	0
Corporate obligations	8,903	0	8,903	0
Other assets:				
Money market fund	4,372	4,372	0	0
	<u>\$311,394</u>	<u>\$278,097</u>	<u>\$33,297</u>	<u>\$0</u>

We used quoted prices in active markets for identical assets as of the measurement dates to value our financial assets that were categorized as Level 1. For assets that were categorized in Level 2, we used:

- quoted prices for similar assets in active markets;
- quoted prices for identical or similar assets in markets that were not active or in which little public information had been released;
- inputs other than quoted prices that were observable for the assets; or
- inputs that were principally derived from or corroborated by observable market data by correlation or other means.

The carrying amounts for cash and cash equivalents, restricted cash, accounts receivable, accounts payable, other current liabilities and deferred revenue approximate fair value because of the immediate or short-term maturity of these financial instruments. Investments classified as available-for-sale are recorded at their market value.

The fair value of the notes receivable included in Other assets on our Consolidated Balance Sheet as of December 31, 2011 is estimated by discounting the future cash flows using current rates for similar arrangements. As of December 31, 2011, the carrying value and the estimated fair value of these financial instruments was approximately \$19,000.

The fair value of our long-term debt is estimated by discounting the future cash flows using current rates for similar loans with similar characteristics and remaining maturities. As of December 31, 2011, the carrying value and the estimated fair value of our long-term debt was approximately \$150,000.

Financial instruments that potentially subject us to credit risk consist primarily of accounts receivable, interest-bearing investments and notes receivable. There is no concentration of credit risk of our accounts receivable, as the total is comprised of a large number of individual balances owed by students whose credit profiles vary and who are located throughout the United States. Our interest-bearing investments generally consist of high-quality securities issued by various entities and major financial institutions. Substantially all of the assets of the party to whom we issued one of the notes receivable serve as collateral for the repayment of the note.

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4. Equity Compensation Plans

We have adopted the following equity compensation plans, referred to collectively as the “Plans”:

- *2006 ITT Educational Services, Inc. Equity Compensation Plan* – Awards may be granted to our employees and directors under the 2006 ITT Educational Services, Inc. Equity Compensation Plan, as amended (“2006 Equity Compensation Plan”) in the form of stock options (incentive and nonqualified), stock appreciation rights (“SARs”), restricted stock, RSUs, performance shares, performance units and other stock-based awards as defined in the plan. The maximum number of shares of our common stock that may be issued pursuant to awards under this plan is 4,000,000. Each share underlying stock options and SARs granted and not forfeited or terminated, reduces the number of shares available for future awards by one share. The delivery of a share in connection with a “full-value award” (i.e., an award of restricted stock, RSUs, performance shares, performance units or any other stock-based award with value denominated in shares) reduces the number of shares remaining for other awards by three shares. As of December 31, 2011, restricted stock, RSUs and nonqualified stock options have been awarded under this plan.
- *1999 Outside Directors Stock Option Plan* – A maximum of 500,000 shares of our common stock were available to be issued upon the exercise of nonqualified stock options granted to non-employee directors under the 1999 Outside Directors Stock Option Plan (“1999 Directors Stock Plan”).
- *1997 ITT Educational Services, Inc. Incentive Stock Plan* – A maximum of 8,100,000 shares of our common stock were available to be issued upon the exercise of stock options and pursuant to other forms of awards under the 1997 ITT Educational Services, Inc. Incentive Stock Plan (“1997 Stock Plan”), but no more than 20% of the total number of shares on a cumulative basis could have been used for restricted stock or performance share awards. A maximum of 1.5% of our outstanding shares of common stock could have been issued annually, with any unissued shares available to be issued in later years.

No additional awards have been or will be granted after May 9, 2006 under the 1999 Directors Stock Plan or the 1997 Stock Plan.

The stock-based compensation expense and related income tax benefit recognized in our Consolidated Statements of Income in the periods indicated were as follows:

	Year Ended December 31,		
	2011	2010	2009
Stock-based compensation expense	\$17,074	\$15,813	\$13,074
Income tax (benefit)	(\$6,574)	(\$6,089)	(\$5,034)

We did not capitalize any stock-based compensation cost in the years ended December 31, 2011, 2010 and 2009.

As of December 31, 2011, we estimated that pre-tax compensation expense for unvested stock-based compensation grants in the amount of approximately \$16,900, net of estimated forfeitures, will be recognized in future periods. This expense will be recognized over the remaining service period applicable to the grantees which, on a weighted-average basis, is approximately 1.9 years.

Stock Options. Under the Plans, the stock option exercise price may not be less than 100% of the fair market value of our common stock on the date of grant. The maximum term of any stock option granted under the 2006 Equity Compensation Plan may not exceed seven years from the date of grant, and those stock options will be exercisable at such times and under conditions as determined by the Compensation Committee of our Board of Directors, subject to the limitations contained in the plan.

Under the 1999 Directors Stock Plan, the stock options granted typically vested and became exercisable on the first anniversary of the grant. The maximum term of any stock option granted under the 1999 Directors Stock Plan was: (a) 10 years from the date of grant for any stock options granted prior to January 25, 2005; and (b) seven years from the date of grant for any stock options granted on or after January 25, 2005.

Under the 1997 Stock Plan, the stock options granted typically vested and became exercisable in three equal annual installments commencing with the first anniversary of the date of grant. The maximum term of any stock option granted under the 1997 Stock Plan was 10 years and two days from the date of grant.

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The stock options granted, forfeited, exercised and expired in the period indicated were as follows:

Year Ended December 31, 2011

	# of Shares	Weighted Average Exercise Price	Aggregate Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ⁽¹⁾
Outstanding at beginning of period	1,724,791	\$77.95	\$134,447		
Granted	159,500	\$69.43	11,074		
Forfeited	0	\$0.00	0		
Exercised	(118,410)	\$47.28	(5,599)		
Expired	0	\$0.00	0		
Outstanding at end of period	<u>1,765,881</u>	<u>\$79.24</u>	<u>\$139,922</u>	<u>3.5 years</u>	<u>\$7,486</u>
Exercisable at end of period	<u>1,319,700</u>	<u>\$72.48</u>	<u>\$95,656</u>	<u>2.8 years</u>	<u>\$7,486</u>

- (1) The aggregate intrinsic value of the stock options was calculated by identifying those stock options that had a lower exercise price than the closing market price of our common stock on December 30, 2011 and multiplying the difference between the closing market price of our common stock and the exercise price of each of those stock options by the number of shares subject to those stock options that were outstanding or exercisable, as applicable.

The following table sets forth information regarding the stock options granted and exercised in the periods indicated:

Year Ended December 31,

	2011	2010	2009
Shares subject to stock options granted	159,500	305,000	258,000
Weighted average grant date fair value	\$28.90	\$43.59	\$54.05
Shares subject to stock options exercised	118,410	179,079	210,044
Intrinsic value of stock options exercised	\$3,095	\$8,920	\$14,626
Proceeds received from stock options exercised	\$5,599	\$7,893	\$8,800
Tax benefits realized from stock options exercised	\$1,190	\$3,385	\$5,475

The intrinsic value of a stock option is the difference between the fair market value of the stock and the option exercise price. The fair value of each stock option grant was estimated on the date of grant using the following assumptions:

Year Ended December 31,

	2011	2010	2009
Risk-free interest rates	1.8%	2.2%	1.6%
Expected lives (in years)	4.7	4.6	4.5
Volatility	48%	43%	54%
Dividend yield	None	None	None

Restricted Stock Units. Under the 2006 Equity Compensation Plan, RSUs awarded are subject to a restriction period of at least: (a) for awards made prior to November 24, 2010, three years in the case of a time-based period of restriction and one year in the case of a performance-based period of restriction; and (b) for awards made after November 24, 2010, one year. All RSUs awarded under the 2006 Equity Compensation Plan as of December 31, 2011 have a time-based restriction period that ranges from ending on the first to the fifth anniversary of the date of grant.

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The following table sets forth the number of RSUs that were granted, forfeited and vested in the period indicated:

	Year Ended December 31, 2011	
	# of RSUs	Weighted Average Grant Date Fair Value
Unvested at beginning of period	128,803	\$99.22
Granted	249,781	\$70.04
Forfeited	(28,011)	\$82.96
Vested	(36,567)	\$82.22
Unvested at end of period	<u>314,006</u>	<u>\$79.44</u>

In 2011, we awarded 50,363 RSUs that had a time-based restriction period that ended on the first anniversary of the date of grant. Each of these RSUs had a grant date fair value of \$69.43 and was settled in cash in January 2012. All other RSUs awarded in 2011 have time-based restriction periods that lapse in thirds on each of the first three anniversaries of the date of grant or in full on the third anniversary of the date of grant and all such RSUs will be settled in shares of our common stock. The total fair market value of the RSUs vested during the year ended December 31, 2011 was \$2,454.

5. Stock Repurchases

As of December 31, 2011, 5,796,725 shares remained available for repurchase under the share repurchase program (the "Repurchase Program") authorized by our Board of Directors. The terms of the Repurchase Program provide that we may repurchase shares of our common stock, from time to time depending on market conditions and other considerations, in the open market or through privately negotiated transactions in accordance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Unless earlier terminated by our Board of Directors, the Repurchase Program will expire when we repurchase all shares authorized for repurchase thereunder.

The following table sets forth information regarding the shares of our common stock that we repurchased in the periods indicated:

	Year Ended December 31,	
	2011	2010
Number of shares	4,040,000	5,657,500
Total cost	\$282,701	\$434,656
Average cost per share	\$69.98	\$76.83

6. Earnings Per Common Share

Earnings per common share for all periods have been calculated in conformity with ASC 260, "Earnings Per Share." This data is based on historical net income and the weighted average number of shares of our common stock outstanding during each period as set forth in the following table:

	Year Ended December 31,		
	2011	2010	2009
	(In thousands)		
Shares:			
Weighted average number of shares of common stock outstanding	27,429	33,165	37,490
Shares assumed issued (less shares assumed purchased for treasury) for stock-based compensation	226	336	452
Outstanding shares for diluted earnings per share calculation	<u>27,655</u>	<u>33,501</u>	<u>37,942</u>

A total of 1,128,236 shares for fiscal year 2011, 1,002,962 shares for fiscal year 2010 and 272,279 shares for fiscal year 2009 were excluded from the calculation of our diluted earnings per common share because the effect was anti-dilutive.

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7. Debt

We are a party to a Second Amended and Restated Credit Agreement dated as of January 11, 2010, as amended (the "Credit Agreement"), which provides that we may borrow up to \$150,000 under two revolving credit facilities: one in the maximum principal amount of \$100,000; and the other in the maximum principal amount of \$50,000. Borrowings under the Credit Agreement have been and may be used to allow us to continue repurchasing shares of our common stock while maintaining compliance with certain financial ratios required by various education authorities that regulate us. Both revolving credit facilities under the Credit Agreement mature on July 1, 2014.

The Credit Agreement was amended as of June 27, 2011 to:

- extend the maturity date;
- decrease the margin applicable to the interest rate that is based on the London Interbank Offered Rate ("LIBOR") and adjusted for any reserve percentage obligations under the Federal Reserve System regulations; and
- decrease the facility fee.

We can borrow under each credit facility on either a secured or unsecured basis at our election, except if an event that would be a default under the Credit Agreement has occurred and is continuing, we may not elect to borrow on an unsecured basis. Cash equivalents and investments held in a pledged account serve as the collateral for any secured borrowings under the Credit Agreement. Secured borrowings may not exceed 95% of the fair market value of the collateral.

The Credit Agreement contains, among other things, covenants, representations and warranties and events of default customary for credit facilities. Our material subsidiaries also guarantee the obligations under the Credit Agreement. Our ability to borrow under the Credit Agreement is subject to our satisfaction of certain specified conditions at the time of borrowing. These conditions include the absence of default by us, as defined in the Credit Agreement, and that the representations and warranties contained in the Credit Agreement and related documents continue to be true and correct. Under the Credit Agreement, we are also required to maintain:

- a certain maximum leverage ratio at the end of each of our fiscal quarters;
- a quarterly minimum ratio of cash and investments to indebtedness; and
- a minimum United States Department of Education ("ED") financial responsibility composite ratio as of the end of each fiscal year.

We were in compliance with those requirements as of December 31, 2011.

Borrowings under the Credit Agreement bear interest, at our option, at the LIBOR plus an applicable margin or at an alternative base rate, as defined under the Credit Agreement. As of December 31, 2011, we pay a facility fee equal to 0.25% per annum on the daily amount of the commitment (whether used or unused) under the Credit Agreement. As of December 31, 2011, the borrowings under the Credit Agreement were \$150,000, all of which were secured and bore interest at a rate of 0.74% per annum. Approximately \$157,950 of our investments and cash equivalents held in a pledged account served as collateral for the secured borrowings as of December 31, 2011.

We recognized interest expense on our borrowings of \$1,825 in the year ended December 31, 2011, \$1,912 in the year ended December 31, 2010 and \$717 in the year ended December 31, 2009.

8. Financial Aid Programs

We participate in various Title IV Programs of the HEA. In 2011, approximately 67% of our revenue determined on a cash accounting basis under the calculation of the provision of the HEA commonly referred to as the "90/10 Rule" was from funds distributed under these programs.

We administer the Title IV Programs in separate accounts as required by government regulation. We are required to administer the funds in accordance with the requirements of the HEA and the ED's regulations and must use due diligence in approving and disbursing funds and servicing loans. In the event we do not comply with federal requirements, or if student loan default rates rise to a level considered excessive by the federal government, we could lose our eligibility to participate in Title IV Programs or could be required to repay funds determined to have been improperly disbursed. Our management believes that we are in substantial compliance with the federal requirements.

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9. Investments

Our available-for-sale investments were classified as short-term investments on our December 31, 2011 and 2010 Consolidated Balance Sheets. The following table sets forth the aggregate fair value, amortized cost basis and the net unrealized gains and losses included in accumulated other comprehensive income (loss) of our available-for-sale investments as of the dates indicated:

	As of:					
	December 31, 2011			December 31, 2010		
	Aggregate Fair Value	Amortized Cost	Net Unrealized Gains (Losses)	Aggregate Fair Value	Amortized Cost	Net Unrealized Gains (Losses)
Available-for-Sale Investments:						
Government obligations	\$100,517	\$100,480	\$37	\$110,560	\$110,550	\$10
Government agency obligations	31,351	31,354	(3)	24,394	24,399	(5)
Corporate obligations	16,620	16,633	(13)	8,903	8,908	(5)
	<u>\$148,488</u>	<u>\$148,467</u>	<u>\$21</u>	<u>\$143,857</u>	<u>\$143,857</u>	<u>\$0</u>

We also held a certificate of deposit with a total principal value of \$5,303 as of December 31, 2010. We did not hold a certificate of deposit as of December 31, 2011. This investment was included in Short-term investments on our Consolidated Balance Sheet. We had \$148,488 of debt securities classified as available-for-sale as of December 31, 2011, and all of those debt securities had contractual maturities within one year.

The following table sets forth the unrealized gains and losses on available-for-sale investments that were included in other comprehensive income (loss) in the periods indicated:

	Year Ended December 31,		
	2011	2010	2009
Unrealized gains	\$0	\$104	\$0
Unrealized losses	(\$60)	\$0	(\$451)

No unrealized gains or losses were reclassified out of our accumulated other comprehensive income (loss) during our fiscal years ended December 31, 2011 and 2010.

The following table sets forth the components of investment income included in interest income in our Consolidated Statements of Income in the periods indicated:

	Year Ended December 31,		
	2011	2010	2009
Realized net gains on the sale of investments	\$325	\$96	\$177
Interest income on investments	414	731	3,114
	<u>\$739</u>	<u>\$827</u>	<u>\$3,291</u>

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10. Property and Equipment

The following table sets forth our property and equipment, net, as of the dates indicated:

	As of December 31,	
	2011	2010
Furniture and equipment	\$167,743	\$153,014
Buildings and building improvements	131,243	126,898
Land and land improvements	39,609	39,598
Leasehold improvements	18,055	16,547
Software	8,620	8,620
Construction in progress	6,000	4,043
	<u>\$371,270</u>	<u>\$348,720</u>
Less: Accumulated depreciation and amortization	(170,013)	(150,507)
Property and equipment, net	<u>\$201,257</u>	<u>\$198,213</u>

Software includes purchased and internally developed software.

The following table sets forth the depreciation and amortization expense for the assets listed above in the periods indicated:

	Year Ended December 31,		
	2011	2010	2009
Depreciation and amortization expense	\$27,856	\$26,764	\$24,895

11. Variable Interests

On January 20, 2010, we entered into agreements with unrelated third parties to establish the PEAKS Private Student Loan Program (“PEAKS Program”), which is a private education loan program for our students. Under the PEAKS Program, an unaffiliated lender originated private education loans to our eligible students and, subsequently, sells those loans to an unaffiliated trust that purchases, owns and collects private education loans (“PEAKS Trust”). The PEAKS Trust issued senior debt in the aggregate principal amount of \$300,000 (“PEAKS Senior Debt”) to investors. The lender disburses the proceeds of the private education loans to us for application to the students’ account balances with us that represent their unpaid education costs. We transfer a portion of the amount of each private education loan disbursed to us under the PEAKS Program to the PEAKS Trust in exchange for a subordinated note issued by the PEAKS Trust (“Subordinated Note”). No new private education loans were or will be originated under the PEAKS Program after July 2011, but immaterial amounts related to loans originated prior to that date will be disbursed by the lender and purchased by the PEAKS Trust through approximately March 2012.

The Subordinated Note is non-interest bearing and has been recorded net of an unamortized discount based on an imputed interest rate of 9.0% in Other assets on our Consolidated Balance Sheets. The discount will be amortized and recognized in Interest income on our Consolidated Statements of Income over the term of the Subordinated Note, which is expected to be approximately 15 years. The face value of the Subordinated Note as of December 31, 2011 was approximately \$78,000.

The PEAKS Trust utilizes the proceeds from the issuance of the PEAKS Senior Debt and the Subordinated Note to purchase the private education loans made by the lender to our students. The assets of the PEAKS Trust (which include, among other assets, the private education loans owned by the PEAKS Trust) serve as collateral for, and are intended to be the principal source of, the repayment of the PEAKS Senior Debt and the Subordinated Note. The PEAKS Trust is required to maintain assets having an aggregate value that exceeds the outstanding balance of the PEAKS Senior Debt. As of December 31, 2011, the value of the assets of the PEAKS Trust satisfied this requirement. We guarantee payment of the principal, interest and certain call premiums owed on the PEAKS Senior Debt, and the administrative fees and expenses of the PEAKS Trust (“PEAKS Guarantee”). See Note 14 – Commitments and Contingencies, for further discussion of the PEAKS Guarantee.

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We did not explicitly or implicitly provide any financial or other support to the PEAKS Trust during the fiscal year ended December 31, 2011 that we were not contractually required to provide, and we do not intend to provide any such support to the PEAKS Trust in the foreseeable future, other than what we are contractually required to provide.

The PEAKS Trust is a variable interest entity as defined under ASC 810. We held variable interests in the PEAKS Trust as of December 31, 2011 as a result of the Subordinated Note and PEAKS Guarantee. To determine whether we were the primary beneficiary of the PEAKS Trust, we:

- assessed the risks that the PEAKS Trust was designed to create and pass through to its variable interest holders;
- identified the variable interests in the PEAKS Trust;
- identified the other variable interest holders and their involvement in the activities of the PEAKS Trust;
- identified the activities that most significantly impact the PEAKS Trust's economic performance;
- determined whether we have the power to direct those activities; and
- determined whether we have the right to receive the benefits from, or the obligation to absorb the losses of, the PEAKS Trust that could potentially be significant to the PEAKS Trust.

We determined that the activities of the PEAKS Trust that most significantly impact the economic performance of the PEAKS Trust involve:

- establishing the underwriting criteria of, and the interest rates and fees charged on, the private education loans acquired by the PEAKS Trust; and
- the servicing (which includes the collection) of the private education loans owned by the PEAKS Trust.

To make that determination, we analyzed various possible scenarios of student loan portfolio performance to evaluate the potential economic impact on the PEAKS Trust. In our analysis, we made what we believe are conservative assumptions based on historical data for the following key variables:

- the composition of the credit profiles of the borrowers;
- the interest rates and fees charged on the loans;
- the default rates and the timing of defaults associated with similar types of loans; and
- the prepayment and the speed of repayment associated with similar types of loans.

Based on our analysis, we concluded that we are not the primary beneficiary of the PEAKS Trust, because we do not have the power to direct the activities that most significantly impact the economic performance of the PEAKS Trust. As a result, we are not required under ASC 810 to include the financial results of the PEAKS Trust in our consolidated financial statements for the fiscal year ended December 31, 2011. Our conclusion that we are not the primary beneficiary of the PEAKS Trust did not change from the prior reporting period. Therefore, there was no effect on our consolidated financial statements.

On February 20, 2009, we entered into agreements with an unaffiliated entity (the "2009 Entity") to create a program that made private education loans available to our students to help pay the students' cost of education that student financial aid from federal, state and other sources did not cover (the "2009 Loan Program"). Under the 2009 Loan Program, an unaffiliated lender originated private education loans to our eligible students and, subsequently, sells those loans to the 2009 Entity. The 2009 Entity purchases the private education loans from the lender utilizing funds received from its owners in exchange for participation interests in the private education loans acquired by the 2009 Entity. The lender disburses the proceeds of the private education loans to us for application to the students' account balances with us that represent their unpaid education costs. No new private education loans were or will be originated under the 2009 Loan Program after December 31, 2011, but immaterial amounts related to loans originated prior to that date will be disbursed by the lender and purchased by the 2009 Entity through approximately June 2012.

In connection with the 2009 Loan Program, we entered into a risk sharing agreement (the "2009 RSA") with the 2009 Entity. Under the 2009 RSA, we guarantee the repayment of any private education loans that are charged off above a certain percentage of the private education loans made under the 2009 Loan Program, based on the annual dollar volume. See Note 14 – Commitments and Contingencies, for further discussion of the 2009 RSA.

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In addition, we have made advances to the 2009 Entity under a revolving promissory note (the “Revolving Note”). We provided advances of approximately \$550 in the fiscal year ended December 31, 2011 and approximately \$6,311 in the fiscal year ended December 31, 2010 to the 2009 Entity under the Revolving Note that we were not contractually required to provide. Substantially all of the assets of the 2009 Entity serve as collateral for the Revolving Note. The Revolving Note bears interest, is subject to customary terms and conditions and may be repaid at any time without penalty prior to its 2026 maturity date.

The advances under the Revolving Note were primarily used by the 2009 Entity to purchase additional private education loans under the 2009 Loan Program that otherwise may not have been originated. We have no immediate plans to significantly increase the amount of advances that we make to the 2009 Entity under the Revolving Note, but we may decide to do so in the foreseeable future.

The 2009 Entity is a variable interest entity as defined under ASC 810. We held variable interests in the 2009 Entity as of December 31, 2011 as a result of the Revolving Note and 2009 RSA. To determine whether we were the primary beneficiary of the 2009 Entity, we:

- assessed the risks that the 2009 Entity was designed to create and pass through to its variable interest holders;
- identified the variable interests in the 2009 Entity;
- identified the other variable interest holders and their involvement in the activities of the 2009 Entity;
- identified the activities that most significantly impact the 2009 Entity’s economic performance;
- determined whether we have the power to direct those activities; and
- determined whether we have the right to receive the benefits from, or the obligation to absorb the losses of, the 2009 Entity that could potentially be significant to the 2009 Entity.

To identify the activities of the 2009 Entity that most significantly impact the economic performance of the 2009 Entity, we analyzed various possible scenarios of private education loan portfolio performance. In our analysis, we made what we believe are conservative assumptions based on historical data for the following key variables:

- the composition of the credit profiles of the borrowers;
- the interest rates and fees charged on the loans;
- the default rates and the timing of defaults associated with similar types of loans; and
- the prepayment and the speed of repayment associated with similar types of loans.

We determined that the activities of the 2009 Entity that most significantly impact its economic performance involve:

- establishing the underwriting criteria of, and the interest rates and fees charged on, the private education loans acquired by the 2009 Entity; and
- the servicing (which includes the collection) of the private education loans owned by the 2009 Entity.

Based on our analysis, we concluded that we are not the primary beneficiary of the 2009 Entity, because we do not direct those activities. As a result, we are not required under ASC 810 to include the financial results of the 2009 Entity in our consolidated financial statements for the fiscal year ended December 31, 2011. Our conclusion that we are not the primary beneficiary of the 2009 Entity did not change from the prior reporting period. Therefore, there was no effect on our consolidated financial statements.

The carrying value of the Subordinated Note and the Revolving Note as of December 31, 2011 was approximately \$19,000 and is included in Other assets on our Consolidated Balance Sheet.

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12. Income Taxes

The following table sets forth the components of the provision for income taxes in the periods indicated:

	Year Ended December 31,		
	2011	2010	2009
Current income tax expense:			
U.S. federal	\$174,264	\$216,839	\$165,806
State and local	35,128	37,687	28,354
Total	<u>\$209,392</u>	<u>\$254,526</u>	<u>\$194,160</u>
Deferred income tax (benefit):			
U.S. federal	(\$7,564)	(\$12,244)	(\$2,579)
State and local	(1,427)	(2,313)	(487)
Total	<u>(\$8,991)</u>	<u>(\$14,557)</u>	<u>(\$3,066)</u>
Total provision for income taxes	<u>\$200,401</u>	<u>\$239,969</u>	<u>\$191,094</u>

The following table sets forth the components of our deferred income tax assets (liabilities) as of the dates indicated:

	As of December 31,	
	2011	2010
Deferral of book costs	(\$1,934)	(\$2,226)
Property and equipment	(9,742)	(2,885)
Pension	(1,674)	(4,465)
Other	(2,159)	(1,230)
Gross deferred tax (liabilities)	<u>(\$15,509)</u>	<u>(\$10,806)</u>
Deferred revenue	\$5,400	\$3,542
Accounts receivable	3,581	2,938
Legal accrual	1,980	2,111
Compensation and benefits	1,316	3,284
Stock-based compensation	20,255	15,113
Operating leases	724	1,426
Other assets	11,575	8,885
Other contingent liabilities	13,704	4,400
Gross deferred tax assets	<u>\$58,535</u>	<u>\$41,699</u>
Net deferred income tax asset	<u>\$43,026</u>	<u>\$30,893</u>

The difference between the U.S. federal statutory income tax rate and our effective income tax rate as a percentage of income in the periods indicated is reconciled in the following table:

	Year Ended December 31,		
	2011	2010	2009
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	4.0%	3.6%	3.6%
Other	0.4%	0.5%	0.3%
Effective income tax rate	<u>39.4%</u>	<u>39.1%</u>	<u>38.9%</u>

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The following table sets forth the activity with respect to our unrecognized tax benefits in the period indicated:

	Year Ended December 31,		
	2011	2010	2009
Balance as of January 1	\$22,888	\$13,274	\$10,889
Increases (decreases) from:			
Tax positions taken during a prior period	1,042	522	0
Tax positions taken during the current period	2,434	9,461	3,053
Settlements with taxing authorities	(2,487)	(78)	(505)
Lapse of statute of limitations	(1,827)	(291)	(163)
Balance as of December 31	<u>\$22,050</u>	<u>\$22,888</u>	<u>\$13,274</u>

The amount of unrecognized tax benefits that, if recognized, would have affected our effective tax rate as of December 31, 2011 was \$10,449. We do not expect the amount of our unrecognized tax benefits to significantly increase or decrease during the next 12 months. The amount of interest and penalties related to unrecognized tax benefits accrued on our Consolidated Balance Sheets was \$5,177 as of December 31, 2011 and \$2,797 as of December 31, 2010. In each of the years ended December 31, 2011, 2010 and 2009, the amount of interest expense and penalties related to our unrecognized tax benefits that we recognized in our Consolidated Statements of Income was not material.

We file income tax returns in the United States (federal) and in various state and local jurisdictions. As of December 31, 2011, we were no longer subject to federal, state or local income tax examinations for tax years prior to 2008, except in nine states where we are still subject to income tax examinations for tax years 2005 through 2007.

13. Employee Benefit Plans

Employee Pension Benefits. Our ESI Pension Plan, a non-contributory defined benefit pension plan, commonly referred to as a cash balance plan, covers substantially all of our employees who began their employment with us prior to June 2, 2003. This plan provides benefits based on an employee's annual earnings times an established percentage of pay determined by the employee's age and years of benefit service. Effective June 2, 2003, we closed participation in the ESI Pension Plan to all new employees. Employees who begin their employment with us on or after June 2, 2003 do not participate in the ESI Pension Plan.

Our ESI Excess Pension Plan, a nonqualified, unfunded retirement plan, covers a select group of our management. The purpose of the ESI Excess Pension Plan is to restore benefits earned, but not available, to eligible employees under the ESI Pension Plan due to federal statutory limitations on the amount of benefits that can be paid and compensation that may be recognized under a tax-qualified retirement plan.

The benefit accruals under the ESI Pension Plan and the ESI Excess Pension Plan for all participants in those plans were frozen effective March 31, 2006, such that no further benefits accrue under those plans after March 31, 2006. Participants in those plans, however, continue to be credited with vesting service and interest according to the terms of the ESI Pension Plan and the ESI Excess Pension Plan.

Effective January 1, 2011, we changed the rates at which interest is credited under the ESI Pension Plan and ESI Excess Pension Plan. This change resulted in the recognition of \$10,370 of prior service credits in other comprehensive loss in the year ended December 31, 2010.

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The information presented below is based on an actuarial valuation date as of December 31 for 2011 and 2010.

The following table sets forth the change in projected benefit obligation for the periods indicated:

	Year Ended December 31,	
	2011	2010
Projected benefit obligation at beginning of year	\$49,878	\$53,854
Service cost	0	0
Actuarial loss	5,215	6,406
Interest cost	2,405	3,048
Benefits paid	(3,013)	(3,060)
Plan amendments	0	(10,370)
Projected benefit obligation at end of year	\$54,485	\$49,878
Fair value of plan assets at end of year	58,839	61,385
Funded status at end of year	\$4,354	\$11,507

Our accumulated benefit obligation was \$54,485 at December 31, 2011 and \$49,878 at December 31, 2010.

The following table sets forth the funded status of our defined benefit plans that was recognized on our Consolidated Balance Sheets as of the dates indicated:

	As of December 31,	
	2011	2010
Non-current assets	\$4,641	\$11,752
Current (liabilities)	0	0
Non-current (liabilities)	(287)	(245)
Total	\$4,354	\$11,507

The weighted-average assumptions used to determine benefit obligations as of December 31, 2011 and 2010 are as follows:

	2011	2010
Discount rate	4.00%	5.00%
Rate of compensation increase	N/A	N/A

The following table sets forth the change in plan assets for the periods indicated:

	Year Ended December 31,	
	2011	2010
Fair value of plan assets at beginning of year	\$61,385	\$56,966
Actual return on plan assets	467	7,479
Employer contributions	0	0
Benefits paid	(3,013)	(3,060)
Fair value of plan assets at end of year	\$58,839	\$61,385

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The following tables set forth the fair value of total plan assets by major asset category as of the dates indicated:

Fair Value Measurements as of December 31, 2011				
(Level 1)				
Asset Category	Total	Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Cash and cash equivalents	\$573	\$573	\$0	\$0
Fixed income securities (a)	19,000	19,000	0	0
Equity securities:				
Domestic large cap	25,424	25,424	0	0
Mid cap value/growth (a)	7,744	7,744	0	0
Small cap value/growth (a)	4,343	4,343	0	0
Foreign equities	1,755	1,755	0	0
Total	<u>\$58,839</u>	<u>\$58,839</u>	<u>\$0</u>	<u>\$0</u>

(a) Mutual funds.

Fair Value Measurements as of December 31, 2010				
(Level 1)				
Asset Category	Total	Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Cash and cash equivalents	\$292	\$292	\$0	\$0
Fixed income securities (a)	20,781	20,781	0	0
Equity securities:				
Domestic large cap	26,322	26,322	0	0
Mid cap value/growth (a)	7,885	7,885	0	0
Small cap value/growth (a)	4,495	4,495	0	0
Foreign equities	1,610	1,610	0	0
Total	<u>\$61,385</u>	<u>\$61,385</u>	<u>\$0</u>	<u>\$0</u>

(a) Mutual funds.

We used quoted prices in active markets for identical assets as of the measurement dates to value our plan assets that were categorized as Level 1.

The following table sets forth the amounts in Accumulated other comprehensive loss on our Consolidated Balance Sheets that have not been recognized as components of net periodic benefit cost as of the dates indicated:

	As of December 31,	
	2011	2010
Net actuarial (loss)	(\$24,322)	(\$17,824)
Prior service credit	8,688	10,242
Total accumulated other comprehensive (loss)	(\$15,634)	(\$7,582)
Income tax benefit	6,134	2,992
Total accumulated other comprehensive (loss), net of tax	<u>(\$9,500)</u>	<u>(\$4,590)</u>

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The following table sets forth the components of net periodic pension cost (benefit) in the periods indicated:

	Year Ended December 31,		
	2011	2010	2009
Interest cost	\$2,405	\$3,048	\$3,103
Expected return on assets	(4,756)	(4,401)	(3,819)
Recognized net actuarial loss	1,802	1,917	2,364
Amortization of prior service (credit) cost	(1,554)	28	28
Settlement loss	1,204	0	46
Total net periodic pension (benefit) cost	<u>(\$899)</u>	<u>\$592</u>	<u>\$1,722</u>

The benefit accruals under the ESI Pension Plan and ESI Excess Pension Plan were frozen effective March 31, 2006. As a result, no service cost has been included in the net periodic pension cost or benefit.

The following table sets forth the amounts related to changes in plan assets and projected benefit obligations that were recognized in other comprehensive (income) loss in the periods indicated:

	Year Ended December 31,		
	2011	2010	2009
Net actuarial loss (gain)	\$9,504	\$3,328	(\$3,719)
Amortization of net actuarial loss	(1,802)	(1,917)	(2,364)
Prior service cost (credit)	0	(10,370)	0
Amortization of prior service cost (credit)	1,554	(28)	(28)
Settlement	(1,204)	0	(46)
Other comprehensive loss (income)	<u>\$8,052</u>	<u>(\$8,987)</u>	<u>(\$6,157)</u>
Total recognized in net periodic pension cost (benefit) and other comprehensive loss (income)	<u>\$7,153</u>	<u>(\$8,395)</u>	<u>(\$4,435)</u>

The amortization of any prior service cost is determined using a straight-line amortization of the cost over the average remaining service period for employees expected to receive benefits under the pension plans. The estimated net actuarial loss that is expected to be amortized from accumulated other comprehensive loss and recognized in net periodic pension cost for the year ended December 31, 2012 is \$2,784 and the estimated prior service credit that is expected to be amortized from accumulated other comprehensive loss and recognized in net periodic pension benefit for the year ended December 31, 2012 is \$1,555.

The weighted-average assumptions used to determine net periodic pension cost in the years ended December 31, 2011, 2010 and 2009 are as follows:

	2011	2010	2009
Discount rate	5.00%	5.50%	6.25%
Expected long-term return on plan assets	8.00%	8.00%	8.00%
Rate of compensation increase	N/A	N/A	N/A

The following table sets forth the benefit payments that we expect to pay from the pension plans in the periods indicated:

Year	Amount
Fiscal 2012	\$3,035
Fiscal 2013	\$3,227
Fiscal 2014	\$3,504
Fiscal 2015	\$3,385
Fiscal 2016	\$3,539
Fiscal 2017 – 2021	\$18,253

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We invest plan assets based on a total return on investment approach, pursuant to which the plan assets include a diversified blend of equity and fixed income investments toward a goal of maximizing the long-term rate of return without assuming an unreasonable level of investment risk. We determine the level of risk based on an analysis of plan liabilities, the extent to which the value of the plan assets satisfies the plan liabilities and our financial condition. Our investment policy includes target allocations ranging from 30% to 70% for equity investments, 20% to 60% for fixed income investments and 0% to 50% for cash equivalents. The equity portion of the plan assets represents growth and value stocks of small, medium and large companies. We measure and monitor the investment risk of the plan assets both on a quarterly basis and annually when we assess plan liabilities.

We use a building block approach to estimate the long-term rate of return on plan assets. This approach is based on the capital market principle that the greater the volatility, the greater the return over the long term. An analysis of the historical performance of equity and fixed income investments, together with current market factors such as the inflation and interest rates, are used to help us make the assumptions necessary to estimate a long-term rate of return on plan assets. Once this estimate is made, we review the portfolio of plan assets and make adjustments thereto that we believe are necessary to reflect a diversified blend of equity and fixed income investments that is capable of achieving the estimated long-term rate of return without assuming an unreasonable level of investment risk. We also compare the portfolio of plan assets to those of other pension plans to help us assess the suitability and appropriateness of the plan investments.

We determine our discount rate by performing a yield curve analysis based on a portfolio of high-quality fixed income investments with various maturities. Our expected future benefit payments are discounted to their present value at the appropriate yield curve rate to generate the overall discount rate for pension obligations.

In 2011 and 2010, we made no contributions to the ESI Excess Pension Plan or the ESI Pension Plan. We do not expect to make any contributions to either the ESI Pension Plan or the ESI Excess Pension Plan in 2012.

Retirement Savings Plan. Our ESI 401(k) Plan, a defined contribution plan, covers substantially all of our employees. All of our contributions under the ESI 401(k) Plan are in the form of cash to plan investment options directed by the participant.

Our ESI Excess Savings Plan, a nonqualified, unfunded deferred compensation plan, covers a select group of our management. The plan provided for salary deferral of contributions that the participants were unable to make under the ESI 401(k) Plan and our contributions that could not be paid under the ESI 401(k) Plan due to federal statutory limits on the amount that an employee could contribute under a defined contribution plan. Effective for plan years beginning on and after January 1, 2008, we froze the ESI Excess Savings Plan, such that employees may no longer make salary deferrals and we will no longer make contributions under the ESI Excess Savings Plan. Amounts previously credited to an employee under the ESI Excess Savings Plan will, however, continue to accrue interest in accordance with the terms of the ESI Excess Savings Plan until those amounts are distributed pursuant to the plan's terms.

The costs of providing the benefits under the ESI 401(k) Plan and ESI Excess Savings Plan (including certain administrative costs of the plans) were:

- \$5,308 in the year ended December 31, 2011;
- \$5,063 in the year ended December 31, 2010; and
- \$4,430 in the year ended December 31, 2009.

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14. Commitments and Contingencies

As part of our normal operations, one of our insurers issues surety bonds for us that are required by various education authorities that regulate us. We are obligated to reimburse our insurer for any of those surety bonds that are paid by the insurer. As of December 31, 2011, the total face amount of those surety bonds was approximately \$33,700.

We are also subject to various claims and contingencies, including those related to litigation, business transactions, guarantee arrangements and employee-related matters, among others. We record a liability for those claims and contingencies, if it is probable that a loss will result and the amount of the loss can be reasonably estimated. Although we believe that our estimates related to any claims and contingencies are reasonable, we cannot make any assurances with regard to the accuracy of our estimates, and actual results could differ materially. As of December 31, 2011, our recorded liability for these claims and contingencies was approximately \$36,000 and is primarily included in Other liabilities on our Consolidated Balance Sheet. The substantial majority of this amount pertains to our guarantee arrangements.

We also considered whether additional losses for claims and contingencies were reasonably possible, could be estimated and might be material to our financial condition, results of operations or cash flows. With respect to our guarantee arrangements under the PEAKS Guarantee, the 2009 RSA and the risk sharing agreement that we entered into in 2007 (the "2007 RSA" and, collectively with the PEAKS Guarantee and the 2009 RSA, the "RSAs"), we believe that it is reasonably possible that we may incur losses in an estimated range of \$15,000 less than to \$10,000 greater than the recorded liability for those contingencies. As with any estimate, as facts and circumstances change, the recorded liability and estimated range of reasonably possible losses could change significantly. With respect to legal proceedings, we determined that we cannot provide an estimate of the possible losses, or the range of possible losses, in excess of the amount, if any, accrued, for various reasons, including but not limited to some or all of the following:

- there are significant factual issues to be resolved;
- there are novel or unsettled legal issues presented;
- the proceedings are in the early stages;
- there is uncertainty as to the likelihood of a class being certified or decertified or the ultimate size and scope of the class;
- there is uncertainty as to the outcome of pending appeals or motions; and
- in many cases, the plaintiffs have not specified damages in their complaint or in court filings.

Litigation. We are subject to various litigation in the ordinary course of our business. We cannot assure you of the ultimate outcome of any litigation involving us. Although we believe that our estimates related to any litigation are reasonable, deviations from our estimates could produce a materially different result. Any litigation alleging violations of education or consumer protection laws and/or regulations, misrepresentation, fraud or deceptive practices may also subject our affected campuses to additional regulatory scrutiny. The following is a description of pending litigation that falls outside the scope of litigation incidental to the ordinary course of our business.

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On November 3, 2010, a complaint in a securities class action lawsuit was filed against us and two of our current executive officers in the United States District Court for the Southern District of New York under the following caption: *Operating Engineers Construction Industry and Miscellaneous Pension Fund, Individually and On Behalf of All Others Similarly Situated v. ITT Educational Services, Inc., et al.* (the "Securities Litigation"). On January 21, 2011, the court named the Wyoming Retirement System as the lead plaintiff in the Securities Litigation. On April 1, 2011, an amended complaint was filed in the Securities Litigation under the following caption: *In re ITT Educational Services, Inc. Securities and Shareholder Derivative Litigation*. The amended complaint alleges, among other things, that:

- the defendants violated Section 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder by creating and implementing a systemically predatory business model that operated as a fraud or deceit on purchasers of our common stock during the class period by misrepresenting our financials and future business prospects;
- the defendants' misrepresentations and material omissions caused our common stock to trade at artificially inflated prices throughout the class period; and
- the market's expectations were ultimately corrected on August 13, 2010 when the ED published the loan repayment rate of our students under a formula contained in proposed regulations published by the ED on July 26, 2010.

The putative class period in this action is from October 23, 2008 through August 13, 2010. The plaintiff seeks, among other things, the designation of this action as a class action, and an award of unspecified compensatory damages, interest, costs, expenses, attorneys' fees and expert fees. All of the defendants intend to defend themselves vigorously against the allegations made in the complaint.

On November 12, 2010, a complaint in a shareholder derivative lawsuit was filed against three of our current executive officers and all of our current Directors in the United States District Court for the Southern District of New York under the following caption: *Antonio Cosing, Derivatively and On Behalf of ITT Educational Services, Inc. v. Kevin M. Modany, et al.* (the "Cosing Lawsuit"). The complaint alleges, among other things, that from October 23, 2008 through August 13, 2010, the defendants breached their fiduciary duties to us, abused their ability to control and influence us, grossly mismanaged us, caused us to waste corporate assets and were unjustly enriched, by making false and misleading statements and engaging in fraudulent business practices. The complaint seeks, among other things, unspecified damages, equitable and/or injunctive relief, restitution, disgorgement of profits, benefits and other compensation, an order directing us to reform our corporate governance and internal procedures, costs, disbursements and attorneys' fees. All of the individual defendants intend to defend themselves vigorously against the allegations in the complaint. On December 14, 2010, the Cosing Lawsuit was consolidated into the Securities Litigation.

On November 22, 2010, another complaint in a shareholder derivative lawsuit was filed against seven of our current officers and all of our current Directors in the United States District Court for the Southern District of Indiana under the following caption: *Roger B. Orensteen, derivatively on behalf of ITT Educational Services, Inc. v. Kevin M. Modany, et al.* The complaint alleges, among other things, that, from January 2008 through August 2010, the defendants violated Sections 10(b) and 20(a) of the Exchange Act, breached their fiduciary duties to us, abused their ability to control and influence us, grossly mismanaged us, caused us to waste corporate assets and were unjustly enriched, by making false and misleading statements and engaging in fraudulent business practices. The complaint seeks, among other things, unspecified damages, restitution, disgorgement of profits, benefits and other compensation, an order directing us to reform our corporate governance and internal procedures, costs, disbursements and attorneys' fees. All of the individual defendants intend to defend themselves vigorously against the allegations in the complaint.

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On December 3, 2010, another complaint in a shareholder derivative lawsuit was filed against two of our current executive officers and all of our current Directors in the United States District Court for the Southern District of New York under the following caption: *J. Kent Gregory, derivatively on behalf of ITT Educational Services, Inc. v. Kevin M. Modany, et al.* (the "Gregory Lawsuit"). The complaint alleges, among other things, that the defendants breached their fiduciary duties to us, were unjustly enriched by us and misappropriated information about us, by making false and misleading statements and engaging in fraudulent business practices. The complaint seeks, among other things, unspecified damages, restitution, disgorgement of profits, benefits and other compensation, an order directing us to reform our corporate governance and internal procedures, costs, disbursements and attorneys' fees. All of the individual defendants intend to defend themselves vigorously against the allegations in the complaint. The Gregory Lawsuit was consolidated into the Cosing Lawsuit on December 13, 2010 and further consolidated into the Securities Litigation on December 14, 2010.

There can be no assurance that the ultimate outcome of these or other actions (including other actions under federal or state securities laws) will not have a material adverse effect on our financial condition, results of operations or cash flows.

Lease Commitments. We lease our non-owned facilities under operating lease agreements. A majority of the operating leases contain renewal options that can be exercised after the initial lease term. Renewal options are generally for periods of one to five years. All operating leases will expire over the next 12 years and we expect that:

- those leases will be renewed or replaced by other leases in the normal course of business;
- we may purchase the facilities represented by those leases; or
- we may purchase or build other replacement facilities.

There are no material restrictions imposed by the lease agreements, and we have not entered into any significant guarantees related to the leases. We are required to make additional payments under the operating lease terms for taxes, insurance and other operating expenses incurred during the operating lease period.

Rent expense under our operating leases was:

- \$47,833 in the year ended December 31, 2011;
- \$43,777 in the year ended December 31, 2010; and
- \$37,987 in the year ended December 31, 2009.

Future minimum rental payments required under our operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2011 are as follows:

2012	\$49,715
2013	44,207
2014	38,020
2015	25,777
2016	12,766
2017 and thereafter	9,255
	\$179,740

Future minimum rental payments related to equipment leases are not significant.

Guarantees. We entered into the PEAKS Guarantee in connection with the PEAKS Program. Under the PEAKS Guarantee, we guarantee payment of the principal, interest and certain call premiums owed on the PEAKS Senior Debt, and the administrative fees and expenses of the PEAKS Trust. The PEAKS Senior Debt bears interest at a variable rate based on the LIBOR plus an applicable margin and matures in January 2020. The PEAKS Guarantee agreement contains, among other things, representations and warranties and events of default customary for guarantees. In addition, under the PEAKS Program, some or all of the holders of the PEAKS Senior Debt could require us to purchase their PEAKS Senior Debt in certain limited circumstances that pertain to our continued eligibility to participate in Title IV Programs. We believe that the likelihood of those limited circumstances occurring is remote. Our guarantee and purchase obligations under the PEAKS Program remain in effect until the PEAKS Senior Debt and the PEAKS Trust's fees and expenses are paid in full. At such time, we will be entitled to repayment of the amount of any payments made under the PEAKS Guarantee to the extent that funds are remaining in the PEAKS Trust.

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The maximum future payments that we could be required to make under the PEAKS Guarantee include:

- up to \$300,000 in principal of PEAKS Senior Debt;
- accrued interest on the PEAKS Senior Debt;
- certain call premiums associated with the PEAKS Senior Debt; and
- the fees and expenses of the PEAKS Trust.

We are not able to estimate the undiscounted maximum potential amount of future payments that we could be required to make under the PEAKS Guarantee, because those payments will be affected by:

- the repayment performance of the private education loans made under the PEAKS Program, the proceeds from which will be used to repay the PEAKS Senior Debt and to pay the fees and expenses of the PEAKS Trust;
- the fact that those loans will consist of a large number of loans of individually immaterial amounts;
- the fact that the interest rate on the PEAKS Senior Debt is a variable rate based on the LIBOR plus a margin;
- whether certain call premiums will be payable in connection with the PEAKS Senior Debt; and
- the amount of fees and expenses of the PEAKS Trust, much of which is based on the principal balance of the private education loans held by the PEAKS Trust.

No new private education loans were or will be originated under the PEAKS Program after July 2011, but immaterial amounts related to loans originated prior to that date will be disbursed and purchased through approximately March 2012.

We entered into the 2009 RSA in connection with the 2009 Loan Program. Under the 2009 RSA, we guarantee the repayment of the principal amount (including capitalized origination fees) and accrued interest payable on any private education loans that are charged off above a certain percentage of the private education loans made under the 2009 Loan Program, based on the annual dollar volume. The total initial principal amount of private education loans that the 2009 Entity purchased under the 2009 Loan Program was approximately \$141,000. No new private education loans were or will be originated under the 2009 Loan Program after December 31, 2011, but immaterial amounts related to loans originated prior to that date will be disbursed and purchased through approximately June 2012. Our obligations under the 2009 RSA will remain in effect until all private education loans made under the 2009 Loan Program are paid in full or charged off. The standard repayment term for a private education loan made under the 2009 Loan Program is ten years, with repayment generally beginning six months after a student graduates or three months after a student withdraws or is terminated from his or her program of study.

Pursuant to the 2009 RSA, we are required to maintain collateral to secure our guarantee obligation in an amount equal to a percentage of the outstanding balance of the private education loans disbursed to our students under the 2009 Loan Program. As of December 31, 2011, the total collateral maintained in a restricted bank account was not material. This amount is included in Other assets on our Consolidated Balance Sheet as of December 31, 2011. The 2009 RSA also requires that we comply with certain covenants, including that we maintain certain financial ratios which are measured on a quarterly basis. We were in compliance with these covenants as of December 31, 2011.

We entered into the 2007 RSA with a different lender for certain private education loans that were made to our students in 2007 and early 2008. We guarantee the repayment of any private education loans that the lender charges off above a certain percentage of the total dollar volume of private education loans made under the 2007 RSA. We will have the right to pursue repayment from the borrowers for those charged off private education loans under the 2007 RSA that we pay to the lender pursuant to our guarantee obligation. The 2007 RSA was terminated effective February 22, 2008, such that no private education loans have been or will be made under the 2007 RSA after that date. Based on information that we have received to date from the lender, we believe that the total original principal amount of private education loans made under the 2007 RSA, net of amounts refunded under those loans, was approximately \$180,000. Our obligations under the 2007 RSA remain in effect until all private education loans under the 2007 RSA are paid in full or charged off by the lender. The standard repayment term for a private education loan made under the 2007 RSA is ten years, with repayment generally beginning six months after a student graduates, withdraws or is terminated from his or her program of study.

ITT EDUCATIONAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data and unless otherwise stated)

As of December 31, 2011, we had made guarantee payments that were not material under the RSAs. At the end of each reporting period, we assess whether we should recognize a contingent liability related to our guarantees under the RSAs and, if so, in what amount. Our recorded liability for the obligations related to the guarantee arrangements under the RSAs is included in Other liabilities on our Consolidated Balance Sheets.

15. Percentage of Revenues Derived by Title IV Programs

We participate in various federal student financial aid programs under Title IV Programs. In accordance with the regulatory provisions, we are required to disclose in the footnotes the percentage of revenues derived by Title IV Programs, including the figures used to calculate that percentage. Management is responsible for our compliance with those requirements. We calculated each of our institutes (which includes the main campus and its related additional locations) for 2011 on a cash basis in accordance with the regulations as follows:

	(\$ in thousands)			
	00732900 Indianapolis	03071800 Spokane	00473100 Daniel Webster College	TOTAL
Adjusted Student Title IV Revenue				
Subsidized Loan	\$ 395,982	\$ 7,739	\$ 7,684	\$ 411,405
Unsubsidized Loan up to pre-ECASLA Loan Limits	450,819	8,457	0	459,276
Plus Loan	84,018	1,786	0	85,804
Federal Pell Grant	376,017	7,713	912	384,642
FSEOG	903	-	57	960
ACG	1,476	20	11	1,507
Smart	5,563	165	36	5,764
Student Title IV Revenue	1,314,778	25,880	8,700	1,349,358
Revenue Adjustment	(289,881)	(6,536)	(1,135)	(297,552)
Adjusted Student Title IV Revenue	\$ 1,024,897	\$ 19,344	\$ 7,565	\$ 1,051,806
Student Non-Title IV Revenue				
Grant funds for the student from non-federal public agencies or private sources independent of the institution	\$ -	\$ -	\$ -	\$ -
Funds provided for the student under a contractual arrangement with a government agency for the purpose of providing job training	-	-	-	-
Amount of Unsubsidized Loan Over the pre-ECASLA Loan Limits	57,618	1,529	0	59,147
Student payments	459,077	13,542	3,374	475,993
Student Non-Title IV Revenue	\$ 516,695	\$ 15,071	\$ 3,374	\$ 535,140
Revenue from Other Sources (Total for the Fiscal Year)				
Activities conducted by the Institution that are necessary for education and training	\$ -	\$ -	\$ -	\$ -
Funds paid to the Institution by, or on behalf of, students for education and training in qualified non-Title IV eligible programs	-	-	-	-
Net present value of institutional loans disbursed to students	-	-	-	-
Total Revenue from Other Sources	\$ -	\$ -	\$ -	\$ -
Total Revenue (Adjusted Student Title IV Revenue + Adjusted Non-Title IV Revenue + Total Revenue from Other Sources)	1,541,592	34,415	10,939	1,586,946
Title IV Revenue percentage	<u>66.48%</u>	<u>56.21%</u>	<u>69.16%</u>	<u>66.28%</u>

Management's Report on Internal Control Over Financial Reporting

We are responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act ("ICFR"). Our ICFR is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of our records that in reasonable detail accurately and fairly reflect our transactions and asset dispositions;
- provide reasonable assurance that our transactions are recorded as necessary to permit the preparation of our financial statements in accordance with generally accepted accounting principles;
- provide reasonable assurance that our receipts and expenditures are being made only in accordance with authorizations of our management and Board of Directors (as appropriate); and
- provide reasonable assurance regarding the prevention or timely detection of any unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Reasonable assurance, as defined in Section 13(b)(7) of the Exchange Act, is the level of detail and degree of assurance that would satisfy prudent officials in the conduct of their own affairs in devising and maintaining a system of internal accounting controls.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we assessed the effectiveness of our ICFR as of December 31, 2011. Our assessment included extensive documenting, evaluating and testing of the design and operating effectiveness of our ICFR. In making this assessment, our management used the criteria for *Internal Control-Integrated Framework* set forth by The Committee of Sponsoring Organizations of the Treadway Commission. These criteria are in the areas of control environment, risk assessment, control activities, information and communication, and monitoring. Based on our assessment using these criteria, our management concluded that we maintained effective ICFR as of December 31, 2011.

The effectiveness of our ICFR as of December 31, 2011 has been audited by PricewaterhouseCoopers LLP, our independent registered public accounting firm, as stated in its accompanying report.



Report of Independent Registered Public Accounting Firm on Accompanying Information

To the Board of Directors and Shareholders of
ITT Educational Services, Inc.:

The report on our audit of the basic financial statements of ITT Educational Services, Inc. as of December 31, 2011 and for the year then ended appears on pages 1 and 2 of this document. That audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of State of Florida Financial Assistance as required by Chapter 6A-20.0021 of the Florida Administrative Code is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying Schedule of Expenditures of State of Florida Financial Assistance is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

PricewaterhouseCoopers LLP

February 23, 2012

**Schedule of Expenditures of State of Florida Financial Assistance
For the Year Ended December 31, 2011**

State Agency/ State Project	Catalog of State of Florida Financial Assistance Number	Grant Code	State of Florida Expenditures
Department of Education and Commissioner of Education			
Florida Student Assistance Grant	48.054	99970	\$ 945,025
Florida Bright Futures Scholarship Program (1)	48.059	97040	\$ 30,012
			<u>\$ 975,037</u>

(1) Florida Bright Futures Scholarship Program includes the Florida Academic Scholars Award, Florida Medallion Scholars Award, and the Florida Gold Seal Vocational Scholars Award.

The accompanying note is an integral part of the schedule of expenditures.

**Note to Schedule of Expenditures of State of Florida Financial Assistance
For the Year Ended December 31, 2011**

1. Basis of Presentation

The accompanying Schedule of Expenditures of State of Florida Financial Assistance (the "Schedule") summarizes the expenditures of ITT Educational Services, Inc. (the "Company") under programs of the State of Florida for the year ended December 31, 2011 as required by Chapter 6A-20.0021, Florida Administrative Code. Because the Schedule presents only a selected portion of the operations of the Company, it is not intended to and does not present the financial position or results of operations of the Company. The Company schools that were recipients of the Financial Assistance during 2011 include the Fort Lauderdale, Jacksonville, Lake Mary, Miami, Orlando, St. Petersburg, Tampa, Tallahassee, and University Park campuses. This schedule is prepared on the accrual basis of accounting.

For the purposes of the Schedule, state financial assistance includes all grants, contracts, and similar agreements entered into directly between the Company and agencies and departments of the State of Florida



Report of Independent Registered Public Accounting Firm on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

To the Board of Directors of
ITT Educational Services, Inc.:

We have audited the consolidated financial statements of ITT Educational Services, Inc. (the "Company") as of and for the year ended December 31, 2011 and the effectiveness of the Company's internal control over financial reporting as of December 31, 2011 and have issued our report thereon dated February 23, 2012. We conducted our audit of the Company's financial statements in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. We conducted our audit of internal control over financial reporting in accordance with standards of the Public Company Accounting Oversight Board (United States) and in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company'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*.

This report is intended solely for the information and use of the Company's Board of Directors, management, the Florida Department of Education, and the Auditor General's Office and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

February 23, 2012



Report of Independent Registered Public Accounting Firm on Compliance with Requirements Applicable to Each Major State of Florida Financial Assistance Program and on Internal Control Over Compliance

To the Board of Directors of
ITT Educational Services, Inc.:

Compliance

We have audited the compliance of ITT Educational Services, Inc. (the Company) with the types of compliance requirements described in the Florida Single Audit Act State Projects Compliance Supplement that are applicable to each of its major State of Florida programs for the year ended December 31, 2011. The Company's major State of Florida programs under audit are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs and Status of Prior Year Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major state programs is the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's compliance based on our audit.

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 *Chapter 10.650, Rules of the State of Florida Auditor General*. Those standards and *Chapter 10.650, Rules of the State of Florida Auditor General* require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major state program occurred. An audit includes examining, on a test basis, evidence about the Company'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 of the Company's compliance with those requirements.

In our opinion, the Company complied, in all material respects, with the requirements referred to above that are applicable to each of its major state programs for the year ended December 31, 2011, except for the requirements related to eligibility and calculation of awards under the Florida Bright Futures Scholarship Program's (Catalog #48.059) Florida Academic Scholars Award and the Florida Medallion Scholars Award. The results of our auditing procedures disclosed instances of noncompliance with those requirements or other matters, which are required to be reported in accordance with *Chapter 10.650, Rules of the State of Florida Auditor General* and which are described in the accompanying Schedule of Findings and Questioned Costs and Status of Prior Year Findings and Questioned Costs as audit findings # 11-1 through # 11-4.

Internal Control Over Compliance

Management of the Company is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to state programs. In planning and performing our audit, we considered the Company's internal control over compliance with the requirements that could have a direct and material effect on a major state program in order to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with *Chapter 10.650, Rules of the State of Florida Auditor General*, 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 Company's internal control over compliance.



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 state program on a timely basis. A material weakness in internal control over compliance is a deficiency, or 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 state 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 internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. However, of the findings described above, we consider them collectively to be a material weakness under the Florida Bright Futures Scholarship Program's (Catalog #48.059) Florida Academic Scholars Award and the Florida Medallion Scholars Award.

The Company'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 Company's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the Company's Board of Directors, management, the State of Florida Department of Education, and the Auditor General's Office and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

June 12, 2012

ITT Educational Services, Inc.
Summary of Population, Sample Tested, and Test Results for
Florida Financial Assistance Programs
For the Year Ended December 31, 2011

Our examination was performed for the calendar year 2011 and included award recipients as follows:

	Description of Category	Number of Students	Percent of Population	Amount of Awards	Percent of Population
FSAG (1)	Population	956	100.0%	\$ 945,025	100.0%
	Sample Tested	50	5.2%	\$ 50,817	5.4%
	Test Results*	-	0.0%	\$ -	0.0%
FASA (2)	Population	1	100.0%	\$ 2,748	100.0%
	Sample Tested	1	100.0%	\$ 2,748	100.0%
	Test Results (5)	1	100.0%	\$ 56	2.0%
FMSA (3)	Population	19	100.0%	\$ 22,608	100.0%
	Sample Tested	19	100.0%	\$ 22,608	100.0%
	Test Results (6)	4	21.1%	\$ 3,521	15.6%
FGSVSA (4)	Population	3	100.0%	\$ 4,656	100.0%
	Sample Tested	3	100.0%	\$ 4,656	100.0%
	Test Results*	-	0.0%	\$ -	0.0%

- (1) Represents the population and sample tested for the Florida Student Assistance Grant, (FSAG).
- (2) Represents the population and sample tested for the Florida Academic Scholars Award, (FASA).
- (3) Represents the population and sample tested for the Florida Medallion Scholars Award, (FMSA).
- (4) Represents the population and sample tested for the Florida Gold Seal Vocational Scholars Award, (FGSVSA).
- (5) Our testing identified one institution that did not award the correct funding amount to an eligible student. See Part III beginning on page 41, specifically audit finding #11-1 for the test results.
- (6) Our testing identified one institution that did not correctly calculate funding amounts, one institution that did not verify a student's financial aid history prior to disbursement and one institution that made an award to an ineligible student. See Part III beginning on page 41, specifically audit findings #11-2, #11-3 and #11-4, for the test results.

* PwC noted no testing exceptions.

ITT Educational Services, Inc.
Summary of Advances, Disbursements, and Refunds for
Florida Financial Assistance Programs
For the Year Ended December 31, 2011

Below is a summary of the payment activity between ITT and the State of Florida for the year ended December 31, 2011:

State Agency/ State Project	Catalog of State of Florida Financial Assistance Number	Grant Code	State of Florida Advances	Awards Disbursed by ITT	Advances Refunded to Florida	Net Amount Due to Florida
Department of Education and Commissioner of Education						
Florida Student Assistance Grant (1)	48.054	99970	\$ 1,077,679	\$ 945,025	\$ -	\$ 164,848
Florida Bright Futures Scholarship Program	48.059	97040	\$ 30,419	\$ 30,012	\$ 4,651	\$ -

(1) Statutes require undisbursed advances for the Florida Student Assistance Grant to be returned by June 1. At December 31, 2011, all undisbursed advances relating to the 2010-2011 school year had been refunded to the State of Florida.

ITT Educational Services, Inc.
Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2011

Part I – Summary of Results

1. The report of independent auditors on the Company's financial statements expressed an unqualified opinion.
2. No instance of noncompliance considered material to Company's financial statements was disclosed by the audit.
3. The independent auditors report on compliance with requirements applicable to major State of Florida projects expressed a qualified opinion.
4. The audit resulted in five exceptions that resulted in four types of findings as discussed in Part III below.
5. The Company's major State of Florida projects under audit were:

State Project	CSFA Number
Florida Student Assistance Grant	48.054
Florida Bright Futures Scholarship Program (1)	48.059

(1) Florida Bright Futures Scholarship Program includes the Florida Academic Scholars Award, Florida Medallion Scholars Award, and the Florida Gold Seal Vocational Scholars Award.

6. A threshold of \$292,600 was used to distinguish between Type A and Type B programs as those terms are defined in Chapter 10.650. However, as required by the Florida Department of Education, we have audited both State of Florida assistance programs as noted in #5 above.

Part II – Financial Statement Findings Section

No findings to report.

Part III – State Project Findings and Questioned Costs Section

The following audit findings were reportable for the year ended December 31, 2011. A management letter is not presented as there are no items related to state financial assistance that would be considered more than inconsequential, other than those included in this report.

Finding #11-1 (FASA, Catalog #48.059: Total population - 1 student, \$2,748)

Our audit identified one institution which failed to award funds based on the predetermined rate per credit hour established by the State of Florida, resulting in a \$56 underaward to the student's account. This was caused by a clerical error in which the institution did not request the proper amount of funding. Upon recognition of the error, the window for requesting additional funding had already closed. This resulted in a difference in the amount disbursed to the eligible student and the amount for which he was eligible. Florida State Code 1009.534 (5) states a student is eligible for an award equal to the amount specified by the State.

ITT Educational Services, Inc.

Schedule of Findings and Questioned Costs

For the Year Ended December 31, 2011

Recommendation

Specific to the above finding, the institution should ensure the applicable student is made whole. Further, management should emphasize the need for exercising proper due diligence in calculating awards. Currently the institution performs a reconciliation of funds received from the State to funds disbursed to students on an annual basis. Going forward, management should consider the cost benefit of performing this reconciliation on a quarterly basis in order to ensure similar errors are caught and corrected in a more timely manner.

Management's View

This finding resulted from one student being underawarded by \$56 due to a clerical error. The Directors of Finance at the ITT Technical Institutes in Florida have been advised to review the State Grant reconciliation report to determine the proper identification and awarding of State Grant eligibility and funding. Management will consider making this reconciliation a quarterly rather than annual process. We understand the importance of proper awarding of State Grant funds so that students obtain the correct award amounts to which they are entitled.

Finding #11-2 (FMSA, Catalog #48.059: Total population - 19 students, \$22,608)

Our audit identified one institution that credited the improper amount of funds to two students, resulting in questioned costs of \$1,253. These students met all of the Bright Futures eligibility requirements, but funding was calculated on a full-time basis for students who were only enrolled in classes part-time. This was caused by a clerical error which resulted in the students being awarded Bright Futures funding exceeding that for which they qualified. Florida State Code 1009.53 (6) states a student enrolled in 6 to 8 semester credit hours can receive up to 50% of the maximum award; a student enrolled in 9 to 11 credits can receive up to 75% of the maximum award; and a student enrolled in 12 or more credits may receive up to the full award.

Recommendation

To avoid such clerical issues in the future, management should seek to refine the review process in place to ensure the accuracy of the student award amounts before they are certified and sent to the State. We further recommend management discuss this finding with the State of Florida to determine the proper resolution going forward, including making the affected program whole.

Management's View

The Finance staff members at the ITT Technical Institutes in Florida have been advised to perform a thorough and comprehensive review of eligibility requirements for each student receiving a State Grant award prior to certifying and sending that award to the state. Particular emphasis has been placed on the importance of reviewing enrollment status in each quarter for eligible students to ensure that students are receiving the proper amount of State Grant funding based on the number of credit hours taken.

ITT Educational Services, Inc.

Schedule of Findings and Questioned Costs

For the Year Ended December 31, 2011

Finding #11-3 (FMSA, Catalog #48.059: Total population - 19 students, \$22,608)

Our audit identified one institution that awarded funds received from the State of Florida to one ineligible student, resulting in \$2,116 in questioned costs. This was caused by a clerical error in which the student's Florida financial aid history was not reviewed prior to awarding Florida funds. This resulted in financial aid being disbursed to a student who had graduated more than 3 years prior to the initial award. Florida State Code 1009.531 (2)(a) states that a student is eligible to accept an initial award for 3 years following high school graduation.

Recommendation

In addition to ensuring that the affected program is made whole, to avoid such clerical issues in the future, management should seek to refine the review process in place to ensure all Florida student aid histories are reviewed prior to award distribution.

Management's View

The Finance staff members at the ITT Technical Institutes in Florida have been advised to carefully review the Florida financial aid history prior to the awarding of any State Grant funds. We understand the requirement that a student is only eligible to accept an initial award for three (3) years following high school graduation. Finance staff will be diligent in their review to ensure that students meet this criteria prior to presenting or awarding any State Grant funds.

Finding #11-4 (FMSA, Catalog #48.059: Total population - 19 students, \$22,608)

Our audit identified one institution that awarded funds received from the State of Florida to one ineligible student who had graduated from high school more than seven years previous. The institution subsequently identified the award made in error and credited the student's account. However, the institution erroneously credited the student's account for \$152 more than the original award, resulting in \$152 in questioned costs. This was caused by a clerical error. Florida State Code 1009.531 (2)(a) states a student is eligible to accept a renewal award for 7 years following high school graduation.

Recommendation

In addition to ensuring that the affected student is made whole, to avoid such clerical issues in the future, management should seek to refine the review process in place to ensure all Florida student aid histories are reviewed prior to award distribution. Further, if errors in awards are identified and corrected, additional review processes should be in place to ensure that the correction process and related amount is accurate.

Management's View

The Finance staff members at the ITT Technical Institutes in Florida have been advised to carefully review the Florida financial aid history prior to the awarding of any State Grant funds. We understand the requirement that a student is only eligible to accept a renewal award for seven (7) years following high school graduation. The Directors of Finance at ITT Technical Institutes in Florida are responsible for ensuring that corrections and adjustments made due to errors are accurate. They have been advised to review all errors identified by Finance staff to ensure that the corrective actions are appropriate and for the accurate amounts. ITT Technical Institute will ensure that the student is made whole for this error.

ITT Educational Services, Inc.
Status of Prior Year Findings and Questioned Costs
For the Year Ended December 31, 2011

Status of Prior Year Findings:

Finding #10-1 (Catalog #48.059)

Our audit identified one institution which failed to return funds for one student who had dropped classes, resulting in \$253 not being returned to the State of Florida. Although the institution has a written policy regarding return of funds calculations, there appeared to be a misunderstanding of the policy regarding when a student has dropped after the add/drop period which caused the error. This resulted in the State of Florida not being able to collect its funds in a timely manner. Florida State Code 1009.53 (5a) states an institution must refund within thirty days of the end of the semester any funds received for courses dropped by a student who has withdrawn after the end of the drop and add period unless the student has been granted an exception by the department. The refund amount was offset against the amount owed the school from the State of Florida.

Status

There were no similar findings noted in the current year compliance examination. The prior year corrective action appears to have been effective. The corrective action taken in the prior year included the return of funds to the State of Florida, as well as a review of the process and further instruction of all Florida financial aid professionals by the Director of Student Financial Services regarding award procedures.

Finding #10-2 (Catalog #48.054)

Our audit identified one institution that credited funds of \$689 to a student during a term in which the Company had not certified the disbursement with the State. This student met all of the FSAG eligibility requirements, but funding was not provided by the State of Florida to the institution because the school did not certify the disbursement with the State. This was caused by a clerical error which resulted in the student not being included on the list of certified students sent to the State and as a result ITT funded the award and was not reimbursed by the State. Florida State Code 1009.51 (4)(d) states an institution that receives funds from the program shall certify to the department the amount of funds disbursed to each student and shall remit to the department any undisbursed advances by June 1 of each year.

Status

There were no similar findings noted during the current year compliance examination. The prior year corrective action appears to have been effective. The corrective action included a review of eligibility requirements by financial aid professionals at each Florida campus, with an emphasis on reconciliation and recordkeeping procedures.

Finding #10-3 (Catalog #48.054)

Our audit identified two institutions that failed to award funds received from the State of Florida to two eligible students, resulting in \$1,490 in questioned costs. This was caused by a clerical error in which the student's accounts were not credited for the amount of funding they were eligible for from the State. This effectively resulted in no financial aid initially being disbursed to the eligible students, despite certification with the State. Florida State Code 1009.51 (4)(d) states an institution that receives funds from the program shall certify to the department the amount of funds disbursed to each student and shall remit to the department any undisbursed advances by June 1 of each year. After making management aware of this finding, the institution posted the \$1,490 to the applicable student accounts during March and April 2011.

ITT Educational Services, Inc.
Status of Prior Year Findings and Questioned Costs
For the Year Ended December 31, 2011

Status

There were no similar findings noted during the current year compliance examination. The prior year corrective action appears to have been effective. The corrective action included a review of reconciliation and recordkeeping procedures with Florida financial aid professionals by the Director of Student Financial Services.

Finding #10-4 (Catalog #48.059)

Our audit identified two institutions that failed to timely refund \$4,996 of undisbursed advances related to the Florida Bright Futures Scholarship Program within 60 days. This error was caused by a misunderstanding by financial aid personnel of the applicable rules for these awards. This resulted in the untimely return of funds to the State of Florida. Florida State Code 1009.53 (5b) states an institution that receives funds from the program shall certify to the department the amount of funds disbursed to each student and shall remit to the department any undisbursed advances within 60 days after the end of regular registration. As a result of the audit, ITT refunded outstanding balances from these two institutions to the State of Florida in May 2011.

Status

There were no similar findings noted during the current year compliance examination. The prior year corrective action appears to have been effective. The corrective action included a review of Florida financial assistance regulations by financial aid professionals at each Florida campus, with an emphasis on ensuring that disbursement information is captured correctly and that undisbursed advances are returned timely.