



Annual Report of the Financial Monitor

The Cooper Union for the Advancement of Science and Art

February 15, 2021

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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”) 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 fifth 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.

This year, as a result of the global COVID-19 Pandemic, we have seen an unprecedented disruption of the expected and normal operations of Cooper Union. This unanticipated disruption has consumed enormous attention and resources as Cooper Union has strived to maintain safety, academic programming, and fiscally responsible adherence to the Board’s strategic plan. As explained in more detail below, against these unprecedented headwinds, 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.

II. The Current Financial Condition of Cooper Union

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 at length in our 2018 annual monitor’s report and the Board’s Plan in our 2019 and 2020 reports. This year’s report focuses on a discussion of Cooper Union’s continued progress against that 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 ending June 30, 2020, as well as budget data provided by Cooper Union for 2021, 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 examine 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, 2020 demonstrated its continued progress against the Plan during an extraordinarily challenging year due to the world-wide pandemic. We believe this progress was due in large part to the structure of the Board’s Plan itself, which prioritized strengthening the long-term financial condition of Cooper Union so it could weather an unforeseen financial downturn, and the prompt action and leadership exhibited by the Board and Cooper Union’s President Laura Sparks and her senior staff. Cooper Union experienced a reduction in operating revenues, but was able to manage costs so that an operating margin of over 12% was realized. This allowed continued allocation of funds for key priorities, albeit not at the levels in 2019, when the operating margin was 17%. Issues associated with the pandemic will undoubtedly continue throughout fiscal year 2021, 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 navigate through these unprecedented economic times. Included below is a discussion of the 2020 financial condition of Cooper Union.

A. 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 cumulative operating deficits of \$181.1 million. In contrast, the 2019 and 2020 audited financial statements reflect operating surpluses of \$16.2 million and \$11.7 million, respectively. In 2019 and 2020, net student tuition and fees were about \$13.5 million each year. This indicates a small surplus, excluding tuition and fees in 2019, and a small deficit,

excluding tuition and fees in 2020. Continuing operating surpluses will be critical to Cooper Union's achieving a tuition free environment, and the Board's Plan projects that surpluses will continue in the coming years.

The operating surplus in 2020, although lower than in 2019, was achieved in the face of the pandemic, which resulted in unprecedented changes in the school's operating model. It was reported at the September 2020 Finance and Business Affairs Committee Meeting that the pandemic had negatively impacted revenues by \$2.9 million, affecting most sources of revenue, including dorm fees, real estate rentals, and lower than anticipated philanthropy. At that same meeting, it was projected that the pandemic would negatively impact the 2021 budget by \$5.1 million.

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 and achieved by Cooper Union in 2019 and 2020, are necessary if Cooper Union is to achieve normal standards of financial viability and health and return to a full-tuition scholarship model.

When comparing the operating results of 2020 (\$11.7 million surplus) to 2019 (\$16.2 million surplus), there were several substantial events that contributed to the decline in operating performance.¹ The most notable of these events include:

- **Total revenues declined \$2.9 million.** This is due principally to a decline in current use contributions of \$4.2 million, partially offset by a modest net increase of \$1.3 million from other revenue lines.
- **Maintaining expense levels in accordance with The Plan.** In 2020, expenses increased by \$1.6 million or 2.1% including expenses related to the pandemic. (\$80.0 million in 2020, \$78.4 million in 2019, \$78.3 million in 2018 and \$82.5 million in 2017). The largest change was a \$2.5 million increase in total compensation, including incremental costs in health insurance. The increase in compensation appears consistent with the commitment in the Plan to invest in program renewal, and reflects changes in response to the pandemic. These increases were somewhat offset by other expense reductions. Expense levels are one of the "secondary guardrails," discussed further below in section II.C.

¹ Although the operating performance in 2020 declined as compared with the performance in 2019, it still met the performance targets in the Plan and it exceeded the performance of any year other than 2019 since at least 2009 when the operating deficit was \$11.9 million.

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. 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 2020 increased by \$835,000 from 2019, and the investment in capital in 2020 was \$6.0 million as compared to \$3.7 million in 2019, indicating a reinvestment in capital, which Cooper Union will need to continue to address in the coming years.

The budget for 2021 anticipates a cash surplus of \$7.3 million, with a provision for COVID 19 revenue losses of \$5.1 million, net of expense savings. The Plan targeted the surplus for 2021 at \$11.9 million, indicating that the operating surplus before COVID 19 costs would have been met. The budget surplus will be applied to approved key priorities identified in the Plan of: (a) operating and capital reserves; (b) debt principal repayment reserve; (c) post-employment health insurance obligation reserve; and (d) investment in deferred maintenance. 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 continued need to restore 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 will allow 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 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 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 \$3.4 million reserved.

- Deferred revenue of \$101.3 million remaining on the balance sheet as of June 30, 2020 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 \$6.6 million from 2019 to 2020. The Board's Plan appropriately considers the impact of the deferred revenue in the computations of financial health.
- There is \$28.8 million (\$22.1 million in 2019) in postretirement benefit costs accrued which will consume cash in future periods, likely at increasing amounts as covered personnel retire.² This obligation has consumed about \$900,000 of cash in 2020. 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, \$1.0 million has been reserved for this obligation.
- From 2016 to 2020, the combined purchases of plant assets totaled \$14.1 million while depreciation and amortization totaled \$41.9 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 current levels by amounts increasing to \$1 million above current levels per year by 2022. While this amount will 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 added two ratios to the financial metrics currently in use: (a) a Physical Asset Reinvestment Ratio (which compares investment in plant to depreciation expense), shows a reinvestment rate in 2020 of 68% and 46% in 2019, while the threshold over a longer period of time is 100%; and (b) an Age of Facilities Ratio (which compares accumulated depreciation to depreciation expense), which shows an age of 17 years in each year, with a threshold value of 12 to 14

² This liability declined from \$40 million in 2016 principally due to the discount rate on the obligation increasing over that period. The liability balance can be expected to fluctuate based on changes in actuarial assumptions, which caused the increase from \$22.1 million in 2019 to \$28.8 million in 2020.

years. These ratios help inform the Board on the status of the physical plant and may indicate the need for adjustments to the Board's Plan in future years.

- Net plant assets were \$137.5 million in 2020 (\$142.5 million in 2019, \$147.6 million in 2018 and \$154.2 million in 2017) while related debt was \$166.0 million. Total debt of \$225.3 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 2020, the principal payments were \$5.8 million (\$3.2 million in 2019). 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.

Cooper Union's operating cash and equivalents as of June 30, 2020 totaled \$39.6 million (\$37.9 million in 2019). 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 will rely heavily on new revenue sources and growth in non-operating resources such as endowment and similar funds. Of this \$250 million required restoration, \$46.3 million has been earmarked for reserves as of 2020.

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. The guardrails and their status as of 2020 follows (amounts in thousands):

<u>Guardrail</u>	<u>Cumulative Value</u>	<u>Guardrail</u>	<u>Favorable (Unfavorable)</u>
<i>Primary Guardrail:</i>			
Net Surplus	\$35,823	\$23,855	\$11,968
<i>Secondary Guardrails:</i>			
Current Use Contributions	\$15,897	\$12,970	\$2,927
Operating Expenses	\$158,998	\$163,692	\$4,694
Cash and Investments	\$232,102	\$179,108	\$52,994

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 2020 continued the 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 2021 impact of the pandemic will continue to challenge Cooper Union as program delivery, auxiliary revenues from students, and testing and cleaning costs will likely continue throughout the year.

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 (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 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 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 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, having been reappointed as Vice Chairs at the annual Board of Trustee’s December 2020 meeting. Mr. Gerard is also an Alumni Trustee.³

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

³ 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 language regarding the inaugural terms of the Student Trustees was removed from the bylaws during the December 2020 Board meeting as it is no longer applicable.

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 1.03.1 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 2020 Board meeting there were nineteen Trustees and seven of the Trustees sitting on the Board were Alumni Trustees, thereby satisfying the one-third requirement.⁴

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

⁴ 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.

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; however, the language regarding the inaugural terms of the Representatives was removed from the bylaws as part of the December 2020 amendments.

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. Three of the recently-elected trustees – Carol Wolf, Dana Hughes, and Jamie Levitt – each qualify for a position on the Board by their experience in a number of the areas specified in the Consent Decree including graphic design, business strategy and operations, law, non-profit governance, and prior board 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. 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.⁵ 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

⁵ <https://cooper.edu/about/trustees/fec>

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 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 2020 Retreat, the Board brought in a facilitator to lead a session on board governance and the roles and responsibilities of a Trustee.⁶

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.⁷ The latest minutes published on the Cooper Union website are from the September 30, 2020 meeting, which are the most recently approved Board meeting minutes.⁸

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 2020 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

⁶ The Board has had a session like this at every annual retreat since 2017.

⁷ See <https://cooper.edu/about/trustees/minutes-board-trustees-meetings>

⁸ Board meeting minutes are approved at the next Quarterly Board meeting.

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.

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, 2020, correspondence with Finance and Administration personnel, and information presented to the 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.

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 non-cash items in the budget include depreciation, amortization, and a postretirement liability adjustment. Although budgeted, the postretirement adjustment is based entirely upon an annual valuation performed by an external actuary.

The total budget for unrestricted operating expenditures for the fiscal year ended June 30, 2020 was \$68.4 million, an increase from the \$67.8 million budgeted total for fiscal year 2019. This fiscal year 2020 unrestricted operating total, however, was less than the budgeted fiscal year totals of 2018 and 2017, which were \$68.6 million and \$69.3 million, respectively. The operating expenses paid by the budgeted temporarily restricted and endowment funds were \$1.8 million and \$1.4 million, respectively. Therefore, the total operating expense budget for unrestricted, temporarily restricted, and endowment funds for the fiscal year ended June 30, 2020, was \$71.6 million. The total for the “other” non-cash items budgeted total was \$9.6 million, which included an estimate of \$8.5 million for depreciation that is based on the Plan’s annual estimate and is not budgeted on an individual asset by asset basis.

Similar to the most recent fiscal years, the most substantial components of the budgeted operating expenses were debt servicing costs, faculty salaries, 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 three departments, there were three individual instances of expense category deficits in excess of \$100,000, totaling (\$1.397) million. There were, however, offsetting savings in these categories, as well as budget surpluses in other categories that resulted in total actual operating expenses of \$68.1 million, which when compared to the total

budgeted operating expenses of \$71.6, resulted in a favorable actual expense surplus of \$3.5 million.

The Cooper Union for the Advancement of Science and Art
Actual versus Budgeted Operating Expense Deficit Summary
Fiscal Year Ended June 30, 2020

Ref #	Department	Expense Category	Actual	Budget	(Deficit)
1	G&A	Legal & Audit	\$ 1,678,253	\$ 710,000	\$ (968,253)
2	Finance	Salaries & Wages	1,894,800	1,677,749	(217,051)
3	Facilities	Materials & Maintenance	874,278	662,500	(211,778)
	Total		\$ 4,447,331	\$ 3,050,249	\$ (1,397,082)

Cooper Union’s explanation and justifications for these identified expense budget deficits are summarized below.

1. General and Administrative: Legal and Audit – Budget Deficit (\$968,253)

There were significant unanticipated legal fees as a result of \$875,000 of unbudgeted advisory fees that were approved by the Board and, pursuant to the Consent Decree, recommended by the Financial Monitor as an “ex-budget” expenditure related to Cooper Union’s real estate assets. Without these Board approved, unbudgeted expenses, the Legal & Audit actual expense category deficit is less than \$100,000.

2. Finance: Salaries and Wages – Budget Deficit (\$217,051)

Increased expenses within the Finance department were primarily related to Office Services headcount related costs, including overtime; higher Human Resource and Finance department expenses related to department organization upgrades; and vacation accrual provision increases. The vacation accruals concerned the timing (deferral) of employee vacation usage related to the COVID-19 Pandemic. Cooper Union allowed employees to carry over vacation days, whereby it was estimated that on average, employees had three more unused days as of June 30, 2020 than they had as of June 30, 2019. This increase in vacation days represented approximately \$293,000 of the overall vacation pay accrual as of June 30, 2020.

3. Facilities: Materials and Maintenance – Budget Deficit (\$211,778)

Expenditures of approximately \$125,000 for the replacement of "Business Personal Property" items, such as computer equipment damaged in a flood during fiscal year 2019, remain under review by Cooper Union's insurance carrier, The Hartford. Thus far, The Hartford has reviewed submitted claims totaling approximately \$8.5 million, of which \$7.9 million have been paid. A provision for the expense has been recorded until the review is completed, which is expected to be in the fiscal year ended June 30, 2021.

As in prior fiscal years, these individual deficits were either offset by surpluses within their respective departments or by Cooper Union's overall favorable budgeted expense variance. Additionally, Cooper Union continues to improve operating results, financial structural issues, and budgeting processes in alignment with the design and implementation of the Plan, while also providing greater transparency and accountability. Dissimilar to prior fiscal years, however, there were and still are the unanticipated challenges related to the COVID-19 Pandemic and its devastating impacts on higher education and across the world. There were dramatic revenue shortfalls in areas including dorm and facility revenue, real estate, contributions, and non-matriculated fees that were marginally lessened by reductions in select related expenses and capital project expenditures. Additional expense cutting initiatives, however, were subsequently identified and executed that resulted in additional savings for the fiscal year ended 2020 and were also factored into the budgeting process for 2021. The expense initiatives paired with additional development money and CARES Act funds received, allowed Cooper Union to end the year approximately 2% ahead of budgeted Net Surplus.

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, 2020. Kroll reviewed available supporting documentation, verified the terms and nature of the services to be performed, and substantiated payment provisions concerning vendors' obligations. The total payments made in connection with these four 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, 2020

Ref#	Name	Description	Total
1	Gibson, Dunn & Crutcher LLP and advisory firm retained by the law firm	Legal / Advisory Services	\$ 875,000
2	Donnelly Mechanical	HVAC Energy Services	556,968
3	Empire Office Inc.	Desks, Bottom Shelves, and Chairs Delivery & Install	206,936
4	Lifetime Commercial Roofing, Inc.	Roofing Work & Brick Pointing	190,000
Total			\$ 1,828,904

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 2020, 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 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.

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, if and when 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, which demonstrated the resilience of the goals and guardrails the Board has put in place.

Added to the risks presented by the pandemic this 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 2020 as a reduction in investment return.

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 fiscal year 2020, unrestricted philanthropy was short of the Plan by about \$1.6 million.⁹ Cumulatively, through fiscal year 2019, unrestricted philanthropy had exceeded Plan by approximately \$3.3 million. The cumulative result as of fiscal year 2020 was that Cooper Union was ahead of Plan by \$1.7 million in unrestricted contributions. The pandemic would appear to have had a substantial impact on philanthropy in fiscal year 2020 that is expected to continue in fiscal year 2021. If Cooper Union achieves its budget target for philanthropy in fiscal year 2021, total contributions will still be approximately \$9.0 million ahead of Plan, but this is a reduction from a cushion of approximately \$13.7 million, suggesting philanthropy is a potential risk and that an ongoing focus on philanthropy is critical.

⁹ In addition to unrestricted contributions, Cooper Union raises restricted contributions, some of which are for current-use scholarship and operating funds and, as such, contribute to the Plan.

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 \$59.2 million in 2020 (\$58.2 million in 2019 and \$45.2 million in 2018). This represents 64% of unrestricted revenues in 2020 (61% in 2019). The increase in real estate revenue of \$13.0 million from 2018 to 2019 was the single largest reason for the improvement in operating results since 2019, and the Board’s Plan is dependent on the continuation of these payments as well as the substantial increases planned in future years.

* * *

Cooper Union’s strong financial performance this past year despite the unprecedented disruptions caused by the global pandemic has demonstrated the wisdom of the Plan adopted by the Cooper Union Board in 2018 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 will undoubtedly 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 presented by these extraordinary economic times.



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