Annual Report of the Financial Monitor

The Cooper Union for the Advancement of Science and Art

February 15, 2018

Table of Contents

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 second 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), 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 unaudited financial statements as of and for the year ending June 30, 2017, as well as budget data provided by Cooper Union for 2018.[1]

In our first Annual Report, dated February 15, 2017, we observed that the financial condition of Cooper Union was under considerable stress, caused by persistent operating losses occurring over a period of years. These losses had been financed by a series of actions which we believe contributed to impairing the long-term financial health of the institution. These actions included incurring incremental debt and receiving, and spending, future lease revenues. In addition, Cooper Union amassed a substantial long-term obligation for post-retirement health benefits.

The recently issued report of the FEC entitled, *Recommended Plan to Return to Full Tuition Scholarships* ("the FEC Report"), soberly discusses the nature and extent of Cooper Union's financial challenges and calculates the amount needed to enable Cooper Union to return to a full-tuition scholarship model at $250 million. This is clearly a substantial sum for Cooper Union to raise from its various revenue and support activities. Nonetheless, we concur with the methodology the FEC used to calculate this amount and have concluded that the plan developed by the FEC to achieve its goal, though aggressive, is responsible.

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. We note that the audited financial statements are prepared on the basis of generally accepted accounting principles ("GAAP"), which differ from Cooper Union's internal budget process, which uses the cash basis.[2] 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.

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[1] As of February 14, 2018, Cooper Union's audited financial statements have not been issued. For purposes of our analysis, we have relied on a draft that we understand is the latest information available. We understand the audited financial statements will be issued shortly.

[2] The cash-based budget excludes depreciation and amortization expenses, but includes capital acquisitions. In future years, as debt is being amortized, the principal payments on debt are included in the cash-based budgets.

(Amounts in millions)

Fiscal Year	Operating Deficit	Margin	Net Tuition	Deficit excluding tuition
2017 (unaudited)	($21.9)	(36.2%)	$10.6	($32.5)
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	($11.9)	(25.1%)	$3.0	($14.9)
Cumulative	($176.9)			($220.0)

We have repeated this information from our prior report with the addition of 2017 activity to re-iterate that the size of Cooper Union's deficits cannot be cured through expense reduction alone and to point out that, although much work and planning has been accomplished during 2017, the persistent deficit levels have not appreciably improved. We discuss financing these losses below in subsection B. In our judgment, there needs to be urgency in moving forward on executing the plan that has been developed. We discuss this in more detail in our review of the FEC Plan in section V, below.

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 FEC Plan, are necessary if Cooper Union is to achieve normal standards of financial viability and health.

A review of the 2018 operating budget suggests planned significant improvements in the operating cash deficit,[3] estimated at $50,000, with net tuition and fees of $12.1 million.[4]

There are several significant structural changes in Cooper Union's forecast of operating results beyond 2018. For example, revenue will be substantially enhanced by an increase in the

[3] As we noted above, 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 $8.4 million in 2017 ($8.6 million in 2016) from the budget and the exclusion of capital acquisitions of $1.2 million in 2017 ($1.7 million in 2016) from operating results in the audited statements.

[4] The $12.1 million is comprised of $7.9 million of undergraduate net tuition, $0.6 million in net graduate tuition and $3.6 million in student fees.

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 additional increases thereafter. This change in 2018 results in an improvement in the operating results by over $12 million from 2017, with the further increase in 2019 contributing to generating positive cash results of operations.

Based on current forecasts (included as Appendix A in the FEC Report) Cooper Union anticipates generating "Cash Available for Other Key Financial Priorities before Interest in Excess of Endowment Payout" of $14 million in 2019. We note that these amounts are calculated under the internal cash-based budget, which, as noted above, is substantially different from the GAAP-based financial operations.

The generation of cash from operating activities in 2019 anticipates $13.1 million in tuition and fees from all students. Although this represents a substantial improvement over prior forecasts, the results do not consider reduction of longer-term obligations that must be met before providing full scholarships to students. These are discussed in more detail below in subsection B.

We recommend that the internal budget basis for measuring operations be reconciled to the GAAP-based audited financial statements to ensure that the differences are accounted for and their impact understood. This should be completed when the 2017 financial statements are finalized with the Auditors opinion.

B. Balance Sheet Structural Issues

Several additional issues will require remedial attention even after Cooper Union addresses its operating deficits and the costs of its operations no longer exceed its revenues. The generation of operating surpluses (under either a GAAP or a cash basis) 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 revenue from certain leased properties and creating 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:

- A bridge loan for $58.8 million Cooper Union secured in June 2014, which has been used to cover 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 FEC plan considers creating a "debt retirement reserve" to ensure availability of resources at the contractual maturity of this loan.

- 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 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, but will need consideration in the GAAP-based model. The FEC Plan appropriately considers the impact of the deferred revenue in the computations of financial health.

- There is $33.0 million in postretirement benefit costs accrued which will consume cash in future periods, likely at increasing amounts as covered personnel retire.[5] It is reasonable to assume that this obligation will continue to grow, even though payments are currently being made for retirees. This obligation consumed about $1.0 million of cash in 2017, an increase of about $100,000 from 2016. The FEC Plan considers this obligation, including an assessment of the growth of the obligation over time. The plan projects providing liquid assets to support this liability in the projection period.

- In 2016 and 2017 combined purchases of plant assets totaled $2.9 million while depreciation totaled $17.0 million, suggesting an under-investment in plant assets, which will likely be required in future periods. The FEC Plan includes funding of capital assets above current levels by amounts increasing to $1 million above current levels per year beginning in 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. In order to understand better 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 Facilities Ratio (which compares accumulated depreciation to depreciation expense). These ratios would help inform the FEC on the status of the physical plant and possibly indicate the need for adjustments to the FEC Plan in future years.

- Net plant assets are $154.2 million in 2017 ($161.4 million in 2016) 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 $56 million.

Cooper Union's operating cash and equivalents as of June 30, 2017 totaled $33.9 million. The persistent operating deficits have consumed most of the cash generated from the above activities,

[5] This liability declined from $40 million in 2016 principally due to the discount rate on the obligation increasing from 3.25% to 3.80%. The liability balance can be expected to fluctuate based on changes in actuarial assumptions.

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 addresses these issues and appropriately considers them in the design of the FEC Plan.

C. Implications of Current Financial Condition on Future Activities

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 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 has shifted in 2017 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 FEC plan appropriately projects a way forward to eliminate operating deficits and produce surpluses. The largest initiatives that move Cooper Union from large deficits to at least break even are the contractual changes in the lease agreement on the Chrysler Building and the continuation of the current tuition plan. 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. We will discuss the FEC Plan and the challenges and risks associated with it in section V, below.

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. No Trustee Emeriti currently serve on the Cooper Union 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 alumnus of Cooper Union, serve on the Board as Vice Chairs. Mr. Gerard is also an Alumni Trustee.

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 enrolled students, one each from the class of 2018 and 2019, 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 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. At the end of the December 2017 Board meeting there were nineteen Trustees, requiring six Alumni Trustees to meet the one-third requirement. Since there were only five Alumni Trustees on the Board as of the December meeting, a sixth must be added if the total number of Trustees remains at nineteen. Pursuant to the protocol, we understand that an additional Alumni Trustee is scheduled to be elected to the Board at the March 2018 meeting.[6]

The Consent Decree states that the Board must include 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. The Board complied with this requirement by adopting Section 1.14 of the amended bylaws. Since spring 2017, however, the School of Architecture has not had a full-time Faculty Representative on the Board after the then-serving full-time faculty member went on leave. The School of Architecture has not yet decided who will fill the position of full-time Faculty Representative to the Board. As a result, there are currently five Representatives to the Board: three full-time faculty members from the School of Engineering, School of Humanities and Social Science, and School of Art; one part-time faculty member; and one staff member.

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 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 five 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

[6] 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.

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, Anne Chao and Wanda Felton, both qualify by their experience in higher-education and finance, respectively, 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 FEC by resolution on November 11, 2015. Current members of the committee include two Alumni trustees, one Trustee, and one Student trustee. The FEC's Progress Report published on January 15, 2017 and the Board of Trustee's response published on March 7, 2017, as well as the FEC's Report published on January 15, 2018, are all available on the committee's website.

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 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. 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 website.

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 27, 2017 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. In 2017, the Board reported updates on the non-real estate endowment, which were included in the meeting minutes and posted on the Cooper Union website following its March and June meetings. We have been advised that the December 2017 Board meeting minutes include a full 2017 fiscal year performance analysis which will be approved by the Board at its March 2018 meeting and posted on the Cooper Union website shortly thereafter.

Regarding the requirement in the Consent Decree concerning disclosure of fees to investment advisors and the identity of advisers, we have been advised that the Investment Committee of the Board has reviewed the drafts of a proposed format for disclosing this information and is expected to review and approve the final format at its upcoming meeting. We will follow up with the Investment Committee to confirm that this task is completed.

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

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[7] *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, 2017. The financial information included the Board approved budget, approved budget resolutions and amendments, accounting system records, cost savings plans and applicable supporting documentation. 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 depreciation. Note, however, that Cooper Union intends to begin budgeting for both unrestricted and restricted expenditures as of fiscal year 2019. The total budget for unrestricted operating expenditures for the fiscal year ended June 30, 2017 was $69,252,000, a 3.70% decrease from the $71,739,323 total of fiscal year 2016.

The most substantial components of the expenditure budget were debt servicing costs, faculty salaries and facilities maintenance. To identify the non-budgeted expenditures exceeding $100,000, Cooper Union and Kroll analyzed more than 1,200 departmental operating expenditure subaccounts and any corresponding cumulative budgeted subaccount expense deficits. As detailed below, there were ten such instances of subaccount deficits in excess of $100,000, totaling $3,707,044. A large portion of this deficit was attributable to higher employee benefit costs from unusually high reported claims activity during the year. There were savings and other budget surpluses in other sub-accounts, however, which reduced the actual expenditure deficit for fiscal year ended 2017 to $166,434.

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The Cooper Union for the Advancement of Science and Art
Budgeted vs. Actual Expenditure Deficit Summary
Fiscal Year Ended June 30, 2017

Ref#	Description	Department - Subaccount Number	Budget	Actual	(Deficit)
1	Employee benefits : Emp med claims CUFCT	502119- 5101005	$ 1,060,196	$ 2,393,007	$ (1,332,811)
2	Employee benefits : Prescrip plan retiree	502119- 5101050	300,000	421,691	(121,691)
3	Engineering school : Early retirement	202010- 5005014	-	908,598	(908,598)
4	General : Bridge financing interest exp	000000- 5206005	2,292,053	2,702,960	(410,907)
5	General expense : Consultants	502115- 5200910	40,000	262,728	(222,728)
6	Art school : Early retirement	102010- 5005014	-	214,000	(214,000)
7	Middle States : Faculty overload	502114- 5001015	-	130,150	(130,150)
8	Admissions : Consultants	451010- 5200910	426,500	552,039	(125,539)
9	29 3rd ave : Contracted svc other	601060- 5200310	-	121,883	(121,883)
10	General expense : Inv Advisors	502115- 5205610	186,000	304,737	(118,737)
	Total		**$ 4,304,749**	**$ 8,011,793**	**$ (3,707,044)**

Cooper Union's explanation and justifications for the identified budget deficits are categorized and listed below, with applicable "Ref. #" corresponding to the table above.

1. Employee benefits : Employee medical claims CUFCT – Budget Deficit ($1,332,811)
2. Employee benefits : Prescription plan retirees – Budget Deficit ($121,691)

   These budget deficits were primarily attributable to the university's self-insured medical plan, which experienced unusually high claims activity throughout the year.

3. Engineering school : Early retirement – Budget Deficit ($908,598)

   Subsequent to budget approval, the Board approved an early retirement program that incurs higher immediate costs but is expected to achieve significant long-term budget savings.

4. General : Bridge financing interest expense – Budget Deficit ($410,907)

   This interest expense was paid from a debt reserve fund. Since it was coming from the reserve fund, the expense would not be reflected in the original operating budget as an operating expense.

5. General expense : Consultants – Budget Deficit ($222,728)

   Management used consultants to perform provisional functions for certain vacant administrative positions. These expenditures were generally offset by the corresponding vacancy-generated payroll savings.

6. Art school : Early retirement– Budget Deficit ($214,000)

   Subsequent to budget approval, the Board approved an early retirement program that incurs higher immediate costs but is expected to achieve significant long-term budget savings.

7. Middle States : Faculty overload– Budget Deficit ($130,150)

   The budget did not sufficiently anticipate the unusual and infrequent expenses, including required faculty stipends, related to the decennial reaccreditation process.

8. Admissions : Consultants– Budget Deficit ($125,539)

   Prior contractual obligations prevented the university from achieving significant reductions in this cost category.

9. 29 3rd Ave. : Contracted services other– Budget Deficit ($121,883)

   Management incurred additional expenses to secure a tenant for retail space that had been vacant for approximately three years.

10. General expense : Investment Advisors– Budget Deficit ($118,737)

    The Investment Committee decided that it was not beneficial for the university to change investment management consultants for this fiscal year. The Committee's decision was based on a broad range of criteria, including qualifications, fees, immediate access to managers and lines of reporting. Management advises that it was not clear that the budgeted savings, which were set before the bids for new investment advisors were received, could have been achieved by changing investment advisors.

It is important to acknowledge a variety of adjustments within the unrestricted operating expenditures budget that were made throughout the fiscal year 2017 in an attempt to reduce costs and provide greater transparency. During the fiscal year, fringe benefit allocations began to be coded directly to the three primary components; benefits, pensions and payroll taxes, rather than solely to fringe benefits. A multi-year cost savings plan was developed and implemented to reduce non-payroll related expenditures, as well as staff salaries and related benefits. As detailed below, the cost savings plan covered a variety of schools, departments and functions. Terms of the plan included staffing reductions, as well as the engagement of a new audit firm, reassignment of athletics to club level participation and no longer accepting credit cards, or paying the resultant fees, for tuition payments. In fiscal year 2017, there was a $1,557,669 budget provision for corresponding staff reductions that resulted in approximately $1,122,598 of severance package and unused vacation time payments. A summary of the Multi-Year Savings Plan by expense category is included below.

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The Cooper Union for the Advancement of Science and Art
Muti-Year Savings Plan
Fiscal Year Ended June 30, 2017

Description		Amount	% Total
Non-Payroll Related			
General Expenses	$	414,000	26.24%
Information Technology		115,000	7.29%
Enrollment Services		101,875	6.46%
Other non-personnel		101,000	6.40%
Athletics		93,050	5.90%
Institutional Safety		35,000	2.22%
School of Engineering & CV Starr		33,000	2.09%
Office of the President		25,000	1.58%
Subtotal	$	917,925	58.18%
Payroll Related			
General Expenses (Increase Reduction)		184,524	11.70%
Communications		120,000	7.61%
Facilities		76,056	4.82%
Athletics		57,000	3.61%
Alumni Affairs & Development		31,563	2.00%
Finance		24,158	1.53%
School of Art		21,566	1.37%
Miscellaneous Correction		(304)	-0.02%
Institutional Safety		(49,053)	-3.11%
Subtotal	$	465,510	29.51%
Benefits			
General Expenses		83,036	5.26%
Communications		54,000	3.42%
Facilities		21,625	1.37%
Alumni Affairs & Development		14,203	0.90%
Finance		10,871	0.69%
School of Art		9,704	0.62%
Athletics		5,700	0.36%
Institutional Safety		(4,905)	-0.31%
Subtotal	$	194,234	12.31%
Total	**$**	**1,577,669**	**100.00%**

Regarding the identification of non-budgeted contractual obligations of Cooper Union exceeding $125,000, there were 22 contractual obligations in fiscal year 2017 in excess of that amount, but all were fully accounted for in the budget. Kroll requested a sample of these agreements and verified the terms and nature of the services performed and payment stipulations. As detailed below, the total contracted amount of these 22 obligations was $6,589,910.

The Cooper Union for the Advancement of Science and Art
Contractual Obligations greather than $125,000 Summary
Fiscal Year Ended June 30, 2017

Ref#	Name	Description	Amount
1	SOS Security LLC	Security services	$ 875,948
2	Robertos Building Maintenance, Co.	Maintenance services	574,189
3	Usi Affinity Collegiate Insurance	Student medical insurance	568,485
4	Ellucian	Technology solutions provider	481,684
5	Marsh Usa Inc.	Insurance	471,685
6	Perfect Building Maintenance	Maintenance services	460,861
7	Patterson Belknap Webb & Tyler	Legal services	301,871
8	Beneflex, Inc.	Third party administration for health	301,772
9	Ruffalocody, LLC	Student services consulting	299,056
10	Proskauer Rose LLP	Legal services	267,048
11	WG Mechanical Corp.	Elevator and other maintenance	230,465
12	Direct Energy Business	Utility provider	211,431
13	NY College & URMG	Insurance	189,975
14	Constellation Advancement LLC	Fundraising consulting	175,500
15	Cambridge Associates, LLC	Investment management consulting	174,184
16	First Unum Life Insurance	Life insurance	169,033
17	Grant Thornton LLP	Audit and tax services	157,403
18	Arts Manager Llc, Devos Institute of Arts Management	Consulting - strategic planning, and development	151,250
19	CDW Government	Technology solutions provider	143,624
20	J.P. Morgan Chase	Banking, custodial services for investments	130,552
21	Korn Ferry International NW 5064	Recruiting services	126,963
22	Siemens Industry, Inc.	Building controls support	126,931
	Total		**$ 6,589,910**

V. The Free Education Committee Report

The FEC Report includes a detailed description of the committee's plan to return to a full-tuition scholarship model for Cooper Union. We have reviewed the plan and its attendant risks and comment on them below.

A. The FEC Plan

Under the FEC's Plan, if all goes well, Cooper Union will be able to reinstitute full-tuition scholarships by fiscal year 2029. This is an improvement from the projection included in the 2017 FEC Report, which suggested that the "return to free" could occur in 2039.

Over the past year, we observed first hand that the development of the FEC Plan was subjected to a rigorous and intense process, and consumed most of the attention of senior leadership and the Board. The plan is aggressive, but that is unsurprising given the magnitude of the financial problems it is designed to address. Whether Cooper Union can meet the conditions of the plan will depend on its ability to move to the execution phase expeditiously and with discipline, and to execute the plan's various components successfully. For the plan to be successful, once it is approved by the Board, it is imperative that the *entire* Board get behind the plan. It will, of course, be necessary and appropriate for the Board to monitor the implementation of the plan and make adjustments as conditions warrant, but it should avoid subjecting the plan to endless second-guessing.

The FEC Plan has already accomplished several critical milestones, including:

1. Re-examining and Correcting Matters from the 2017 FEC Plan

As Cooper Union re-examined the forecast created last year, which produced the expectation that the institution could return to full-tuition scholarships by 2039, it identified several areas where expenses were projected forward when they in fact would not have continued past a certain period of time. Correction of these erroneous expense projections resulted in an improvement in the overall projected operating results.

2. Confirming the Level of Financial Challenges Cooper Union Faces

The FEC Plan estimates the overall level of financial challenges Cooper Union must address before it can return to full-tuition scholarships at $250 million, which we believe is a reasonable estimate of the size of the depletion of resources that has occurred and needs to be replaced before cash operating surpluses can allow a return to a full-tuition scholarship model. The components of this $250 million are delineated in the FEC Plan and appear to reflect the substantial issues that Cooper

Union must address. We have highlighted these matters in section II (B), above, "Balance Sheet Structural Issues."

3. Designing Changes in Operations to Meet the Required Level of Financial Sustainability to Support Full-Tuition Scholarships

The FEC Plan necessarily targets substantial changes in Cooper Union's current operations, while seeking, as the Consent Decree mandates, to maintain Cooper Union's academic quality in its three program areas at their historical levels of enrollment. Some of the improvements in operating results are attributable to substantial changes in the contractual obligations related to the Chrysler Building lease payments that will close the operating deficit gap by approximately $12.3 million in 2018 and another $12.4 million in 2019. This combined amount of $24.7 million over two years will be the principal cause of declining cash operating deficits during that time. This increase in lease payments will not, by itself, however, allow a return to full-tuition scholarships. Other initiatives contemplated in the plan, when added to the additional revenues anticipated from the Chrysler Building lease, will be necessary to provide sufficient resources to allow a return to full-tuition scholarships. The most significant of these other initiatives is long-term growth in philanthropy, particularly current use philanthropy.

The 2017 unaudited financial statements recorded contributions of $5.1 million (unrestricted contributions of $3.4 million and net assets released from restrictions of $1.7 million) and $6.4 million in 2016. By 2024, the plan calls for current use philanthropy to reach $10.7 million with growth to $17.8 million by 2029, the year the plan projects Cooper Union may return to full-tuition scholarships. This is, in our opinion, the most significant risk in this plan, which we will discuss further below.

4. Creating a Path from the Current Level of Scholarship Support to Full-Tuition Scholarships over the Next 10 Years

The FEC Plan provides for a gradual increase in scholarship levels as overall financial health improves. In 2018, the overall scholarship level is set at 76%. The plan anticipates increasing the scholarship level to 77% in 2020 and to 100% by 2029.

The plan includes a structured method of allocating cash generated to cover longer-term liabilities that are not covered by annual expenditures, such as the long-term debt balance remaining at maturity, the expected postretirement obligation that will exist in 2029, and a set aside for incremental capital investments.

5. Establishing "Guardrails" that Require that the Plan's Financial Targets be met before Scholarship Levels are Increased

The FEC plan is necessarily ambitious given the magnitude of the financial issues Cooper Union is facing. The ambitious nature of the plan creates significant risk if the plan's financial targets are not met. To address that risk, the FEC has wisely recommended creating "guardrails" that require a re-examination of the planned scholarship increases should Cooper Union confront an unanticipated financial shortfall. The plan requires that, if Cooper Union fails to meet a projected financial threshold by more than 5% over the course of the plan, it will initiate an examination of the cause of the shortfall and adjust the plan accordingly. Adjustments could include stopping or limiting planned scholarship increases, or in an extreme case, reversing scholarship levels for future students until Cooper Union gets "back on track." We strongly endorse this approach as an essential ingredient of the plan.

The FEC also developed a series of potential or "bullpen" financial initiatives that may be considered if changing financial circumstances require an unanticipated need for additional resources.

B. Summary of Risks to Achieving the Plan

The risks to achieving the FEC Plan 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 identifies 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 plan's guardrails, if faithfully invoked and enforced, should provide adequate coverage for these issues, should they occur.

2. Internally Managed Risks

The plan also acknowledges various internal risks including the risk that a future Board or administration may decide that the FEC Plan is no longer a priority. We believe the FEC appropriately observes 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 plan is the long term expectations for philanthropy. While the targets set 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.

There are other risks that must be managed, including 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 FEC Report, 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 $33.1 million in the 2017 unaudited financial statements. This represents 55% of unrestricted revenues. These amounts are expected to grow to $47.4 million in 2018 due to the contractual change in revenues owed from the Chrysler Building. As noted above, this increase of $12.3 million is the single largest reason for the improvement in forecasted operating results for 2018 and the FEC Plan is dependent on the continuation of these payments as well as the substantial increases planned in future years.

C. Governance

The Board made important improvements in its overall governance in 2017, most notably by drafting and adopting 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. The Board's committees worked effectively together, with the FEC focusing on its responsibility to formulate initiatives aimed at returning Cooper Union to a sustainable, full-tuition scholarship model, and the Board then assigning each initiative to the appropriate committee to evaluate and provide feedback to the Board and the FEC. The FEC also developed and proposed a strategic plan for Cooper Union to return to a full-tuition scholarship model, which it submitted to the Board for its consideration on January 15, 2018 as required by the Consent Decree. As discussed above, that plan soberly and responsibly addresses the formidable financial challenges Cooper Union faces and charts an aggressive middle course seeking to incrementally return to free as Cooper Union returns to financial health.

If there is one area of concern we continue to have it is the Board's occasional propensity to endlessly debate issues, or to re-open issues that have already been debated thoroughly. The issues facing Cooper Union need to be confronted rather than endlessly debated. For the Board to continue to make progress in returning to a free-tuition model, it will be essential that the Board and the Cooper Union community thoughtfully address issues, agree on a plan and expeditiously move forward.

* * *

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." Although Cooper Union has made significant progress this past year in developing a thoughtful and responsible plan 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, its unsustainable deficits and balance sheet weaknesses remain. The hard work of improving Cooper Union's financial condition needs to be aggressively pursued if the goal of returning to a full-tuition scholarship model is to be achieved. Now is the time for the Board and the entire Cooper Union community to get behind the FEC's plan and, as the plan urges, "to join in the effort to start a new chapter in Cooper Union's history."

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