THE COOPER UNION
ALUMNI PIONEER

Do You Want Deficit With That? (rev 2)

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Abstract
An explanation of how Cooper hides information in its consolidated statements by reclassification, how the presentation of data makes surplus years look like deficit years and negative cash flows look positive (they particularly enjoy calling things "totals" and then putting additional negative or positive dollars under a double underline), and how Cooper used a change in accounting principle to enable participation in a hedge fund that lost $80 million in the 2008 crash, with a note about conversion of restricted endowment into unrestricted endowment.

[On Wednesday, November 23, 2011, TC Westcott's office provided to *The Alumni Pioneer* the audited consolidated financial statements for Fiscal Years (FY) 2000 through 2010. At her invitation, *The Alumni Pioneer* made an appointment to sit down with TC Westcott on Tuesday, November 29, 2011, to discuss this analysis and other questions *The Alumni Pioneer* may have. Prior to reading this, Ms. Westcott asked to delay that meeting until after December 16, 2011. If she chooses to reply prior to the meeting, *The Alumni Pioneer* will endeavor to publish her response and/or publish a revised version of this analysis.]

1. Since FY 2004, the administration can choose whether to declare a surplus or a deficit of any amount and any percentage.
2. In FY 2009, The Cooper Union lost $80 million in risky hedge fund investments, and the value of the Chrysler Building dropped by $100 million.

The three documents distributed to the Cooper Community, including the pie charts and the two expense vs. revenue graphs, have been based on data arbitrarily chosen to tell whatever story the current administration and previous administrations wanted to tell. If the Board of Trustees issues, on December 16, 2011, a report based upon the same consolidated financial statements that *The Alumni Pioneer* was provided, they may be able to draw entirely different conclusions from the exact same data.

Declaring a Deficit when you have a Surplus

The four key terms are "consolidated," "reclassification," "presentation," and "investment return utilized for operations." "Consolidated" means the administration can take the data used to generate the information in the Form 990s and break up and/or lump those numbers together in almost any fashion. "Reclassification" means that the administration can decide to change where each expense is allocated from one year to the next. Of the twelve fiscal years provided, in three years the administration decided to "reclassify" certain embedded expenses between years, so that the same listing of instruction expenses for 2002, say, will appear as one number in the FY 2002 statement and as a different number in the FY 2003 statement. The sum of total expenses stays the same, they just put a note saying that the numbers are different for this "presentation."

"Investment return utilized for operations" means that the administration can take any amount of profit from their investment portfolio and add it to the revenue column. Prior to FY 2004, the administration had a sane policy based upon preserving the endowment; they would declare as "investment return utilized for operations" 6% of the average over 3 years of the fair value of their investment portfolio. Starting FY 2004, that language disappears and the administration starts putting large amounts of money into the "investment return utilized for operations" column. More on that later.

They're more careful when it comes to satisfying the auditors in reporting operating expenses. Although there was an overall drop in expenses in FY 2003 and 2004, starting in FY 2005, there has been uncontrolled growth, continuing through the 2008 crash without pause. Close examination of the financial statement notes reveals that the "management and general" operating expense category includes the cost of various loans during the past decade, amortized over the length of the loan. This does not include the debt service on the loans themselves, as previously reported – the debt service can be found at the very bottom of the cash flows. More on that later. *The Alumni Pioneer* is still trying to figure out where the debt service actually is on the assets and liabilities page; the administration sprinkled references in different places on the same page all pointing to the same note and, with consolidating, it has been difficult to pull it out from there (we'll probably figure it out). Sometimes the notes in the financial statements provide information on where amounts are allocated into rows in the front of the document, sometimes the notes don't. A debt service is not an operating expense, but the administration issued a pie chart with a slice listing the debt service, because it really likes to vary the "presentation."

The government, of course, controls the "presentation" of the Form 990. The Form 990 does not let them take the debt service, which everyone should know is a nonoperating capital expense, and pair it up with other non-operating expenses and operating expenses. Because the Attorney General of the State of New York does not let them play these games, *The Alumni Pioneer* graphs (http://www.notnicemusic.com/counter-narratives.pdf), which showed surpluses in several years, did not align with the two graphs provided to the Cooper Community, which showed nothing but deficits for a decade. More on that later, too.

An analogy will be helpful. Let's say you live in a house, and you like to dabble, so you own the house across the street, have some cash and CDs in the bank, and own some stocks. Every year you get a salary and place it in your bank account, and you have expenses that you pay in cash from ATM withdrawals, by check, and by credit card. Since you own your house, you may have a mortgage loan you need to pay, but you can't sell the value of your home – you need to live there. The value of your house is a paper value – only if you go bankrupt and become homeless will that asset be sold. The house you own across the street is different. You collect rent from its tenants. Theoretically, you could boot all of the tenants out, tear down the building and put up a new one, or you could sell your ownership of the land and house to someone else and take the cash and use it, but that's unlikely. Like The Cooper Union, you may own other properties that you buy and sell, but that big building across the street is a big money maker for you and since you inherited it, you'd rather just collect the rent.

Some of your money is tied up in CDs – you might need to pay a penalty for early withdrawal if you want to get your hands on that money. But you have money in a checking/savings account, a credit card, and you've got those stocks. The stocks are where you get to have fun and do whatever you want. You can sell the stocks and use the money to buy more stocks. You can sell the stocks and put the money in one of your banking accounts. Or you can just hold on to the stocks and look at their value from year to year. It's really completely up to you, and there is nothing illegal or dishonest about it at all – although, of course, there can be plenty of risk.

But then your spouse asks you how you're doing, and whether your family can afford to buy a new washing machine. So you decide: Do I take money from the checking/savings account, do I take early withdrawal on a CD, do I sell some stocks, do I put it on a credit card? All your spouse knows is you now have a washing machine.

Your house is the Foundation Building and New Academic Building and everything inside. The house across the street is the Chrysler Building and its rent. (There are other properties, but let's keep it simple for this presentation.) Your salary is student fees, contributions, and government grants. Your living expenses are salaries, benefits, maintenance and security staff, utilities and the like. Your credit card is loans that The Cooper Union has obligations on. The cash in bank accounts is exactly that, cash assets. The CDs are restricted gifts. And the stocks are the investment portfolio (I've simplified a little for the sake of the analogy, because the concept of restricted and unrestricted endowment is hard to put into personal finance terms – the restricted endowment can also be stocks, or bonds, or CDs, or any financial instrument).

On the next page is one way to look at the Cooper financial state over the last twelve years. The three years in boldface are ones where the "presentation" has changed and some expenses have been "reclassified" – since you're only seeing the total, you can't see the distinction.

Now it gets really interesting. The graphs presented to the Cooper Union Community come from some minion in the Finance office typing in all of the total operating expenses and total operating revenues into an Excel spreadsheet and generating a chart. But the operating expenses does **not** include capital expenses, and the revenues contain **a portion** of the investment portfolio earnings.

So below the "total expenses" row, which does not contain the debt service, and the "total revenues" row, numbers which are arbitrary because they contain "investment return utilized for operations," is a completely arbitrary number, the difference between the first row and the second row, which the administration told the Cooper Union Community is the deficit. TC Westcott was hired in the middle of FY 2010, and the KPMG audits were performed in December after each fiscal year ended, so you really have to hold Robert Hawks and George Campbell, who came to The Cooper Union in 2000, responsible for most of the creative accounting in these consolidated statements. (To his credit, President Lacy, who followed the controversial President White, provided *The Cooper Pioneer* with *un*consolidated financial statements from the sole same Robert Hawks.)

The Form 990s are provided so that donors to not-for-profit institutions can make sure that all of the money they donate isn't going to management and fundraising. The audited consolidated financial statements are most likely a dumb show for the Board of Trustees, because the notes contain information about the endowment and real estate transactions, and there is information about cash flow and the like. There is some breakdown, and the current year is always compared to the previous year, which can be soothing if you don't look too closely. And it's audited, and most of the Board of Trustees want to know that an independent auditor has looked at the numbers they don't want to.

The auditors expect The Cooper Union to be a little honest, so right under the revenues and expenses they put a few more rows. These are called "nonoperating activity." Some of these rows only appear for a year as The Cooper Union decides to change its accounting practices and really mess the numbers up. There is the "excess of investment return over amount utilized for operations," which brings back in the rest of the investment profit that has not been arbitrarily placed under total revenues. It all ends with a line, increase (or decrease) in unrestricted net assets. Now this is *not* the number you want your spouse to look at, because if you get divorced, your spouse may find out what you're really earning. Those numbers are included in the row below the surplus (deficit) row.

If that number is negative, you haven't done very good at playing the stock market. If that number is positive, you have.

If the number is negative, you not only had expenses, you lost money on your endowment, so it's like an extra expense (watch out for the negative sign!). If the number is positive, it's like additional revenue, so you can add it to the other revenues. Now you have new numbers for expenses and revenues, and the surplus (deficit) swings wildly all over the place, sometimes up 80%, sometimes down over well 100%. The new surpluses have been placed in boldface.

	Investments	FY1999	FY2000	**FY2001**	**FY2002**	FY2003	FY2004	**FY2005**	FY2006	FY2007	FY2008	FY2009	FY2010
Total expenses		$35.74	$37.25	$41.46	$42.82	$40.91	$38.81	$41.53	$43.71	$50.06	$54.01	$59.41	$66.83
Total revenues		$27.02	$32.18	$30.34	$42.75	$29.04	$30.82	$33.64	$32.87	$39.38	$45.96	$47.48	$45.40
Surplus (deficit)		$(8.72)	$(5.07)	$(11.11)	$(0.06)	$(11.87)	$(8.00)	$(7.90)	$(10.85)	$(10.68)	$(8.06)	$(11.93)	$(21.43)
		-32%	-16%	-37%	0%	-41%	-26%	-23%	-33%	-27%	-18%	-25%	-47%
Gain (decrease) in unrestricted assets		$(6.80)	$5.29	$(30.34)	$(13.48)	$131.78	$22.54	$45.31	$186.61	$104.04	$(14.95)	$(99.23)	$73.45
Expenses + loss in unrestricted assets		$42.54	$37.25	$71.80	$56.30	$40.91	$38.81	$41.53	$43.71	$50.06	$68.96	$158.64	$66.83
Revenue + gain in unrestricted assets		$27.02	$37.47	$30.34	$42.75	$160.81	$53.35	$78.95	$219.47	$143.42	$45.96	$47.48	$118.86
Surplus (deficit)		$(15.52)	$0.23	$(41.46)	$(13.54)	$119.91	$14.54	$37.41	$175.76	$93.36	$(23.00)	$(111.16)	$52.03
		-57%	**1%**	-137%	-32%	**75%**	**27%**	**47%**	**80%**	**65%**	-50%	-234%	**44%**
	$113.17	$97.65	$97.88	$56.43	$42.88	$162.79	$177.33	$214.74	$390.51	$483.87	$460.87	$349.71	$401.74

You have to start with money in your bank account, so let's arbitrarily start with the cash cost of the Cooper Union investment portfolio in 1999 (whether that's actually the beginning of FY1999 or the end is of no matter). Now we subtract or add that deficit or surplus to our bank account, and see how we're doing. Not bad!

We started with over $100 million dollars, let that fall all the way down to under $30 million dollars, then rode the stock market all the way to a high of over $500 million in FY2007, and get to brag to the Wall Street Journal that the financial crisis in FY2009 didn't affect us much. Nice job!

But what did we do with all that money? Did we go out and buy a second home? Did we actually go out and *build* a second home? How come we have so little unrestricted money left in the bank?

Because those numbers are fake, too. And they don't include the amount you have to pay on the mortgage of your house!

	FY1999	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010
Hedge Funds	$ -	$ -	$ -	$ -	$3.00	$4.32	$5.64	$19.41	$75.64	$102.92	$18.84	$29.75
Real Estate and other	$3.16	$0.71	$0.71	$0.75	**$152.74**	$178.55	$224.45	$421.75	$530.70	$530.39	$473.21	$509.37
Everything Else	$122.16	$146.43	$107.17	$80.27	$70.65	$78.40	$77.76	$59.69	$64.67	$77.15	$121.47	$101.41
Temporarily restricted	$3.43	$9.58	$(9.69)	$(6.62)	$(0.62)	$1.46	$1.58	$1.36	$5.45	$1.51	$(4.35)	$6.35
Used for operations	$4.91	$5.33	$4.80	$2.64	$1.03	**$18.06**	$18.91	$19.26	$23.52	$30.96	$33.98	$32.00
Nonoperating revenue	$1.92	$10.36	$(19.23)	$(13.42)	$(2.41)	$28.69	$53.21	$200.04	$118.72	$(1.23)	$(87.46)	$37.94
Investment return	$10.27	$25.27	$(24.11)	$(17.40)	$(2.01)	$48.21	$73.70	$220.65	$147.69	$31.25	$(57.83)	$76.29

Inside the Investment Portfolio

A closer look at the investment portfolio reveals the real story behind the risky financial strategy that appears to have resulted in a lot of trustee members getting out of Dodge, or resigning in protest over.

From FY 1999 through FY 2002, The Cooper Union is following what anyone would call a rational and transparent financial policy. "The Cooper Union utilizes a spending rate of 6% of the average of the previous three years' fair value of investments as the investment return to be utilized for operations. Amounts in excess of such amounts are reported as nonoperating revenue" (even when that revenue is negative). Then, in FY 2003, The Cooper Union does a strange thing – it decides to report the fair value of the Chrysler Building as part of the investment portfolio. For those who understand the financial market, perhaps it is more than a coincidence that that is also the year that The Cooper Union decides to put a little money into a hedge fund. The following year, the 6% spending rate note disappears, and suddenly $18 million is listed as the investment return used for operations.

Before going on, it is important to note that, if you own a rental property, you probably want it valued as low as possible, because then your property taxes are as low as possible, and you make more net profit off of the rent you're charging. There are two exceptions to this. One is if you are about to sell the property; then, of course, you want the property valued as high as possible. The second is if you're The Cooper Union. In February 1998, The Cooper Union entered into an operating lease agreement, expiring in 2147, with New York City. Cooper gets a base rent of $5.5 million through 2007, $7 million through 2012, and $7.75 million through 2017, with further adjustments from 2018 onward. In addition, The Cooper Union receives in rent from the Chrysler Building the amount equivalent to the property taxes "were it subject to taxation." So you want your property valued, and the property taxes, as high as possible.

The value of the Chrysler Building starts zooming upward. You start collecting more in rent, which you decide to put into hedge funds, since they're doing so well. 2004, 2005, 2006, 2007, 2008 – then, the crash. The value of the Chrysler Building plummets by almost $60 million. And the value of your hedge funds plummet by $80 million.

Of course, these are end of fiscal year numbers, so you might have pulled some money out of the hedge funds before you lost everything. But no matter which way you look at FY 2009, things are bad. You tell the following story to the auditors that year:

> The Cooper Union invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheet.

You're about to open the New Academic Building. Businesses are closing all around you. But you're so optimistic! You also add this statement about your net assets (if it were only true):

> The Cooper Union manages its long-term investments in accordance with the total return concept and the goal of maximizing long-term return within acceptable levels of risk. The Cooper Union's spending policy is designed to provide a stable level of financial support and to preserve the real value of its endowment. The Cooper Union compares the performance of its investments against several benchmarks, including its asset allocation spending model policy index.

So let's get this straight. You have the "goal" of maximizing long-term return within acceptable levels of risk. And you've designed a "spending policy" designed to provide a stable level of financial support and to preserve the real value of the endowment. Is this the spending policy you abandoned in FY 2004? Is that why you **didn't** preserve the real value of the endowment?

That's FY 2009. In FY 2010, Robert Hawks, after decades of safe stewardship of the finances of The Cooper Union, retires and gets a nice thank-you bonus from the Board of Trustees. TC Westcott is hired, and publishes a financial statement where every dollar of the investment portfolio is broken down into levels and redemption times and the like (perhaps new legislation requires this). You slowly start to recover. You've got about $120 million in liquid assets – about the same as you had back in 1999 – which, due to inflation, means you've lost 15% of the worth of your endowment, despite a capital campaign, a decade of fundraising, a decade of elaborate real estate deals and gifts and five years of record profits on your investment portfolio (which you've cleverly disguised as "deficit spending").

Accentuate the Positive (cash flow, that is)

Unfortunately, cash flow is real. The uncontrolled growth that started in FY 2005 (remember that uncontrolled growth from the first page?), paired with the debt service that you signed on to at the beginning of FY 2007, have created a huge gap between your earnings (revenues plus investment gains) and your spending (expenses plus obligations). But that's all right, because you have plans to "reinvent" The Cooper Union or, to use the title of a book by the head of the Board of Trustees investment committee, you're "Restructuring for Growth." <http://www.amazon.com/Restructuring-Growth-John-C-Michaelson/dp/0071590056/>.

(If a reviewer is accurate, the book teaches that "emphasis on acquisitions and getting bigger is being replaced by focus on core competence" – you mean like sticking with providing an excellent undergraduate program in New York City and dropping President Bharucha's fantasies about research and merging with a campus in India? See Michaelson lord it over Yale at http://www.topgunfp.com/cooper-union-endowment-dodges-stock-market-crash-criticizes-the-yale-model/)

Of course, we can hide the cash flow numbers, too. Just as they love to call something "total revenues" and call something else "total expenses," draw big lines under each, create a third line called "deficiency of operating expenses over operating revenues" (which they sometimes have the guts to call "excess" and hope you're too stupid to realize is negative) and **then** add more rows below that they don't add or subtract (but which *The Alumni Pioneer* did), similarly, on their cash flow page, they have a whole lot of numbers that end with a final row with a double underline that they call "cash and cash equivalents at end of year." You'd think that would be it, but then they add "supplemental cash flow information" below the line, and that's where they hide the money they have to pay on debt services and loans. Remember that debt service you signed on to at the beginning of FY 2007? Once again, *The Alumni Pioneer* will do the math: Again, we'll arbitrarily start with the $113 million figure from before.

It's like, you're so eager to be Good News Charlie, you just have to show positive cash numbers every year. Then you put that nasty interest and those big loans under the line, and you even have the nerve to not use a negative sign (we did), so that people won't notice that "cash paid" is not positive cash flow, it is a negative! This "presentation" is different than the others because it shows restricted amounts, real estate, and the debt service.

What's my cash flow? I have cash flows from operating activities, cash flows from investing activities, cash flows from financing activities, I'll total all of that, write about how much money I had at the beginning of the year and at the end of the year – and, oh yeah, I have supplemental cash flow information: I forgot to say I have to pay the mortgage on my house!

		FY1999	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010
Cash and equivalents at end of year		$0.60	$0.46	$0.48	$6.61	$0.63	$0.62	$0.09	$2.50	$88.67	$108.14	$36.42	$19.63
Cash paid for interest		$(0.95)	$(0.83)	$(1.70)	$(1.56)	$(1.53)	$(1.49)	$(1.46)	$(1.41)	$(6.69)	$(12.00)	$(14.27)	$(10.38)
Transfer of investment to plant assets		$ -	$(2.55)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$(96.97)
Net cash		$(0.34)	$(2.93)	$(1.22)	$5.05	$(0.90)	$(0.87)	$(1.37)	$1.09	$81.98	$96.14	$22.15	$(87.72)
	$113.17	$112.83	$109.90	$108.68	$113.73	$112.83	$111.96	$110.59	$111.68	$193.66	$289.80	$311.95	$224.23

Two more points. Restricted endowment can be turned into unrestricted endowment – you just have to pay a penalty. And since when is unrestricted endowment your only source of revenue? You get money from the restricted endowment. That silly calculation where President Bharucha takes the $50 million in unrestricted endowment, tells you to divide by the imaginary $16.5 million deficit, which means you have only three years to live – I bet John Michaelson and the others on the Board of Trustees investment committee would be positively giggling in their limos if they heard that one. Simple math for those simple artists, architects, engineers, and education reporters! Charge tuition to save our lives!

For four weeks we've all been played like Bharucha's violin.

The current version of this document can be found at <http://www.notnicemusic.com/deficit.pdf>. Corrections to this document are appreciated and, if based on substantiated facts from legitimate sources, will be implemented by the author. The original version was completed on November 24, 2011, with a later version completed on November 26, 2011.

The Alumni Pioneer, <http://www.notnicemusic.com/Cassandra/cooper.html>, is a virtual newspaper with breaking news stories and links to analyses, sources and the media. It is written and formatted in an inverted-pyramid newspaper style to facilitate quick access to what is deemed the most important information. The abstract was added on January 28, 2012