



# Annual Report of the Financial Monitor

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February 15, 2023

Prepared for  
**The Cooper Union for the Advancement of Science and Art**

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# 1 Introduction

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The Amended Consent Decree (“the Consent Decree”) issued by the Supreme Court of the State of New York in December 2015 settling the legal action over the charging of tuition at The Cooper Union for the Advancement of Science and Art (“Cooper Union”) provided for the selection of a Financial Monitor to evaluate and report on the financial management of Cooper Union and its compliance with the Consent Decree. Among the duties assigned to the Financial Monitor in the Consent Decree are the preparation and issuance of an annual report (a) summarizing the financial condition of Cooper Union; (b) reporting on measures proposed by the Cooper Union Board of Trustees (“the Board”) and its committees relating to the Consent Decree, and opining on whether those actions were made in good faith and in the best interest of Cooper Union; (c) identifying any non-budgeted expenditures by Cooper Union exceeding \$100,000 and any non-budgeted contractual obligations of Cooper Union exceeding \$125,000 during the preceding twelve-month period; and (d) analyzing the Free Education Committee (“FEC”) Report, the feasibility of the Board’s strategic plan, and the practicality of Cooper Union’s returning to a full-tuition scholarship model that maintains Cooper Union’s strong reputation for academic quality within its Art, Architecture and Engineering programs at their historical levels of enrollment.

In July 2016, the Attorney General’s Office of the State of New York selected Kroll Associates, Inc. (“Kroll”) to serve as the Financial Monitor of Cooper Union. This is Kroll’s seventh Annual Report as Financial Monitor. In this report, we address each of the issues outlined above as required by the Consent Decree. Our analysis is informed by our having attended, since our appointment as Financial Monitor, every meeting of the Board (including executive sessions), and meetings of the FEC, the Audit Committee, the Finance and Business Affairs Committee, the Governance Committee, the Investment Committee, the Academic and Student Affairs Committee, and the Alumni Affairs and Development Committee. In addition, we have reviewed extensive financial information including Cooper Union’s audited financial statements, its Board approved budget, approved budget resolutions and amendments, and select accounting system records. Finally, we have reviewed Board resolutions relating to the Cooper Union bylaws.

This year, as a result of the ongoing global COVID-19 Pandemic and the challenges presented by a substantial decline in the market value of Cooper Union’s investments and a dramatic increase in

inflation, we have seen continued disruption of the normal operations of Cooper Union, requiring attention and resources from the Cooper Union Administration as it strived to maintain safety, academic programming, and fiscally responsible adherence to the Board's strategic plan. Nevertheless, as explained in more detail below, Cooper Union has maintained its momentum in implementing the thoughtful and responsible plan it adopted in 2018 to improve Cooper Union's financial condition and to return to a full-tuition scholarship model within the foreseeable future.

## 2 The Current Financial Condition of Cooper Union

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The report of the FEC entitled, *Recommended Plan to Return to Full Tuition Scholarships* (“the FEC Report”), approved with revisions by the Board on March 18, 2018 (hereinafter, “the Board’s Plan” or “the Plan”), is Cooper Union’s roadmap to return to a full-tuition scholarship model. We discussed the FEC Report and the Board’s Plan at length in our prior reports. This year’s report is focused on Cooper Union’s continued progress against the Board’s Plan and the monitoring mechanisms used by Cooper Union to ensure compliance with the Plan.

Our assessment of Cooper Union’s current financial condition is based on our review of Cooper Union’s audited financial statements as of and for the year that ended June 30, 2022, as well as budget data provided by Cooper Union for fiscal year 2023, and our assessment of Cooper Union’s progress against the Board’s Plan to return the institution to a full-tuition scholarship model. We also reviewed Cooper Union’s financial status as measured against the financial guardrails adopted in the Plan.

Cooper Union’s financial performance for the year ended June 30, 2022 demonstrated continued progress against the Plan despite the continuing world-wide pandemic and the challenges presented by a substantial decline in the market value of Cooper Union’s investments and a dramatic increase in inflation.<sup>1</sup> We believe this progress was due in large part to the structure of the Board’s Plan, which prioritized strengthening the long-term financial condition of Cooper Union so it could weather an unforeseen financial downturn, as well as the leadership and consistent commitment to the Plan exhibited by the Board and Cooper Union’s President Laura Sparks and her senior staff. Cooper Union experienced a decline in operating revenues of 6.7% over 2021, but was able to manage costs so that an operating margin of over 10% was realized. This allowed continued allocation of funds for key priorities. Cooper Union’s operating margin in 2022 continues to be extraordinary, albeit substantially lower than in 2021, as we think a “normal” operating margin would be in the 2% to 4% range.

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<sup>1</sup> We note that the financial impact of the pandemic was ameliorated in part by Cooper Union’s receipt of \$7.8 million in pandemic-related Federal program funds.

Cooper Union’s key priorities are intended to ensure a viable financial footing when Cooper Union returns to a full-tuition scholarship model by 2029. The priorities and the status of Cooper Union’s progress against those priorities are presented in the table below (amounts in thousands):

Key Initiative	Total Need	Funded at 6/30/2022	Forecast Funded at 2023
Operating & Capital Reserve	\$152,000	\$108,857	\$111,530
Bridge Loan Bullet	\$39,000	\$7,421	\$9,477
Post-Retirement Health Insurance Reserve <sup>2</sup>	\$48,000	\$2,000	\$2,500
Deferred Maintenance	<u>\$11,500</u>	<u>\$2,722</u>	<u>\$7,522</u>
<b>Total</b>	<b>\$250,500</b>	<b>\$121,000</b>	<b>\$131,029</b>

Collectively, these initiatives are 48% funded as of fiscal year 2022 (51% in 2021), and the forecast suggests over 52% funding by fiscal year 2023. While the funding status of these initiatives declined in 2022 due to the investment market declines, Cooper Union’s financial performance continues to be ahead of the Plan and remains comfortably within the guardrails discussed later in this report. Both the recent operating margins and substantial market returns in prior years have contributed to Cooper Union’s ability to secure the funding for its key priorities.

## 2.1 Continued Improvement in Operating Results

Beginning in fiscal year 2019, Cooper Union has generated significant operating surpluses (excess of operating revenues over operating expenses), which reversed the persistent and substantial operating deficits (deficiency of operating revenues when compared to operating expenses) that had accumulated over many years. Between 2009 and 2018, based on its annual audited financial statements, Cooper Union had a cumulative operating deficit of \$181.1 million. In contrast, the cumulative operating surplus between 2019 and 2022 was \$59.8 million. Net tuition and fees for this period totaled about \$52.7 million. This indicates a cumulative surplus, excluding net tuition and fees for the period, albeit clearly insufficient to restore fiscal viability to Cooper Union without some continuing level of support from student revenues. Continuing operating surpluses will be critical to Cooper Union’s achieving a full-tuition scholarship environment, and the Board’s Plan projects that surpluses will continue in the coming years.

<sup>2</sup> This liability is volatile as market conditions cause fluctuations. The Plan sets aside \$500,000 each year.

As of June 30, 2022, on a budget basis, the cumulative surplus is in excess of the Plan by \$18.2 million. This amount is significantly greater than the guardrails discussed in section 2.3, below. The fiscal year 2022 results against budget were positively impacted by various Federal programs, including the conversion of Federal pandemic loans to grants and other Federal COVID assistance grants received of approximately \$7.8 million.

We continue to believe a positive margin of at least 2% per year represents a sustainable operating performance. That margin, however, would be appropriate *after* restoring resources to a level appropriate for Cooper Union. Therefore, positive margins substantially higher than 2%, and at the levels suggested in the Board's Plan and achieved by Cooper Union in the past four years, are necessary if Cooper Union is to achieve normal standards of financial viability and health to support a return to a full-tuition scholarship model.

When comparing the operating results for 2022 of a \$9.9 million surplus to 2021 (\$22.0 million surplus), there were several significant events that contributed to the results in operating performance. The most notable of these events included:

- **Total operating revenues decreased by \$6.9 million.** This was due principally to a reduction in investment returns utilized for operations of \$20.2 million, an increase in pandemic funding from the Federal government of \$6.6 million, and increases in current use contributions of \$3.9 million and net tuition and fee increases of \$1.4 million. The reduction in investment returns was principally due to the non-endowment investment losses, accounting for over \$18 million of the decline. The Tax Equivalence payments received declined \$2 million as a result of declining real estate values. The increase in student revenues of \$1.4 million was the result of the growth of the student population over the prior year. Cooper Union appears committed to the Plan to return to free tuition as the student discount rate, or tuition scholarship percentage, was 78.8% in 2022 against the Plan number of 78.5%.
- **Maintaining expense levels in accordance with the Plan.** In 2022, expenses increased by \$5.2 million or 6.3%, including expenses related to the pandemic. Control over operating expenses is one of the secondary guardrails. When the Plan was approved, expense control was perceived to be a key element to the financial recovery. While still a critical element,

there are several pressures that will need to be assessed for their impact on the Plan going forward:

- The impact of inflation causing price levels to be higher than the Plan anticipated.
- Whether COVID-related costs will abate in 2023 and in future years or continue.
- The need for program renewal and expansion may make the targets in the Plan harder to achieve. As an example, a significant program has been proposed and will be implemented when sufficient funding sources are secured to ensure its success. This incremental spending may make staying within the operating expense guardrail difficult to achieve, even though the incremental costs would be funded by new revenues.

The Board's Plan and the deliberations of the various committees of the Board have acknowledged the need for incremental investment in curriculum renewal and increases in capital spending. With the passage of time and changing circumstances, however, the amounts allocated to these initiatives may need to be reassessed. The investment in capital in 2022 was \$6.5 million as compared to \$4.0 million in 2021, but both levels are below the annual depreciation expense, which averaged \$8.5 million for these two years. Depreciation expense is a reasonable proxy for the level of reinvestment in capital that an institution should make over a period of years. Cooper Union has begun tracking its reinvestment needs using two key industry standard ratios.

The budget for fiscal year 2023 anticipates a cash surplus of \$4.3 million. The forecast as of September 2022 indicates Cooper Union expects to meet this goal in 2023. The budget surplus for 2022 was \$15.9 million.<sup>3</sup> The budget surplus will be applied to approved key priorities identified in the Plan, including: (a) operating and capital reserves; (b) debt principal repayment reserve; (c) post-employment health insurance obligation reserve; and (d) investment in deferred maintenance. The schedule showing the status of funding of these initiatives was presented earlier in this report. This is consistent with the Board's Plan to use the cash generated from budget surpluses to restore prior uses of funds and invest in initiatives identified in the Plan. We discuss the continued need to restore resources under the Balance Sheet Structural Issues section below.

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<sup>3</sup> Cooper Union has provided a reconciliation between the budget surplus of \$15.9 million and the surplus shown in the audited financial statements of \$9.9 million. Most of the difference represents converting from a cash-based budget to accrual accounting used in the financial statements as well as the classification of certain items out of unrestricted operating results in the budget but included in the results shown in the audited financial statements.



## 2.2 Balance Sheet Structural Issues

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In our prior annual reports, we have discussed the need for Cooper Union to strengthen its overall financial condition. The need for this remediation is justified by the data contained in Cooper Union's Balance Sheet and the structural issues that data highlights. These issues continue to require attention even as Cooper Union has begun generating operating surpluses (both on a cash and accrual basis). The generation of operating surpluses allows the replenishment of resources that were consumed when Cooper Union financed past operating losses through consumption of available net assets, incremental debt, front loading of revenue from certain leased properties, and the creation of unfunded obligations for post-retirement benefits. Once these various items are funded, the operating surpluses anticipated to be generated will be available to support a return to a full-tuition scholarship model. The items referenced above include the following and have been discussed in our prior reports, but are significant enough to warrant repeating in this report:

- A bridge loan for \$58.8 million Cooper Union secured in June 2014, which has been used to cover some of the historical operating losses. Cooper Union will pay interest only on this loan until 2025. The loan will not be fully repaid at maturity requiring a refinancing of the remaining balance of \$39 million or a significant cash payment. The Board's Plan created a "debt retirement reserve" to ensure availability of resources at the contractual maturity of this loan. Since Cooper Union has met the cumulative financial targets contained in the Board's Plan, these resources have been funded thus far, with \$7.4 million reserved.
- Deferred revenue of \$101.0 million remaining on the balance sheet as of June 30, 2022 is comprised principally of agreements to lease certain properties for ninety-nine years to a third party. The deferred revenue represents the unamortized balances of these leases that Cooper Union entered into in 2004 and 2008. These leases previously provided cash to cover persistent operating losses. In the audited financial statements, the accretion of the deferred revenue will add to revenues each year, but will provide no cash or other resources to the institution. This deferred revenue does not impact the cash-based financial model. The Board's Plan appropriately considers the impact of the deferred revenue in the computations of financial health.

- There is \$34.0 million (\$44.5 million in 2021) in postretirement benefit costs accrued that will consume cash in future periods, likely at increasing amounts as covered personnel retire.<sup>4</sup> This obligation has consumed approximately \$1.4 million of cash in 2022. The Board's Plan considers this obligation, including a factor for growth of the obligation over time. If discount rates increase or remain constant in the current environment, this may represent a cushion in the Plan for the amounts that will be required to liquidate this obligation. Further, health care costs trending at a different rate than planned would impact this obligation. The Plan projects providing liquid assets to support this liability in the projection period. Of the cash surpluses incurred thus far, \$2.0 million has been reserved for this obligation.
- From 2016 to 2022, the combined purchases of plant assets totaled \$24.6 million while depreciation and amortization totaled \$58.9 million, suggesting an under-investment in plant assets, which will need to be addressed in future periods. The Board's Plan includes funding of capital assets above historic levels, which occurred in 2022 with an increase of \$2.5 million. While this amount will not fully fund the amounts necessary to maintain the current plant, there is also a plan for programmatic investments that began in 2019 and is expected to grow to \$3 million per year by 2025. We believe a portion of these programmatic investments will need to be used for capital in the related program areas. To better understand the relative position of capital, Cooper Union has added two ratios to the financial metrics currently in use:
  - A **Physical Asset Reinvestment Ratio**, which compares investment in plant to depreciation expense and which shows a reinvestment rate in 2022 of 76% as compared to 47% in 2021, 68% in 2020 and 46% in 2019. The threshold value over a longer period of time is 100%.
  - An **Age of Facilities Ratio**, which compares accumulated depreciation to depreciation expense, and which shows an age of 19 years in 2022 as compared to 18 years in 2021, with a threshold value of 12 to 14 years.

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<sup>4</sup> This liability changed from \$40 million in 2016 principally due to changes in the discount rate on the obligation increasing over that period. The liability balance can be expected to fluctuate based on changes in actuarial assumptions throughout the program period.

These ratios help inform the Board on the status of the physical plant assets and may indicate the need for adjustments to the Board's Plan in future years. Bringing these ratios into line with threshold values would require substantial investment in future years, but the amounts and the specific investments would also need to be based on an assessment at a detailed level throughout the institution.

- Net plant assets were \$131.0 million in 2022 (\$133.0 million in 2021, \$137.5 in 2020, \$142.5 million in 2019, \$147.6 million in 2018 and \$154.2 million in 2017), while plant-related debt exceeds the asset balance. Total debt of \$206.7 million includes amounts related to loans to support past deficits. The depreciation of assets at a rate faster than the liquidation of debt, without a renewals and replacements reserve, further supports the conclusion that Cooper Union is under-investing in capital. Cooper Union began making principal payments on these loans during 2019. In 2022 principal payments were \$6.6 million, while in 2021 they were \$6.2 million. The contractual payment structure, however, will not fully service the principal on the largest loan by its maturity date, requiring the debt reserve fund contemplated by the Plan. Further, a significant prepayment penalty exists on this loan, making prepayment uneconomical and requiring this debt service reserve. As of June 30, 2022, the prepayment penalty would have been \$30.1 million. In late January 2023, the penalty would have declined to \$22.7 million, due to the dramatic rise in interest rates. The volatility of this amount is related to the significant increase in interest rates.

The FEC Report addressed these issues, and the Board appropriately considered them in the design of the Board's Plan.

## 2.3 Financial Status Compared to the Guardrails

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To ensure appropriate monitoring of financial progress against the Plan, the FEC developed interim measures that require activities in certain key areas to reach specific targets in the interim years leading up to the implementation of a full-tuition scholarship model. In each case, should the target be missed by 5% or more, the FEC would examine the causes and determine a recommended course of action to the Board. The guardrails and their status as of 2022 follow (amounts in thousands)<sup>5</sup>:

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<sup>5</sup> As presented at the October 6, 2022 quarterly Board Meeting.

<u>Guardrail</u>	<u>Cumulative Value</u>	<u>Guardrail</u>	<u>Favorable (Unfavorable)</u>
<b><i>Primary Guardrail:</i></b>			
Net Surplus	\$67,290	\$46,649	\$20,641
<b><i>Secondary Guardrails:</i></b>			
Current Use Contributions	\$34,152	\$27,124	\$7,028
Operating Expenses	\$267,620	\$278,060	\$10,440
Cash and Investments	\$299,263	\$212,331	\$86,932

These guardrails are reviewed each quarter and reported to the Board to ensure appropriate transparency. The primary guardrail is considered the critical measure as it is the source of the funds needed to restore the balance sheet and provide the resources to ultimately return to a full-tuition scholarship model. The secondary guardrails act in support of the primary guardrail. In the case of the cash and investments guardrail, the primary driver of the results will be market conditions as the largest component of this measurement is dependent on external markets. The operating expense guardrail, while in a positive position currently, may prove difficult to maintain over the coming years as Cooper Union considers its needs for key items, such as curriculum investments and renewal, expanded student services, and further investment in physical plant beyond that specified in the Plan. We note that the favorable variance in the operating expenses guardrail in 2021 was \$10,078.

Historically we expressed concern regarding Cooper Union’s ability to generate the levels of philanthropy the Plan requires. Performance to date has demonstrated significant growth in philanthropy and the cumulative excess against the Plan guardrail in 2022 of \$7.0 million demonstrates the progress in this area. We would also note that this is measuring only current use funds, and Cooper Union has been successful in raising longer term funds, such as endowment which totaled \$6.4 million in 2022 and 2021 combined. The Plan continues to be aggressive in the amount of philanthropy required, but the progress in recent years would suggest this is not as great a risk as we once thought.

## 2.4 Implications of Current Financial Condition on Future Activities

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The Board's Plan, when approved, was acknowledged as aggressive, but achievable. The activities of the current year appear focused on a structured, disciplined approach pursued in the context of long-term financial improvements. The focus of the Board and the FEC in 2022 continued an emphasis on creating a sustainable financial environment. After achieving a sustainable level of financial health, the focus can shift to creating an environment for a fiscally thriving institution, followed by a focus on moving to a tuition-free environment.

The Board's Plan appropriately projected a way forward to eliminate the structural operating deficits and to produce and grow financial resources to an appropriate level. With the positive operating performance of the past four years, the structural deficit would appear eliminated and the focus on restoring financial resources to allow a return to full tuition scholarships is reasonable. The most significant initiatives that move Cooper Union from large structural deficits to sustainable operating surpluses are the contractual changes in the lease agreement on the Chrysler Building (which increased rents starting from \$20.1 million in 2018 to \$32.5 million in 2019 through 2027), enhanced philanthropy, and the continuation of the current tuition plan, which moves to full-tuition scholarships over time by providing annual increments in scholarship levels.

The largest contractual challenge Cooper Union faces relates to the continuation of the revenue streams associated with the Chrysler Building, both in terms of the rental payments as well as the tax equivalency payments ("TEP"). While all payments are current, the change in ownership of the Chrysler Building lease three years ago and the recent disruption in the New York City real estate market raises concerns that these primary revenue streams may undergo additional modifications from the Plan.

### 3 Measures Proposed by the Board of Trustees and its Committees

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The Cooper Union Board has adopted a number of resolutions to the Cooper Union bylaws to comply with the various provisions of the Consent Decree. We believe that, in each instance, the Board acted appropriately, in good faith, and in the best interests of Cooper Union.

The Consent Decree states that the Cooper Union Board was required to amend the Cooper Union bylaws or approve resolutions making the changes recommended in the Consent Decree “at the earliest of the next quarterly Board of Trustee meeting following the entry of this Consent Decree or at the next quarterly Board of Trustees meeting following the election(s) of Alumni Trustee, Faculty Representatives or a Staff Representative, or sixty (60) days.” The Board complied with this requirement by adopting resolutions making the necessary changes to the Cooper Union bylaws on November 11, 2015. The Cooper Union bylaws were then further updated by the Board on December 9, 2020, with no additions or modifications inconsistent with the Consent Decree. Most recently, during the Board of Trustees Meeting on October 6, 2022, an amendment to the bylaws was approved. The amendment changed the term limit for a Board Chair, which was formerly based on a term of two years, with a maximum service of three terms (six years), to a term length of three years, with a maximum service of two terms (six years).

The Consent Decree states, “that no Trustee who was a member of the Board of Trustees on October 6, 2006 shall be reappointed to the Board, and all who served on the Board as of October 6, 2006, shall have their terms expire as of December 7, 2016, and that no person shall be named Trustee Emeritus while this Consent Decree is in effect.” The Board complied with this requirement by passing a resolution stating that no Trustee Emeriti will be named during the duration of the Consent Decree. The only two Trustees who had served on the Board as of October 6, 2006, were not reappointed to, and do not currently serve on the Board. Furthermore, no Trustee Emeriti currently serves on the Cooper Union Board, or has been named since the Consent Decree was entered into.

The Consent Decree states that “at all times one (1) of the Alumni Trustees shall serve as either the Chair or Vice Chair of the Board of Trustees and have the responsibilities of Chair and/or Vice Chair of the Board of Trustees.” The Board complied with this requirement by adopting Section 3.01 of the

amended bylaws. Moreover, Aftab Hussain, an alumnus of Cooper Union, was appointed at the Board of Trustee’s meeting in June 2021, and now serves on the Board as Vice Chair. During the June 2022 Board of Trustee’s meeting, Anthony Ianno was elected as Alumni Trustee<sup>6</sup> to the Board, Ben Vinson was elected as Trustee to the Board and Elias Dills was elected as Student Trustee to the Board. Additionally, during that meeting a departing Trustee, Adriana Gomez, who joined the Board in December 2020 as a Student Trustee, was recognized for her service by the Chair.

The Consent Decree states that the Board should always include “two (2) Student Trustees, who shall be current students at Cooper Union, shall each serve two-year terms that are staggered, shall have voting power afforded to other Trustees on the Board, . . . shall be considered as members of the Board in determining whether a quorum is present, and shall be entitled to attend executive sessions of the Board” except for those meetings in which matters of academic governance, employment and personnel matters, or other conflict of interests issues are discussed. The Board complied with this requirement by adopting Section 1.03.2 of the amended bylaws. As part of the December 2020 amendments, the Board also removed Consent Decree language regarding the inaugural terms of the Student Trustees that was no longer applicable. Two students with staggered terms currently sit on the Board as Student Trustees.

The Consent Decree states that “at all times, the Board of Trustees shall have alumni representation pursuant to an agreement entered into by the Cooper Union Alumni Association (“CUAA”) and Cooper Union and approved by the Attorney General for the State of New York.” The Board complied with this requirement by adopting Section 1.03.1 of the amended bylaws. There are currently six Alumni Trustees serving on the Board.

The Consent Decree states that the Board must meet the requirements for confirming the nominations of Alumni Trustees outlined in the CUAA protocol attached to the Consent Decree as Exhibit A. The protocol states that the total number of Alumni Trustees sitting on the Board should equal one-third the total number of individuals sitting on the Board at the December meeting of the Board (rounded to the nearest whole number). This requirement is reflected in section 1.03.1 of the amended bylaws. As of December 2022, there were seven Alumni Trustees of the twenty-two total individuals sitting on the

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<sup>6</sup> Alumni Trustees as defined in the Consent Decree are those selected by the Cooper Union Alumni Association. Other Trustees, who happen to be alumni of Cooper Union but who were not elected by the Cooper Union Alumni Association, are thus not “Alumni Trustees” within the meaning of the Consent Decree.

Board, which meets the one-third requirement. After the December 2022 meeting, one Alumni Trustee, Cristina Ross, departed the Board as her term ended, reducing the number of Alumni Trustees to six, which is below the one-third requirement. This shortfall has been acknowledged by the Chair of the Board who explained that elections for Alumni Trustee will take place from mid-March through the end of April 2023. There are four candidates for two positions, so the Board should be at the required ratio of Alumni Trustees by the second quarter of 2023, which complies with the CUAA Protocol.

The Consent Decree states that four full-time faculty members, one from each of Cooper Union's four divisions, elected by the full-time faculty; one part-time faculty member elected by the part-time faculty; and one staff member elected by the staff shall serve as Faculty Representatives. The Board complied with this requirement by adopting Section 1.14 of the amended bylaws. There are currently five representatives serving, but only three full-time faculty members from each of Cooper Union's four designated divisions. There is currently no Representative for the School of Art because the previously elected faculty member is leaving her position at Cooper Union. Kroll was informed that the Dean is aware of this issue and is currently seeking a qualified replacement.

The Consent Decree states that the six Faculty Representatives shall serve one four-year term, shall be observers and advisers without voting power, shall not be counted towards a quorum, and shall "not be entitled to attend executive sessions." The Faculty Representatives shall "be entitled to observe all other sessions of the Board" except in which a conflict of interest may arise, shall be entitled "to receive any information or documents not designated as privileged, private, or confidential during an executive session, and may provide advice or information when solicited by the Board." The Board complied with this requirement by adopting Section 1.14 of the amended bylaws.

The Consent Decree states that "the Board shall make good faith efforts to recruit candidates who are experts, by training or profession, in the areas of higher-education, accounting, finance, law, non-profit governance, communications, management, or management-labor relations, or who have substantial fundraising-development experience or potential." The Board complied with this requirement. Two of the recently-elected trustees – Ben Vinson and Anthony Ianno – each qualify for a position on the Board based on their experience in a number of the areas specified in the Consent Decree including higher education, accounting, finance, non-profit governance, management, and substantial fundraising-development experience.



The Consent Decree states that the respondents agreed to create a Free Education Committee “at the earliest of the next quarterly board meeting or sixty days following the entry of this Consent Decree.” The Board complied with this requirement when it created the FEC by resolution on November 11, 2015. The FEC Report was approved by the Board of Trustees on March 6, 2018, with amendments and is available on the committee’s website.<sup>7</sup> The FEC continues to function as required by monitoring Cooper Union’s progress against the Board’s Plan.

The Consent Decree states that respondents were required to form a Governance Committee, “which shall assume the duties of the present Committee on Trustees.” In addition to those duties formerly assumed by the Committee on Trustees, the Governance Committee is also responsible for “ensuring that the Board (a) observes best practices of non-profit governance; (b) has a robust conflict of interest policy; (c) is provided with annual training on non-profit governance and the duties and responsibilities of trustees; (d) develops a governance structure for the schools within Cooper Union; and (e) understands the fiduciary duties and responsibilities of trustees.” Current members on the Governance Committee include the Chair of the Board, as well as two Alumni Trustees, and one Student Trustee, as stipulated in the Consent Decree.

The Board has taken steps to comply with the Consent Decree’s requirements concerning the Governance Committee. By resolution, the Board renamed the Committee on Trustees the Governance Committee. The resolution also expanded the Governance Committee’s responsibilities and codified them in section 2.02.4 of the amended bylaws to mirror the requirements of the Consent Decree, as reflected above. The Board requires Trustees to execute conflict of interest forms on an annual basis, which are reviewed by the chair of the Audit Committee. The Board also requires Trustees to attend an instructional session with outside legal counsel (who has extensive experience with non-profit institutions) to better understand their fiduciary and legal obligations as Trustees. Under the Consent Decree, this training must be annual. In 2017, the Board took the additional step of adopting a formal Code of Conduct to guide the behavior of Trustees and committee members, which is available to the public through the Cooper Union Board of Trustee page on the Cooper Union website. During 2019, the Code of Conduct for Trustees was amended to make it explicit that the obligations thereunder (specifically, the duty of confidentiality) extended beyond a Trustee’s term. All Trustees are required to

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<sup>7</sup> <https://cooper.edu/about/trustees/fec>

execute a statement acknowledging that they have read, understood, and agreed to abide by the Code of Conduct as a condition of serving on the Board. In addition, the Board adopted a Code of Conduct for Staff and Faculty Representatives and each of the Representatives were required to execute a statement acknowledging that they have read, understood, and agreed to abide by the Code of Conduct as a condition of serving in that position. Further, at its June 2022 Retreat, the Board completed required annual governance training, as well as additional courses focused on the responsibilities the Board has for stewardship of the institution's investments.

The Consent Decree states that the Board shall make meeting minutes promptly available on Cooper Union's website. The Board complied with this requirement. Board meeting minutes are available on Cooper Union's website.<sup>8</sup> The latest minutes published on the Cooper Union website are from the October 6, 2022, meeting, which are the most recently approved Board meeting minutes.<sup>9</sup>

The Consent Decree states that the Board shall make "annual statements that outline fiscal year dollar-value and percentage-change performance of the non-real-estate investments in Cooper Union's endowment . . . along with disclosures of all fees paid directly by Cooper Union during the quarter and fiscal year to any investment advisers or fund managers, and the identity of the chief adviser or fund manager responsible for handling each investment." The Board generally reports on the performance of the non-real estate endowment at its quarterly meetings. We have been advised that the information for 2022 will be compiled, and thereafter posted to the Cooper Union website, once the final numbers as contained in the recently issued audited financial statements are reviewed by the Investment Committee at its next scheduled meeting.

The Consent Decree states that the Board shall "cause the information now provided on its website to be revised or deleted in response to notice from the Attorney General, prior to entry of this Consent Decree, identifying items that are alleged to be inaccurate and need to be clarified or revised." The respondents complied with this requirement in 2015 by updating the Cooper Union website.

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<sup>8</sup> See <https://cooper.edu/about/trustees/minutes-board-trustees-meetings>

<sup>9</sup> Board meeting minutes are approved at the next Quarterly Board meeting.

## 4 Identification of Non-Budgeted Expenditures and Obligations

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Kroll's identification of non-budgeted expenditures by Cooper Union exceeding \$100,000 and non-budgeted contractual obligations exceeding \$125,000 was based upon our review of Cooper Union's financial information for the fiscal year ended June 30, 2022, correspondence with Finance and Administration senior staff, and information presented to the Board of Trustees and Finance and Business Affairs Committee. The financial information included the Board approved budget, accounting system reports, transaction details, and applicable supporting documentation. Cooper Union's annual budgeted operating expenses include unrestricted, temporarily restricted, and endowment funds, as well as "other" non-cash items.<sup>10</sup>

The unrestricted funds represent Cooper Union's regular operating budget accounts that are associated with the organization's normal, everyday operating activities. The temporarily restricted funds are more generally used by specific schools and departments for certain operating expenditures, as well as select donor-designated activities outside of the scope of standard operations. The budgeted endowment expenditures represent endowment payout funds that the designated schools will utilize to fund normal, everyday operating activities. The non-cash items in the budget include depreciation, amortization, and a postretirement liability adjustment. Although budgeted and monitored, the postretirement adjustment is based entirely upon on an annual valuation performed by an external actuary.

The total budget for unrestricted operating expenditures for the fiscal year ended June 30, 2022, was \$69.6 million, an increase from the unrestricted \$67.9 million budgeted total for fiscal year 2021. This represents only a 2.56% increase in unrestricted operating expenditures, in comparison to revenues that were forecasted to increase approximately 6.50% in the same fiscal year. The fiscal year 2022 unrestricted operating expenditure budget was only marginally higher than the \$68.5 million average budgeted total for the four fiscal years ended 2017 through 2020. The 2022 operating expenses budgeted for the temporarily restricted and endowment funds were \$2.7 million and \$1.8 million,

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<sup>10</sup> Note that the terminology used in the audited financial statements is now "Net Assets without Donor Restriction" and "Net Assets with Donor Restriction." In this report we use the terminology used in the Board approved budget.

respectively. Therefore, the total operating expense budget for unrestricted, temporarily restricted, and endowment funds for the fiscal year ended June 30, 2022, was \$74.2 million. The total for the “other” non-cash items budgeted total was \$9.6 million, which included \$8.5 million for total depreciation expense that is based on the Plan’s annual estimate and is not budgeted on an individual asset by asset basis.

Similar to recent fiscal years, the most substantial components of the budgeted operating expenses were debt servicing costs, faculty salaries and benefits, leases and taxes, and facilities costs. To identify the non-budgeted actual expenditure deficits exceeding \$100,000, Cooper Union and Kroll analyzed budgeted departmental operating expenditure categories and corresponding cumulative budgeted expense variances. As detailed below, within four departments, there were five instances of expense category deficits in excess of \$100,000, totaling approximately (\$3.0) million . There were, however, offsetting savings in these categories, as well as budgeting surpluses in other categories that resulted in total actual operating expenses of \$73.4 million, which when compared to the total budgeted operating expenses of \$74.2 million, resulted in a favorable actual expense surplus of approximately \$0.8 million.

**Summary of Actual versus Budgeted Operating Expense Deficits in Excess of (\$100,000)**

For the Fiscal Year Ended ("FYE") June 30, 2022

<b>Ref. #</b>	<b>Department</b>	<b>Expense Category</b>	<b>Actual</b>	<b>Budget</b>	<b>(Deficit)</b>	<b>% of Total</b>
1	Facilities	Materials & Maintenance	\$ 2,203,960	\$ 880,000	\$ (1,323,960)	43.84%
2	G&A	Legal & Audit	2,001,881	986,000	(1,015,881)	33.64%
3	Safety	Security	1,439,052	1,200,000	(239,052)	7.92%
4	Facilities	Utilities	1,397,802	1,163,000	(234,802)	7.78%
5	Finance	Recruiting	256,149	50,000	(206,149)	6.83%
<b>Total</b>			<b>\$ 7,298,844</b>	<b>\$ 4,279,000</b>	<b>\$ (3,019,844)</b>	<b>100.00%</b>

Cooper Union's explanations for these identified expense budget deficits are summarized below:

(1) Facilities: Materials and Maintenance – Budget Deficit (\$1,323,960)

There were expenditures of approximately \$1.2 million in excess of budgeted costs that were related to COVID-19 safety and prevention costs (testing services and kits, cleaning and disinfectant materials, and protective equipment service, *etc.*). These higher than budgeted costs were funded by the Higher Education Relief Fund ("HEERF") and reimbursements from the Federal Emergency Management Agency ("FEMA"), which offset these budgeted deficits. As a result, there were no net expense variances or deficits for these amounts. The balance of the higher-than-expected expenses was due to unanticipated maintenance costs, including air conditioning, elevators, water testing, air quality testing, graffiti remediation, and plumbing.

(2) General and Administrative: Legal and Audit – Budget Deficit (\$1,015,881)

There were significant unanticipated legal and advisory fees in excess of \$1.0 million related to Cooper Union's real estate assets. These assets are critical to Cooper Union's long-term success and were approved by the Board and, pursuant to the Consent Decree, recommended by the Financial Monitor as an "ex-budget" expenditure. If Cooper Union had not incurred these additional Board approved expenses, the total Legal and Audit actual expenditure variance would have been below the \$100,000 threshold.

(3) Safety: Security – Budget Deficit (\$239,052)

Increased security monitoring expenses were related to COVID testing, as well as heightened crime levels and associated risks in New York City. Additionally, during the fiscal year, Cooper Union commenced several significant construction and restoration projects that also required increased security on or around the work sites and facilities.

(4) Facilities: Utilities – Budget Deficit (\$234,802)

The increased utility costs were primarily the result of the significant increases in utility rates. Economic developments resulted in upward trends of inflation, which coincided with the fiscal

year's full return to onsite campus schooling and activities, which resulted in increased utility consumption.

(5) Finance: Recruiting– Budget Deficit (\$206,149)

The increased recruiting costs related to Cooper Union's future organizational personnel investments. These costs, which were not individually budgeted, were generally funded from cost savings in other departments and are intended to benefit the institution for years to come.

As in prior fiscal years and as noted above, these and other lesser individual budgeting deficits were either offset by budgeting surpluses within the respective departments, or by Cooper Union's overall favorable budgeted expense variance.

Regarding the identification of non-restricted individual contractual obligations of Cooper Union exceeding \$125,000, there were four such obligations entered into during the fiscal year ended June 30, 2022. Kroll reviewed available supporting documentation, verified the terms and nature of the services to be performed, and substantiated payment provisions concerning the vendors' obligations. The agreements and their respective fiscal year 2022 payments are summarized below:

**Summary of Contractual Obligations in Excess of \$125,000**

For the Fiscal Year Ended ("FYE") June 30, 2022

Ref. #	Name	Dated	Description	Contract Amount	FYE Paid Amount
1	Taurino Management Inc.	7/1/2021	Reconfiguration of Dean's Office to allow a centralized space for offices and Engineering School Meeting Room to reclaim other space within 41 Cooper Square for academic classrooms.	\$ 490,000	\$ 517,361
2	SPK/Lewis Construction, LLC	7/1/2021	The Photo Workshop Renovation Project at 41 Cooper Square to create state-of-the-art workspace for School of Art students.	465,000	518,210
3	Preserv Building Restoration	9/3/2021	The Foundations Building Façade Restoration.	2,282,482	638,214
4	Preserv Building Restoration	11/1/2021	President's House Phase 1 Façade Restoration and safety repairs at 21 Stuyvesant Street.	313,855	284,036
<b>Total</b>				<b>\$ 3,551,337</b>	<b>\$ 1,957,822</b>

Both the Dean's Office reconfiguration and Photo Workshop renovation projects (Ref. #s 1 and 2) incurred additional costs greater than the original contracted amount, predominantly as a result of numerous project change orders. The change orders ranged in purpose and value from \$1,695 up to \$11,500 for added materials, equipment, and labor. A summary of the respective change orders, which have been tested and verified for applicable, external supporting documentation, as well as Cooper Union's approvals, is listed below:

- Taurino Management Inc. – Dean's Office Reconfiguration
  - There were six change orders totaling approximately \$27,331 that required additional scope and services for metal fabrication, design revisions, electrical and carpentry work, and panel installation.
  
- SPK / Lewis Construction, LLC. – Photo Workshop Renovation
  - There were ten change orders totaling approximately \$53,561 that required additional scope and services for HVAC and lighting upgrades, floor and ceiling work, and mechanical equipment installation.

## 5 The Free Education Committee Report

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The FEC Report included a detailed description of the plan to return Cooper Union to a full-tuition scholarship model, which was subsequently adopted by the Board with revisions. We have reviewed the Board's Plan and its attendant risks and have commented on them in our prior reports. Summarized below is our review of Cooper Union's implementation of the Board's Plan over the past year.

### 5.1 The Board's Plan

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The Board's Plan, if met, would allow Cooper Union to reinstitute full-tuition scholarships by fiscal year 2029. Cooper Union is focused on the implementation of the Plan, and the FEC is focused on monitoring Cooper Union's progress against the Plan. In 2022, the FEC formally assessed progress against the Plan on a semi-annual basis.

The FEC uses a formal review document to determine if the Plan is on track or if any modifications are warranted. An example of a potential modification would be to move an initiative from the "bullpen" – which contains initiatives considered part of the overall Plan but held in reserve – to active consideration. Examples of the review the FEC performs include determining whether: (a) current financial results are meeting the long-term financial goals of the Plan; (b) revenue initiatives are being implemented, such as reducing graduate scholarships, and increasing ancillary revenues and current use fundraising; (c) expense initiatives are being met; and (d) all active initiatives are on track, including space reduction, increasing summer dorm rentals, consideration of restructuring or refinancing debt, developing a capital campaign, and consideration of the bullpen items.

### 5.2 Risks to Achieving the Board's Plan

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Summarized below are the risks to achieving the Board's Plan. These risks include risks discussed in our prior reports, which are repeated here due to their significance, as well as some newly identified risks. These risks can be categorized as external and beyond Cooper Union's direct control, and internal and capable of being actively managed.



### 5.2.1 External Risks

The FEC has identified several external risks in its deliberations over the past several years, including: (1) the economy and potential economic downturns, (2) the impact of inflation on expense control, (3) uncertainty in investment markets, and (4) Federal and State tax and student aid policy. Each of these forces beyond the control of Cooper Union could have a substantial impact on Cooper Union's financial condition and might adversely affect the institution's timetable for a return to full-tuition scholarships. We believe, however, that the guardrails in the Board's Plan, if faithfully invoked and enforced, should provide adequate coverage for these issues as they occur. Support for this conclusion can be found in Cooper Union's management of the safety, academic programming, and financial challenges presented by the COVID-19 Pandemic and this past year's decline in the investment market and dramatic increase in inflation, which demonstrated the resilience of the goals and guardrails the Board has put in place.

Added to the risks presented by the pandemic and economic downturn this year, Cooper Union is now subject to an endowment tax on invested balances if certain conditions are met. This tax did not exist when the Plan was approved. In 2021 this tax was \$1.1 million and was recorded as a reduction in investment return. In 2022, Cooper Union was not subject to the tax, but potentially could be in future years.

### 5.2.2 Internally Managed Risks

The Board's Plan also acknowledges various internal risks, including that a future Board or administration may decide that the Board's Plan is no longer a critical priority. We believe the FEC appropriately observed that this risk is mitigated in the early years by the presence of the Financial Monitor, and even when the term of the Monitor has expired, by the Consent Decree itself, which has imposed an ongoing requirement that, "At any time tuition is being charged . . . Cooper Union is required to make ongoing, good faith efforts to determine whether it is practical to return to a free-tuition model . . ." Furthermore, the Consent Decree requires that "[i]f it is practical to return to such a free-tuition model, Cooper Union must expeditiously develop and implement a plan to do so [and] maintain that model as long as it is practical."

The Consent Decree requires that the return to a free-tuition scholarship model must be pursued while maintaining Cooper Union's "strong reputation for academic quality." The FEC has undertaken efforts

to assess the institution's continuing academic quality, the Board's Plan has made financial commitments to curriculum renewal, and Cooper Union has been investing in personnel, programs, and facilities. We believe, however, that the need for these investments will likely continue to increase in coming years.

Other risks that must be managed include certain contractual or legal rights that, if altered, would place substantial pressure on the financial health of Cooper Union. Many of these issues are addressed in the Board's Plan, the most notable being the continuation of the TEP in the amounts forecasted, and the continuation of the contractual payments pursuant to the Chrysler Building lease. Revenue from the Chrysler Building lease and TEP totaled \$51.8 Million in 2022, (53.6% of budgeted revenues including endowment payout), \$53.5 million in fiscal year 2021 (61.9% of budgeted revenues including endowment payout) and is forecasted for \$50.6 million in fiscal year 2023 (56.1% of forecasted revenues including endowment payout). The decline in the amount of revenue from the Chrysler Building is related to higher vacancy rates which affected assessment values and correspondingly contributed to a reduction in the TEP. The continuation of these payments is a key component of the Board's Plan.

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Cooper Union's strong financial performance this past year despite the continued disruptions caused by the global pandemic and economic downturn has demonstrated the wisdom of the Plan adopted by the Cooper Union Board in 2018. The Plan was strategically designed to implement long-term financial improvements that would allow the school to weather an unforeseen financial downturn while continuing on the path to a return to a full-tuition scholarship model within the foreseeable future. Issues associated with the pandemic, the decline in the market value of investments, and inflationary pressures may well continue throughout the coming year, affecting all aspects of Cooper Union, but the steady leadership of Cooper Union's Board and President Sparks provides confidence that the school will continue to manage the academic, health, and financial challenges it faces.

### **About Kroll**

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