



Annual Report of the Financial Monitor

The Cooper Union for the Advancement of Science and Art

February 15, 2020

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I. Introduction

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 is 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”) Progress Report, the feasibility of its 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 fourth 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 accounting system records. Finally, we have reviewed Board resolutions relating to the Cooper Union bylaws.

As explained in more detail below, Cooper Union has made significant progress this past year in implementing the thoughtful and responsible plan it adopted in 2018 to improve Cooper Union’s financial condition and put it on the path to a return to a full-tuition scholarship model within the foreseeable future.

II. The Current Financial Condition of Cooper Union

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 ending June 30, 2019, as well as budget data provided by Cooper Union for 2020, and our assessment of Cooper Union’s progress against the previously-approved FEC plan to return the institution to a full-tuition scholarship model.

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, and we have discussed at length the FEC Plan in our 2018 annual monitor’s report and the Board’s Plan in our 2019 report. This year’s report focuses on a discussion of Cooper Union’s progress against that Board’s Plan and the monitoring mechanism used by Cooper Union to ensure compliance with the Plan.

A. Continued Improvement in Operating Results

Cooper Union has had substantial operating deficits (deficiency of operating revenues over operating expenses) for many years. Between 2009 and 2018, based on its annual audited financial statements, Cooper Union had cumulative operating deficits of \$181.1 million. The deficit in 2018 was \$4.2 million, reduced from a peak of \$24.5 million. The 2019 audited financial statements, however, reflect an operating surplus (excess of operating revenues over operating expenses) of \$16.2 million. In 2019, net student tuition and fees totaled \$13.5 million, leaving an operating surplus excluding all tuition of \$2.7 million.¹ Accordingly, there has been a significant decrease the size of the deficit since 2018, and the substantial surplus in 2019 demonstrates a continued improving trend. This progress is expected to continue in coming years, as described in the Board’s Plan.

We continue to believe a positive margin of approximately 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, are necessary if Cooper Union is to achieve normal standards of financial viability and health and return to a full-tuition scholarship model.

¹ We note that the audited financial statements are prepared on the basis of generally accepted accounting principles (“GAAP”), which differs from the internal budget process used by Cooper Union through June 30, 2018, which is the cash basis. The cash-based budget excludes depreciation and amortization expenses, but includes capital acquisitions and principal payments on loans, which started in 2019 and totaled \$3.3 million for the year. Other items that are excluded from the budget are all other non-cash amortization and accretion items among other smaller items.

When comparing the operating results of 2019 (\$16.2 million surplus) to 2018 (\$4.2 million deficit), there were several substantial events that contributed to the improved operating performance. The improvement of \$20.4 million results from both continuing or structural events, and some events that may or may not be repeatable. The most notable of these events include:

- **Increase in investment return utilized for operations of \$13.8 million** (\$63.8 million in 2019 compared to \$50.0 million in 2018 and \$37.7 million in 2017). This is principally the result of a reset in rents on the Chrysler Building land lease. This is a structural event, and there are contractual increases throughout the term of the lease, which expires in 2147. The contractual rents received under the Chrysler Building lease increased from \$7.8 million in 2017 to \$20.1 million in 2018, and to \$32.5 million in 2019 through 2027, with additional increases thereafter. A significant event has occurred where the owner of the Chrysler Building sold its interest to a new owner. This is discussed in more detail in section V.B, below.
- **Maintaining expense levels in accordance with The Plan.** In 2019, expenses increased by \$134,000 or 0.2% (\$78.4 million in 2019, \$78.3 million in 2018 and \$82.5 million in 2017). The largest change was a \$2 million reduction in total compensation. Some of the other changes that are part of the Board’s Plan scheduled to reduce expenses over several years are structural and are part of the implementation of the institution’s expense-reduction program. These reductions would appear to be partially offset, however, by other changes in expenses. The planned initiatives are detailed in the Board’s Plan. Expense levels are one of the “secondary guardrails,” discussed further below in section II.C.

The deliberations of the various committees of the Board and the Board’s Plan acknowledge the need for incremental investment in curriculum renewal, and increases in capital spending. The capital spending itself will not impact the audited financial statements, but the incremental depreciation will. In the budget, however, which follows the Board’s Plan, this spending is considered a charge against the operating results, while the incremental depreciation is not. We would note that the depreciation expense in 2019 decreased by \$166,000 from 2018 following a \$300,000 reduction in 2018, indicating a reduced reinvestment in capital, which Cooper Union will need to address.

- **Contributions without donor restrictions show a net improvement of \$4.9 million,** with a total current use change of \$7.4 million. Total contributions in the financial statements are \$21.1 million, which demonstrates a substantial increase over the Plan. This is discussed further below in section II.C.
- **All Other Changes result in a net improvement of \$1.6 million.** This would be a normal range of change for all other revenue activities.

A review of the 2019 cash operating budget actual results for the fiscal year ending June 30, 2019 shows a cash operating surplus of \$18.3 million with net tuition and fees of \$13.9 million² and expenditures of \$71.2 million,³ excluding flood-related net costs.⁴

The budget for 2020 anticipates a cash surplus of \$12.5 million, with an allocation to approved initiatives of: (a) operating and capital reserves of \$16.1 million; (b) debt principal repayment reserve of \$1.7 million; and (c) post-employment health insurance obligation reserve of \$0.5 million.⁵ This is consistent with the plan to use the cash generated to restore prior uses of funds and invest in initiatives identified in the Board's Plan. We discuss the need for restoring resources under the Balance Sheet Structural Issues section below.

B. Continued Improvement in Balance Sheet Structural Issues

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 will 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 necessarily requires 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 of enough significance 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

² The \$13.9 million of net tuition and fees in 2019 is comprised of \$8.8 million of undergraduate net tuition, \$0.7 million of graduate net tuition and \$4.4 million of student fees.

³ As noted above, Cooper Union principally used a cash-based budget for fiscal year 2019, which has presented expenditures, rather than total expenses.

⁴ On February 2, 2019, extreme water leakage from a ruptured pipe in the 41 Cooper Square building caused extensive property damage. Estimates of the loss approximated \$7 to \$8 million. The costs of repairs and property replacement totaled \$3,860,890 through June 30, 2019. The consolidated financial statements reflect insurance recovery proceeds for the same amount, less a \$10,000 property insurance deductible. Cooper Union recognized a gain from insurance recoveries of \$614,260 in the 2019 consolidated statement of activities. Costs of repairs in excess of the \$10,000 deductible on the repair and replacement work related to the loss are expected to be covered in full by insurance.

⁵ Cooper Union self-insures most health benefits, with a stop-loss policy to cap the total loss on a claim. The payment of a claim passes directly through to the statement of activities, which can create volatility in employee benefits.

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 considers creating a "debt retirement reserve" to ensure availability of resources at the contractual maturity of this loan. Since Cooper Union has met the financial targets contained in the Board's Plan, these resources have been funded thus far, with \$1.7 million reserved.

- Deferred revenue of \$107.9 million on the balance sheet 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 and the change in the deferred revenue amounted to \$1.1 million from 2018 to 2019. The Board's Plan appropriately considers the impact of the deferred revenue in the computations of financial health.
- There is \$22.1 million (\$31.8 million in 2018) in postretirement benefit costs accrued which will consume cash in future periods, likely at increasing amounts as covered personnel retire.⁶ This obligation has consumed about \$900,000 of cash per year. The Board's Plan considers this obligation, including a factor for growth of the obligation over time. If discount rates increase or stay steady with 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, \$500,000 has been reserved for this obligation.
- From 2016 to 2019, the combined purchases of plant assets totaled \$8.1 million while depreciation and amortization totaled \$33.1 million, suggesting an under-investment in plant assets, which will likely need to be addressed in future periods. The Board's Plan includes funding of capital assets above current levels by amounts increasing to \$1 million above current levels per year by 2022. While this amount may not fully fund the amounts necessary to maintain a current plant, there is also a plan for programmatic investments starting in 2019 and growing 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 at Cooper Union, we have recommended adding two ratios to the financial metrics currently in use: a Physical Asset Reinvestment Ratio (which compares investment in plant to depreciation expense) and an Age of

⁶ This liability declined from \$40 million in 2016 principally due to the discount rate on the obligation increasing from 3.25% to 4.10%. The liability balance can be expected to fluctuate based on changes in actuarial assumptions.

Facilities Ratio (which compares accumulated depreciation to depreciation expense). These ratios would help inform the Board on the status of the physical plant and possibly indicate the need for adjustments to the Board's Plan in future years. At the end of 2019, Cooper Union reserved \$33.5 million for an operating and capital reserve and \$0.5 million for a deferred maintenance reserve.

- Net plant assets were \$142.5 million in 2019 (\$147.6 million in 2018 and \$154.2 million in 2017) while related debt was \$171.8 million. 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 this loan in the middle of 2019 and has reduced the principal balance by \$3.2 million. In 2020, the principal payments will be approximately \$5.8 million. The contractual payment structure, however, will not fully service the principal on this loan by its maturity date, requiring the debt reserve fund contemplated by the plan. Further, a significant prepayment penalty exists on this loan.

Cooper Union's operating cash and equivalents as of June 30, 2019 totaled \$37.9 million (\$31.1 million in 2018). Cash balances are rebuilding as a result of the surpluses generated. This is a significant change from the persistent historical operating deficits requiring the activities that produced cash to fund the deficits, such as loans and prepayment of rental income, resulting in a substantial "borrowing from the future." This borrowing, as well as the need for plant and programmatic investments totaling \$250 million by the FEC's estimate, will necessarily have to be funded from future operating positive margins, which necessarily will rely heavily on new revenue sources and growth in non-operating resources such as endowment and similar funds.

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

C. Financial Status Compared to the Guardrails

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.⁷ The guardrails and their status as of 2019 follows (amounts in thousands):

⁷ In the case of cash surplus, contributions and operating expenses guardrails, should the target be missed by 5% or more of the planned cash surplus, and in the case of the cash and investments guardrail, 5% or more of the planned cash and investments balance, the FEC would examine the causes and determine a recommended course of action.

<u>Guardrail</u>	<u>Cumulative Value</u>	<u>Guardrail</u>	<u>Favorable (Unfavorable)</u>
<i>Primary Guardrail:</i>			
Net Surplus	\$23,107	\$12,579	\$10,528
<i>Secondary Guardrails:</i>			
Current Use Contributions	\$11,524	\$7,552	\$3,972
Operating Expenses	\$105,464	\$108,749	\$3,285
Cash and Investments	\$218,641	\$163,684	\$54,957

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 may prove difficult 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.

D. Implications of Current Financial Condition on Future Activities

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 2019 emphasized the creation of 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 projects a way forward to eliminate operating deficits and to produce and grow financial resources to an appropriate level. The largest initiatives that move Cooper Union from large deficits to operating surpluses are the contractual changes in the lease agreement on the Chrysler Building, 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 incremental initiative, not currently under contractual or legal obligation, that moves Cooper Union to large enough surpluses to allow the return to a full-tuition scholarship model is heavily dependent on incremental philanthropy, particularly current-use philanthropy.

III. Measures Proposed by the Board of Trustees and its Committees

The Cooper Union Board 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 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. No Trustee Emeriti currently serve on the Cooper Union Board. Furthermore, the two Trustees who had served on the Board since October 6, 2006, were not reappointed to and currently do not serve on the Board.

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, Stephen Gerard and Eric Hirschhorn, both alumni of Cooper Union, serve on the Board as Vice Chairs. Mr. Gerard is also an Alumni Trustee.⁸

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

⁸ Alumni Trustees as defined in the Consent Decree are those elected by the CUA. There are other Trustees, who happen to be alumni of Cooper Union, who were not elected by the CUA and are thus not “Alumni Trustees” within the meaning of the Consent Decree.

complied with this requirement by adopting Section 1.03.2 of the amended bylaws. 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 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 3.01 of the amended bylaws. There are currently seven 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 Cooper Union Alumni Association 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. The Board complied with this requirement. Further, the Board has interpreted the Protocol to mean that there will be two Alumni Trustee seating periods in December and June. A determination of the number of Alumni Trustees required to satisfy the one-third ratio will be determined prior to the Annual December meeting (based on the number of trustees expected to be appointed at that meeting) with the understanding that the Alumni Trustee(s) will be seated only if the total number of trustees expected to be appointed are, in fact, appointed. Further, the calculation of the one-third ratio will include any newly elected Alumni Trustee(s). At the end of the December 2019 Board meeting there were twenty-two Trustees and seven of the Trustees sitting on the Board were Alumni Trustees, thereby satisfying the one-third requirement.⁹

The Consent Decree states that four full-time faculty members, one each from 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 six representatives serving, one from each of the designated groups.

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

⁹ The protocol also has a provision for electing additional Alumni Trustees if the Board increases the number of Trustees during the year in a way that would leave the representation of Alumni Trustees below one-third of the Board for two consecutive Board meetings.

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. Four of the recently-elected trustees -- Pam Flaherty, Margaret Matz, Aftab Hussain, and Elizabeth Graziolo -- each qualify for a position on the Board by their experience in finance, architecture, higher-education and architecture, respectively.

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. Current members of the committee include two Alumni trustees, one Trustee, and one Student Trustee. The FEC Report was approved by the Board of Trustees on March 6, 2018 with amendments and is available on the committee’s website.¹⁰ 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.” Currently sitting on the Governance Committee are 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.

¹⁰ <https://cooper.edu/about/trustees/fec>

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 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, in June 2019, the Board brought in a facilitator to lead a session on board governance and the roles and responsibilities of a Trustee.

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.¹¹ The latest minutes published on the Cooper Union website are from the September 25, 2019 meeting.

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 2019 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.

¹¹ See <https://cooper.edu/about/trustees/minutes-board-trustees-meetings>

IV. Identification of Non-Budgeted Expenditures and Obligations

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, 2019 and meetings with Finance and Administration personnel. The financial information included the Board approved budget, approved budget adjustments, accounting system records, and applicable supporting documentation. This year, Cooper Union's budgeted expenditures included unrestricted fund cash operating expenditures, temporarily restricted and endowment funds, as well as non-cash items. This expanded budget varies from prior years in which the budget only included unrestricted fund expenditures.

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 in association with certain operating expenditures, as well as select donor-designated activities beyond standard operations. The budgeted endowment expenditures represent endowment payout funds that the designated schools will utilize to fund normal, everyday operating activities.

The total budget for unrestricted operating expenditures for the fiscal year ended June 30, 2019 was \$67,844,517, which was a 1.16% decrease from the \$68,637,000 total for fiscal year 2018. This fiscal year 2019 unrestricted operating total was also a 2.03% decrease and 5.43% decrease from the fiscal year totals of 2017 and 2016, which were \$69,252,000 and \$71,739,323, respectively. The operating expenditure totals for the newly budgeted temporarily restricted and endowment funds were \$1,800,000 and \$645,000, respectively. The newly budgeted non-cash items budgeted total was \$9,620,000 and included depreciation, amortization and a postretirement liability adjustment. The depreciation and amortization were classified as unrestricted, while the postretirement adjustment, which is formulated based on an annual valuation performed by an external actuary, was classified as temporarily restricted.

As in the three previous fiscal years, the most substantial components of the expenditure budget were debt servicing costs, faculty salaries and facilities costs. To identify the non-budgeted expenditures exceeding \$100,000, Cooper Union and Kroll analyzed departmental operating expenditure categories and corresponding cumulative budgeted departmental categorical expense variances. As detailed below, within four departments, there were seven individual instances of expense category deficits in excess of \$100,000, totaling \$1,772,226. There were, however, offsetting savings and budget surpluses in other categories that resulted in a favorable actual expenditure surplus of \$2,108,640, to the overall cash budgeted expenditure total of \$70,289,517.

For the fiscal year ended June 30, 2019, there was also a non-cash budgeted item surplus of \$683,148.

The Cooper Union for the Advancement of Science and Art
Budgeted vs. Actual Expenditure Deficit Summary
Fiscal Year Ended June 30, 2019

Ref #	Department	Expense Category	Budget	Actual	(Deficit)
1	Facilities	Contracts Other	\$ -	\$ 576,972	\$ (576,972)
2	Facilities	Cleaning	1,218,500	1,573,410	(354,910)
3	Facilities	Materials & Maintenance	687,500	913,929	(226,429)
4	Facilities	Salaries & Wages	1,499,881	1,699,920	(200,039)
5	Safety	Security	1,050,000	1,220,629	(170,629)
6	Finance	Salaries & Wages	1,664,950	1,796,069	(131,119)
7	G&A	Leases & Real Estate Taxes	1,424,300	1,536,428	(112,128)
Total			\$ 7,545,131	\$ 9,317,357	\$ (1,772,226)

Cooper Union’s explanation and justifications for the identified budget deficits are categorized and discussed below.

1. Facilities: Contracts Other – Budget Deficit (\$576,972)

Facilities incurred a variety of significant expenses related to departmental relocations that were required as a result of an occupancy reduction, from four floors to two floors, at the 30 Cooper Square facility. This space reduction process was conducted over multiple months, during both regular working and non-working hours and included additional expenses not considered at the time of budgeting. Examples of these types of services included persistent air quality testing, spatial designs, options mapping and layouts for multiple buildings, as well as construction and demolition debris and waste removal.

Additionally, there were escalated repair, maintenance and design costs incurred in the Residential Building and carryover costs from a previous vendor in fiscal year 2018 that also contributed to the budget discrepancies and deficit.

2. Facilities: Cleaning – Budget Deficit (\$354,910)

As noted above, Facilities incurred a variety of significant expenses related to the occupancy reduction at the Cooper Square facility. The long-term relocation and construction required additional contemporaneous cleaning efforts, that were not fully considered at the time of budgeting. Also, similar to “Facilities: Contracts Other,” there

were also higher cleaning costs incurred at the Residential Building that factored into the 2019 deficit.

3. Facilities: Materials and Maintenance – Budget Deficit (\$226,429)

Facilities’ increased work hours and efforts related to the 30 Cooper Square relocations also resulted in consistently increased materials and maintenance.

4. Facilities: Salaries and Wages – Budget Deficit (\$200,039)

The most significant component of this deficit was Facilities’ employee overtime, which was conservatively budgeted at \$150,000, substantially less than in previous years. The actual overtime incurred was \$289,452, almost twice the budgeted amount. This actual overtime amount, including the 30 Cooper Square relocation, aligns more closely to the overtime incurred in the three previous fiscal years of \$291,000, \$307,000 and \$265,000, respectively.

The conservative budgeted amount of \$150,000 was primarily the result of a new Facilities Director’s involvement in the budgeting process. As part of his initial Facilities assessment, he felt that he could reduce programmatic inefficiencies, including the reduction of necessary overtime. Throughout the year, however, the occupancy reduction and escalated maintenance led to increased overtime and the budget deficit.

5. Safety: Security – Budget Deficit (\$170,629)

There was a new security company, Allied Universal Security, that was hired in the fiscal year ended June 30, 2019. The construction and activities related to the previously mentioned 30 Cooper Square occupancy reduction and over all campus security needs necessitated a year-round roaming patrol officer that was not fully considered in the initial agreement, pricing structure or budgeting. These additional costs, however, were generally funded from other surpluses of Cooper Union’s overall budget.

6. Finance: Salaries and Wages – Budget Deficit (\$131,119)

For reporting and budgeting purposes, the “Finance” Department collectively includes the Business Office, Human Resources and Office Services. In the fiscal year ended June 30, 2018, the Human Resources department had experienced considerable turnover. Additional temporary staffing was required to facilitate a new leadership transition and the reorganization of workflows in the fiscal year ended June 30, 2019.

7. General and Administrative – Budget Deficit (\$112,128)

Similar to the previous year, Cooper Union under-budgeted the "additional rent" amount that was needed to pay to the landlord of the 29 Third Avenue retail space. The lease agreement requires Cooper Union to pay this landlord 40% of its "excess revenues" as additional rent. The excess revenues are generated from Cooper Union subleasing this commercial space to multiple retail tenants and receiving additional monies that exceed 110% of the lease amount paid to the landlord. Cooper Union budgeted this amount to be \$40,000, but the volatile New York City marketplace yielded an actual \$193,239 in additional rent paid.

As in prior reports, it is important to acknowledge a variety of operational adjustments that have been made within the operating expenditures and budgeting process in this most recent fiscal year, as well as prior fiscal years. These adjustments have successfully reduced operating costs, while also providing greater transparency and accountability. For example, this year's expanded budgeting and tracking more accurately represents Cooper Union's flow of funds through unrestricted, temporarily restricted and endowment related sources and uses. A multi-year cost savings plan was developed and successfully implemented to reduce non-payroll related expenditures, as well as staff salaries and related benefits.

Regarding the identification of non-restricted individual contractual obligations of Cooper Union exceeding \$125,000, there were six such obligations entered into during the fiscal year ended June 30, 2019. Kroll reviewed available supporting documentation, verified the terms and nature of the services to be performed and substantiated payment provisions concerning vendors' obligations. This fiscal year's payment, accrual and prepayment activities in connection with these six agreements are summarized below:

The Cooper Union for the Advancement of Science and Art

Contractual Obligations greater than \$125,000 Summary

Fiscal Year Ended June 30, 2019

Ref#	Name	Description	Payments	Accruals	Prepayments	Total
1	DWD Builders, Inc.	Flood Related Contractor Services	\$ 2,872,750	\$ 845,354	\$ -	\$ 3,718,104
2	Allied Universal Security Services	Campus Uniformed Security Services	1,188,173	97,784	-	1,285,957
3	UG2 LLC	Custodial Services	921,961	332,448	-	1,254,409
4	30 Cooper Square, LLC	30 Cooper Square Lease	531,251	45,333	(34,396)	542,188
5	Interra Consulting	Interim Chief Information Officer	366,843	24,000	-	390,843
6	Spring Scaffolding LLC	Pipe Scaffolding Services	38,000	175,000	-	213,000
Total			\$ 5,918,978	\$ 1,519,919	\$ (34,396)	\$ 7,404,501

V. The Free Education Committee Report

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. We review below Cooper Union's implementation of the Board's Plan over the past year.

A. The Board's Plan

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 2019, the FEC has been formally assessing 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 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, growing facility rentals, increasing ancillary revenues, and increasing 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.

B. Summary of Risks to Achieving the Board's Plan

The risks to achieving the Board's Plan include risks discussed in our prior reports, which have been repeated here because of their significance to achieving the Plan, as well as some new risks. These risks can be categorized as external and beyond Cooper Union's direct control, and internal and capable of being actively managed.

1. External Risks

The FEC Report identified several external risks, 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, should they occur.

Added to these risks in the current year, Cooper Union is now subject to a recently-passed endowment tax on invested balances, which did not exist when the Plan was approved. This tax is estimated at \$900,000 per year and is recorded in 2019 as a reduction in investment return. In addition, the current lessee of the land associated with the Chrysler Building sold its rights to an unrelated third party. This requires Cooper Union to establish a working relationship with the new lessee. Under the current agreement with the lessee, Cooper Union had no input in or involvement with this transaction.

2. Internally Managed Risks

The Board’s Plan also acknowledges various internal risks including the risk that a future Board or administration may decide that the Board’s Plan is no longer a 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 after the Monitor has left the scene, 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.”

We believe the most significant internal risk to the Board’s Plan remains the long-term expectations for philanthropy. The level of philanthropy in the first years of the Plan have exceeded the philanthropy targeted, but there are substantial further increases in the levels of philanthropy required by the Plan. While the targets established for the early years of the Plan would appear achievable within the context of existing resource allocations, the longer-term annual use funds that need to be raised to meet the Plan’s targets will require a substantial change in the methods of raising funds and the sources of those funds.

In addition, 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, program and facilities. We believe, however, that the need for these investments will likely continue to increase in coming years, beyond the current projections in the Plan.

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 tax equivalency

payments in the amounts forecasted, and the continuation of the contractual payments pursuant to the Chrysler Building lease. Revenue from real estate sources (including modest amounts from other properties) totaled \$58.2 million in 2019 (\$45.2 million in 2018 and \$33.1 million in 2017). This represents 61% of unrestricted revenues in both 2019 and 2018. This increase of \$13.0 million is the single largest reason for the improvement in operating results for 2019 and the Board’s Plan is dependent on the continuation of these payments as well as the substantial increases planned in future years.

* * *

The Cooper Union Board and administration agreed in the Consent Decree that Cooper Union “should expeditiously attempt to balance its budget,” and that all parties should “work together to try to expeditiously return Cooper Union to a sustainable, full-tuition scholarship model within the foreseeable future that maintains Cooper Union’s strong reputation for academic quality within its Art, Architecture and Engineering programs at their historical levels of enrollment.” Under the strong leadership of President Laura Sparks and Board Chair Rachel Warren, Cooper Union has made significant progress this past year in continuing the implementation of the thoughtful and responsible plan the Board adopted in 2018 to improve Cooper Union’s financial condition and put it on the path to a return to a full-tuition scholarship model within the foreseeable future. For Cooper Union to continue to make progress in returning to a full-tuition scholarship model, it will be essential that the Board, the administration and the Cooper Union community continue to thoughtfully address issues as they arise, to faithfully pursue the current Plan and to agree on adjustments to the Plan when changing conditions require it.



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