

Annual Report of the Financial Monitor

The Cooper Union for the Advancement of Science and Art

February 15, 2017



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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 first 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, following our appointment in July, every meeting of the Board (including executive sessions), the FEC, the Audit Committee, and the Finance and Business Affairs Committee, as well as meetings of the Governance and Investment Committees. In addition, as explained in more detail below, 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 and amendments to the Cooper Union bylaws.

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, 2016, as well as budget data provided by Cooper Union for 2017.

In short, the financial condition of Cooper Union is under considerable stress caused by the need for additional liquidity. This need has been driven by persistent operating losses occurring over a period of years, which the Board and the Cooper Union administration are in the process of addressing. The financial issues Cooper Union faces are not limited to annual operations, however, and we believe a view of the full, long-term financial health of Cooper Union is essential to any assessment of Cooper Union’s financial condition. Our discussion below assesses Cooper Union’s current operating structure, as well as the long-term structural weaknesses of its balance sheet.

A. Operating Results

A summary of Cooper Union’s operating deficits for the past several years follows. The amounts in the table below and the table in the next section are taken from Cooper Union’s annual audited financial statements. The first schedule is presented as an indication of the size and persistence of the deficits Cooper Union has incurred. We note that substantial deficits occurred in years prior to 2009 as well.

(Amounts in millions)

<u>Fiscal Year</u>	<u>Operating Deficit</u>	<u>Margin</u>	<u>Net Tuition</u>	<u>Deficit excluding tuition</u>
2016	(\$21.3)	(36.1%)	\$8.2	(\$29.5)
2015	(\$24.5)	(45.9%)	\$5.8	(\$30.3)
2014	(\$19.8)	(36.6%)	\$3.0	(\$22.8)
2013	(\$14.6)	(27.2%)	\$3.4	(\$18.0)
2012	(\$17.9)	(34.5%)	\$3.1	(\$21.0)
2011	(\$23.6)	(51.5%)	\$3.0	(\$26.6)
2010	(\$21.4)	(47.2%)	\$3.0	(\$24.4)
2009	<u>(\$11.9)</u>	(25.1%)	\$3.0	<u>(\$14.9)</u>
Cumulative	(\$155.0)			(\$187.5)

The margin percentage in the table represents each year’s deficit compared to operating revenues. The cumulative deficits, coupled with the deficits in years prior to fiscal 2009, prompted Cooper Union to seek sources of cash to pay for current operating costs that have

placed substantial pressure on the future financial health of the institution. Financing these losses is discussed below under the Balance Sheet Structural Issues section.

We believe a positive margin of approximately 2% per year represents a sustainable operating performance. The current deficits, even with net tuition revenues in each year, are extraordinarily large, putting significant pressure on Cooper Union's overall financial health and causing a need for substantial changes in the Cooper Union business model and financing sources. The size of the cumulative operating deficit indicates that this issue cannot be solved through budget cuts alone.

A review of the 2017 operating budget suggests a continuation of a significant operating deficit, estimated at \$15.3 million, with net tuition of \$9.8 million.¹

We note that there are several significant structural changes in Cooper Union's forecast of operating results beyond 2017. Revenue will be substantially enhanced by an increase in the contractual rents received under the Chrysler Building lease, from \$7.8 million in 2017, to \$20.1 million in 2018, and \$32.5 million in 2019 through 2027, with increases thereafter. Based on current forecasts (included as Appendix B in the FEC Progress Report), however, rising costs will result in anticipated deficits before tuition in all years through 2037, except 2019. In addition to normal and expected changes in costs, in 2019 Cooper Union's outstanding loan payments will change from interest-only payments to include principal payments, which will result in a significant increase in costs that will consume liquid assets.

B. Balance Sheet Structural Issues

A sole focus on Cooper Union's current operating deficit ignores several key issues that will necessarily require remedial attention even after the costs of Cooper Union's operations no longer exceed its revenues. These issues include the following:

- A bridge loan for \$58.8 million Cooper Union secured in June 2014, which has been used to cover operating losses. Cooper Union is currently paying interest only on this loan, which has a twenty-year life. The loan will not be fully repaid at maturity requiring a refinancing of the remaining balance or a significant cash payment.

¹ This deficit reflects a reduction in operating costs approved by the Cooper Union Board. We note that Cooper Union principally uses a cash-based budget, which has presented operating deficits less than the amounts in the audited financial statements. There are several differences between Cooper Union's cash-based budget and its audited financial statements, the most significant being the exclusion of non-cash charges, including depreciation and amortization of \$9.2 million in 2016 (\$9.0 million in 2015) from the budget and the exclusion of capital acquisitions of \$1.7 million in 2016 (\$2.5 million in 2015) from operating results in the audited statements.

- Deferred revenue of \$104.4 million on the balance sheet representing 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 provided cash to cover persistent operating losses.
- There is \$40.0 million in postretirement benefit costs accrued which will consume cash in future periods, likely at increasing amounts as covered personnel retire. Note that this obligation consumed about \$900,000 in cash in 2016, an increase of about \$100,000 from 2015.
- In 2015 and 2016, purchases of plant assets totaled \$4.3 million while depreciation totaled \$17.1 million, suggesting an under-investment in plant assets, which will likely be required in future periods.
- Net plant assets are \$161.4 million while related debt is \$175.0 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 is currently paying interest only on this loan and there is a prepayment penalty recently estimated at over \$58 million.

Cooper Union's operating cash and equivalents as of June 30, 2016 totaled \$26.5 million. The persistent operating deficits have consumed most of the cash generated from the above activities, resulting in a substantial "borrowing from the future." This borrowing, as well as the need for plant investments, together exceeding \$200 million, will necessarily have to be funded from future operations and new funding sources.

A schedule presenting the imbalance in Cooper Union's fiscal health reflected in the balance sheet follows:

(Amounts in millions)

Bridge loan	\$58.8
Deferred revenue	\$104.4
Postretirement benefits	\$40.0
Difference in plant and debt	\$13.6
Cash offset	<u>(\$26.5)</u>
Net financial condition imbalance	\$190.3

C. Implications of Current Financial Condition on Future Activities

In order for Cooper Union to become sustainably tuition free, we believe both the balance sheet structural issues, as well as the operating deficits will need to be addressed. We have emphasized in our discussions with the Cooper Union Board and its committees, and we will continue to emphasize, the need for a structured, disciplined approach pursued in the context of long-term financial improvements.

We believe the focus of the Board and the FEC must first be directed toward 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 organization, followed by a focus on moving to a tuition free environment.

The Board has approved using a metric that assesses the overall financial health of Cooper Union. This metric is called the Composite Financial Index (CFI). The CFI is discussed in detail in the FEC Progress Report and we comment on this measure further in this Report, below. We believe the use of this metric can assist Cooper Union in evaluating, in a structured way, the various financial options it may consider in its effort to become a fiscally thriving institution and to return to a full tuition scholarship model.

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 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. 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, a Cooper Union alumnus is currently serving as one of the Board’s Vice Chairmen.

The Consent Decree states that the Board must choose one of three nominees for Student Representative, who, together with the Board’s current Student Representative, “shall be confirmed immediately as the inaugural class of Student Trustees.” The Board complied with this requirement by adopting Section 1.03.2 of the amended bylaws. Furthermore, by resolution, a student nominee submitted to the Board was elected to serve as a Student Trustee until June 2016. Two other students currently sit on the Board as Student Trustees.

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 Board complied with this requirement. The protocol states that the total number of Alumni Trustees sitting on the Board must equal one-third the total number of individuals sitting on the Board (rounded down to the nearest whole number). This requirement is reflected in section 1.03.1 of the amended bylaws. Currently, six of the nineteen trustees sitting on the Board are Alumni Trustees.

The Consent Decree states that there must be 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 sitting on the Board as Faculty and Staff Representatives at all times. The Board complied with this requirement by adopting Section 1.14 of the amended bylaws.

The Consent Decree states that the Board should always include “two (2) Student Trustees, who shall be current students at Cooper Union, shall each serve two-year terms that are staggered, shall have voting power afforded to other Trustees on the Board, . . . shall be considered as members of the Board in determining whether a quorum is present, and shall be entitled to attend executive sessions of the Board” except for those meetings in which matters of academic governance, employment and personnel matters, or other conflict of interests issues are discussed. The Board complied with this requirement by adopting Section 1.03.2 of the amended bylaws. Two students 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 six Alumni Trustees serving on the Board.

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

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

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 Free Education Committee by resolution on November 11, 2015.

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 currently 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.”

The Board has taken steps to comply with this requirement. 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. We have encouraged the Board to take the additional step of adopting a formal Code of Conduct to guide the behavior of trustees and committee members, and it has agreed to do so.

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.² The latest minutes published on the Cooper Union website are from the November 8, 2016 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 and administration have informed us that the investment advisor Cooper Union uses does not disclose its fees in the statements it provides to Cooper Union. We have advised the Board and administration that this information is required by the Consent Decree and must be obtained and disclosed, and the administration has agreed to do so. We will follow up to ensure that this occurs.

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 by updating the Cooper Union website.

The Consent Decree states that the respondents shall create a Presidential Search Committee to identify candidates to become the next non-interim President of Cooper Union. The Consent Decree also states that the Committee shall consist of "at least (1) Alumni Trustee and (1) Student Trustee, unless the Committee has more than seven (7) voting members, in which case the Committee shall include at least two (2) Alumni Trustees and one (1) Student Trustee." In addition, the Committee shall have one full-time faculty acting as an adviser and observer. Finally, at least one of the Alumni Trustees sitting on the Committee shall "also be a member of the Free Education Committee." The Board complied with this requirement. The Presidential

² See <https://cooper.edu/about/trustees/minutes-board-trustees-meetings>

Search Committee was established by resolution and exceeded the stipulations outlined in the Consent Decree, as stated above. The resolution stated that the Committee shall have two full-time faculty members and one part-time faculty member, in addition to the full-time faculty member serving as an adviser and observer on the Committee.

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, 2016. The financial information included the Board approved budget, approved budget resolutions and amendments, and accounting system records. Cooper Union's budgeted expenditures consist solely of unrestricted-fund cash operating expenditures. These operating expenditures exclude restricted and temporarily restricted funds, including research grants and non-credit program expenditures, as well as scholarship expenditures and other non-cash expenses, such as asset write-offs and depreciation. The total budget for unrestricted operating expenditures for the fiscal year ended June 30, 2016 was \$71,739,423, but increased to \$71,914,423 as a result of a \$175,000 Board-approved adjustment in September 2015.

The most substantial components of the approved expenditure budget were debt servicing costs, employee benefits, faculty salaries and facilities maintenance. To identify "non-budgeted" expenditures exceeding \$100,000, Kroll analyzed more than 1,500 departmental operating expenditure subaccounts and identified any cumulative budgeted subaccount expense deficits greater than (\$100,000). As detailed below, Kroll identified twelve such instances of subaccount deficits in excess of (\$100,000), totaling (\$2,242,943).

The Cooper Union for the Advancement of Science and Art

Budgeted vs. Actual Expenditure Deficit Summary

Fiscal Year Ended June 30, 2016

Department - Subaccount

Ref#	Description	Number	Budget	Actual	(Deficit)
1	Student housing :	401020 -	\$ 50,000	\$ 421,145	\$ (371,145)
	Contracted svc other	5200310			
2	Development :	551010 -	558,689	822,194	(263,505)
	Staff full time	5003010			
3	Admissions :	451010 -	525,768	785,147	(259,379)
	Staff full time	5003010			
4	Employee benefits :	502119 -	165,000	387,910	(222,910)
	Prescrip plan retiree	5101050			
5	Development :	551010 -	218,000	415,688	(197,688)
	Consultants	5200910			
6	Capital Projects :	502199 -	-	171,825	(171,825)
	Consultants	5200910			
7	Art school :	102010 -	729,637	896,045	(166,408)
	Faculty adjunct	5001030			
8	Engineering school :	202010 -	50,000	212,412	(162,412)
	Faculty overload	5001015			
9	Employee benefits :	502119 -	300,000	412,685	(112,685)
	Emp med claims CUOP	5101055			
10	Capital Projects:	502199 -	-	109,141	(109,141)
	Capital equipment >1000	5250010			
11	Capital Projects :	502199 -	-	103,260	(103,260)
	Construction costs	5251040			
12	Athletics :	401021 -	32,000	134,585	(102,585)
	Travel	5203020			
	Total		\$ 2,629,094	\$ 4,872,037	\$ (2,242,943)

To understand these subaccount deficits it is important to recognize the interrelationship and allocation of departmental costs. As initial singular subaccount expenditure budget projections are incurred and expensed throughout the year, they may often be allocated to, and create budget variances in other subaccounts within that same department. For example, the entire “Capital Projects” Department #502199 budget of \$1,500,000 is initially recorded to the “Capital Projects: Construction Costs” Subaccount #502199 – 5251040, but as they occur, the costs are expensed to applicable departmental subaccounts, such as architecture, equipment, furniture, permits and fees. Cooper Union’s explanation and justifications for the identified budget deficits are categorized and listed by applicable “Ref. #s” below corresponding to the above table.

1. Student Housing: Contracted Services Other – Budget Deficit (\$371,145)

The budget deficit was primarily related to work performed by Roberto's Building Maintenance, which also provides housekeeping services to the residence hall. This "Student Housing: Contracted Service Other" deficit is closely related to "Student Housing: Contracted Service Cleaning," which had a \$77,450 surplus. These additional costs were incurred for summer cleaning and construction project services provided by Roberto's Building Maintenance.

2. Development: Staff full time – Budget Deficit (\$263,505)

The "Development: Staff Full Time" deficit is offset by the related "Development: Administration" staff salary account \$679,439 surplus. The Development Department had an overall budget surplus in excess of \$150,000.

3. Admissions: Staff full time – Budget Deficit (\$259,379)

A portion of the "Admissions: Staff Full Time" deficit is offset by the related "Admissions: Administration" staff salary account \$215,000 surplus. The deficit and surplus are attributable to subaccount mispostings of salaries. The Admissions Department had an overall budget surplus in excess of \$104,000.

4. Employee benefits: Prescrip plan retiree – Budget Deficit (\$222,910)

9. Employee benefits: Emp med claims CUOP – Budget Deficit (\$112,685)

The “Employee benefits: Prescrip plan retiree” and “Employee benefits: Emp med claims CUOP” deficits were primarily attributed to the self-funded nature of medical benefits. Cooper Union is responsible for paying for health, prescription, dental and vision claims for which the volumes and values vary annually. There was an overall Employee Benefit surplus in excess of \$623,000.

5. Development: Consultants – Budget Deficit (\$197,688)

The "Development: Consultants" deficit was entirely related to payments made to Constellation Advancement, LLC, for the services of the interim Vice-President of Alumni Affairs and Development. The "Development: Consultants" deficit is offset by the related "Development: Administration" \$679,439 surplus.

6. Capital Projects: Consultants – Budget Deficit (\$171,825)

10. Capital Projects: Capital equipment >1000 – Budget Deficit (\$109,141)

11. Capital Projects: Construction Costs – Budget Deficit (\$103,260)

As noted earlier, the entire Capital Projects Budget was initially recorded to the "Capital Projects: Construction Costs" and the actual expenses were then allocated to subaccounts (*e.g.* architecture, equipment, consultants, furniture, permits and fees) within that department. For the fiscal year ended 2016, Capital Projects had an overall budget surplus of \$22,006.

7. Art school: Faculty Adjunct – Budget Deficit (\$166,408)

The "Art school: Faculty adjunct" deficit was offset by the related "Art school: Faculty full time" \$281,077 surplus. The variance was attributed to full-time faculty positions not being filled during the fiscal year and adjunct professors being paid to teach those classes. Per Cooper Union, for the fiscal year ended 2016, The School of Art had an approximate overall budget surplus of \$306,000.

8. Engineering school: Faculty overload – Budget Deficit (\$162,412)

The "Engineering school: Faculty overload" deficit is offset by the related "Engineering school: Administration" staff salary account \$401,265 surplus. Per Cooper Union, for the fiscal year ended 2016, The School of Engineering had an approximate overall budget surplus of \$363,000.

12. Athletics: Travel – Budget Deficit (\$102,585)

The athletic teams took pre-season trips to Cape Cod (August), Florida (winter break) and North Carolina (March), which exceeded budgeted costs.

Regarding the identification of non-budgeted contractual obligations of Cooper Union exceeding \$125,000, per William E. Mea, Vice President for Finance and Administration, there were no such contractual obligations identified in fiscal year 2016. Mea acknowledged that there was one vendor, Roberto's Building Maintenance Co. (See Ref. # 1 above), who received more than \$125,000 in connection with unbudgeted obligations. Mea maintained, however, that there was no contract negotiated in connection with these student housing construction maintenance services, and therefore, it would not qualify as an identifiable contractual obligation. As noted above, however, these charges were, at a minimum, unbudgeted expenditures in excess of \$100,000. Collectively, Cooper Union's (\$2,242,943) deficit in budgeted operating cash expenditures in excess of \$100,000 makes up approximately 29% of the (\$7,780,415) subaccount operating expenditure budget deficit. When this deficit is netted with the corresponding \$11,224,231 subaccount operating expenditure budget surplus, it results in a fiscal year 2016 total operating expenditure budget surplus of \$3,443,816. Of the total deficit, the Student Housing Department component, as described above, was the most substantial. A majority of the other identified deficits are the result of allocations or mispostings within their respective departments, which will be monitored in the fiscal year ending June 30, 2017.

V. The Free Education Committee Progress Report

The FEC issued its Progress Report on January 15, 2017. The Report thoughtfully recounts (a) the FEC's efforts over the past year to create a governance structure to carry out its mandated work, (b) the adoption of financial metrics to enable Cooper Union to measure and evaluate alternative initiatives to improve its financial condition and return to a full tuition scholarship model, and (c) the FEC's substantial fact-finding efforts, which contributed to the identification of significant budget cuts and new initiatives that the FEC has begun to explore. We address each of these below.

A. Governance

When we began our work as Financial Monitor in July 2016, we were struck by the degree of discord and dysfunction at FEC meetings. The meetings were at times acrimonious and unfocused, often with one member consuming an inordinate amount of time on agenda items without the support of a majority of the committee. At other times, a single member would pursue an initiative without coordinating the effort with other members of the FEC, the Board or other committees having jurisdiction over the subject matter of the initiative. In close coordination with the Financial Monitor and the Board, the FEC worked to address these governance deficiencies that were impeding its ability to operate effectively and fulfill its mission. First, the FEC agreed to focus on its primary responsibility to formulate initiatives aimed at returning Cooper Union to a sustainable, full tuition scholarship model, which the Board would then assign to the appropriate committee to evaluate and provide feedback to the

Board and the FEC. Second, the FEC would develop and propose a strategic plan for Cooper Union to return to a full tuition scholarship model, which it will submit to the Board for its consideration by January 15, 2018. Third, the Board will develop a Code of Conduct for members of the Board and its committees, including the FEC, to provide guidance to trustees and committee members on their fiduciary duties and obligations, and on the standards of conduct each is expected to observe.

This governance framework for the FEC's role, responsibilities and interaction with the Board and its other committees was a critical process improvement that, once adopted, allowed the FEC to use its time and resources effectively to advance its mission.

B. Financial Metrics

In addressing financial challenges of the magnitude facing Cooper Union, it is critically important for the Board, its committees and the administration to all be speaking the same financial language and to have common metrics to evaluate the institution's current financial condition and how its future financial condition may improve or be adversely affected if proposed initiatives are pursued. The FEC supported the Board's adoption of a metric, the CFI, to measure Cooper Union's financial health. This metric provides a framework for Cooper Union to evaluate in a structured way both its current financial condition and the various financial options it may consider in its effort to become a fiscally thriving institution and to return to a full-tuition scholarship model. We fully endorse Cooper Union's adoption of the CFI, which was designed specifically for institutions of higher education to measure long-term financial health and determine the financial impact of strategic decisions.³

C. Fact-Finding Efforts and Initiatives

The FEC led a substantial fact-finding effort during the course of the year focusing on potential reductions in operating costs, revenue-enhancement plans, and refinancing of debt obligations and other financial engineering techniques. The most successful of these efforts involved the identification of significant cuts to the Cooper Union operating budget. These cuts, totaling \$9.1 million (which represents a seventeen percent reduction in operating expenses, excluding debt service, capital and auxiliary expenses), were identified in collaboration with other committees of the Board, academic, administrative and union leadership. Although these savings are substantial, we agree with the conclusion in the FEC Progress Report that cost savings alone will not enable Cooper Union to reach its goal of returning to financial health and a tuition free environment.

³ The CFI is discussed at length in the book, *Strategic Financial Analysis in Higher Education: Identifying, Measuring & Reporting Financial Risks*, which was first published in 1980 and is now in its 7th edition. Ronald Salluzzo, CPA, a member of the Financial Monitor team, is one of the book's authors.

Other initiatives that the FEC identified for further consideration in 2017 include large multiyear projects, such as a major fund raising campaign, strategic partnerships and non-tuition revenue streams. The FEC will be coordinating a review of these initiatives with Cooper Union's newly appointed President, Laura Sparks. We endorse an aggressive focus on these revenue-enhancing initiatives and are encouraged by the determination and enthusiasm President Sparks brings to that effort.

Two initiatives mentioned in the FEC Progress Report that cause us some concern, however, include refinancing of debt obligations and other financial engineering techniques that may provide a short-term benefit of increased liquidity, but are rife with the risks of further damage to Cooper Union's long-term financial health. Indeed, these are precisely the types of techniques Cooper Union has turned to in the past that have led to its current unsustainable financial condition. The refinancing options also rely on the entirely unrealistic premise that Cooper Union's counterparties will be willing to surrender valuable components of the current financing arrangements. We have difficulty understanding why the counterparties would ever be motivated to take that action.

An example of this is the discussion in the FEC Progress Report related to refinancing existing debt. The Met Life loan is currently at above market interest rates, includes substantial "make whole" or prepayment penalties, and has interest-payment-only terms in the early years. All of these provisions protect the return anticipated by the lender and increase costs to Cooper Union. The current low-interest-rate environment may price new debt for Cooper Union at a much more attractive rate, but because the lender would have weaker reinvestment alternatives, it would, logically, need to protect its returns on any refinance or repayment, making the refinancing option unattractive to it, and as a result, not a promising initiative for Cooper Union to spend its time and resources pursuing.

Although we have not examined the concept of a "sandwich lease" from an accounting-treatment perspective, based on the information we have reviewed, we do not see it, or similar financial engineering techniques, providing any improvement to Cooper Union's long-term financial health because the balance sheet is already over-burdened after many years of funding cash deficits. As mentioned previously, these persistent deficits will require substantial amounts of cash to be generated in the future to liquidate those deficits. In our judgment, Cooper Union must focus on reducing the debt burden on its balance sheet and the annual debt service requirements to reduce the burden on future operations and return Cooper Union to financial health.

Accordingly, we believe the concept of refinancing Cooper Union's current debt obligations should be followed to a logical conclusion, but it should not consume substantial amounts of

time, nor should plans being developed suggest that this step would assist in improving the financial sustainability of Cooper Union.

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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.” As our observations on Cooper Union’s unsustainable deficits and balance sheet weaknesses make clear, Cooper Union has a significant amount of work to do before it can realize its ultimate goal of returning to a full-tuition scholarship model. Although we have been impressed with the commitment we have seen on the part of the Board, its committees and the administration to find a path to return to a full-tuition scholarship model, that goal cannot be achieved without Cooper Union’s first returning to financial health. One cannot be achieved without the other.

As a result of the progress the Board, the FEC and the administration have made this past year, they have created an environment and structure that allows them to examine, in an organized and comprehensive fashion, initiatives to improve Cooper Union’s financial condition and put it on the path to a return to a full-tuition scholarship model. We look forward to continuing to work closely with the Board, its committees and the administration to achieve those dual goals in a responsible manner.



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