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In 2004 this author presented to the court written testimony that disagreed with many of the assumptions and analyses presented by witnesses for the Barnes Foundation. The presentation refuted the testimony that moving the collection to a new facility in downtown Philadelphia was a better solution than maintaining the current facility in Merion Township.

The author disputed the assumption that the construction costs would be in the area of $100 million and that an endowment of approximately $50 million would be generating income of approximately $2.5 million in operating income when the new facility opened. The author also pointed to the dangers of new museum construction and how the greatest danger to museums is the overexpansion and overreaching, particularly with new facilities.

The construction costs have far exceeded the estimates and, as predicted, because of the way endowment income is collected and invested, there is no prospect for $2.5 million of endowment income supplementing the operating costs for the new facility when it opens. Also, because of the nature of the economy and current interest rates, eve with a fully invested endowment of $50 million, there is little change of operating income of $2.5 million.

The following however, is a refutation of the argument that the Barnes Foundation, remaining in Merion, would become bankrupt. At that time, full financial data and multi year trends were not available. The following includes that data.

There are over 5,000 museums in the United States. No matter the kind of museum (history, art, science, etc.), the board size or type, the existence or size of the endowment, the level of quality of its management and administrative staff and the quality of its collections, very few have filed for protection under chapter 11 or chapter 7 of the bankruptcy laws in the last ten years. This, even though much of the past decade has been marked by financially challenging conditions for museums: Admissions, contributions and endowment earnings are all related to broader financial trends and during this period the economy has experienced negative financial conditions, yet almost no museum declared bankruptcy, certainly no museum with the history, quality of collection, endowment, management team and scholarship connected to its collection. The notions that the Barnes Foundation was on an imminent path to bankruptcy and that therefore a threat that the collection was to be dispersed, run sharply counter to facts and are contradicted by many known indicators of financial health of similar museum in the United States.

It has been argued that because the Barnes location in Merion is inaccessible, the earned and unearned income combination needed to support a museum was insufficient, that zoning laws prevented increases in the income making the Barnes unsustainable. This argument ignores the facts that there are thousands of house museums, gardens and historic sites, which are not located in urban areas, yet are self-sustaining. The one exception illustrates that the threat to financial stability comes from aggressive institutional expansion in size and operations -- not from relatively modest challenges such as those faced by the Barnes Foundation. The essential challenge for the Barnes Foundation is finding its balance as an integrated complex of a school, a public gallery, an arboretum, and a historic site, not as a major international museum in an urban setting

The high profile example of a financially troubled museum relevant to the matter at hand: The American Folk Art Museum in New York City recently was unable to sustain operations and sold its newly constructed building to the Museum of Modern Art. Ironically, the nature of the financial problems of the institution is <u>not</u> inaccessibility – the American Folk Art Museum was re-located to East 53 Street in New York City, a location at the epicenter of the critical mass of potential visitors and near other great museums (similar to the proposed location for the Barnes). A closer examination of the causes for the financial problems of the institutions reveals that the AMFM suffered from the increased costs that accompany the construction and operations of new facilities. The Folk Art Museum originally occupied a townhouse in Manhattan and later moved to a smaller facility north of midtown Manhattan. However, cost overruns of construction; debt incurred to float bonds to complete construction; debt service payments; increased operating costs that are a result of operating a new building; and the unanticipated distractions to both board and management that accompany a shift in focus from operating a museum to operating development/construction projects caused the AFAM to seek bankruptcy protection. In a foreboding coincidence, the architects of the AFAM are the same that designed the new Barnes facility in downtown Philadelphia.

Was the Barnes Foundation unsustainable?

In previous hearings, testimony was presented attempting to show that the Barnes Foundation was financially unsustainable and that if it continued on its present course at that time, it would quickly burn through its cash assets. Witnesses opined that the **only** course of action was to relocate the collection to the city of Philadelphia where attendance could be increased and, once the move was confirmed, contributed income would be available.

To reach those decisions an inaccurate and misleading financial picture was presented. Witnesses stated that the organization would burn through its cash assets in a few years; that board and management of the Foundation had exercised all possible means of eliminating annual operating deficits; and that major donors would not contribute to the Barnes if the collection remained in its current location. This author takes issue with these suppositions and the facts do not support the testimony presented.

The author offers as evidence an examination of the audited financial statements of the Barnes Foundation for 2001, 2002 and 2003 (presented as exhibit A). Mr. Matthew Schwenderman, of Deloitte & Touche testified that during that period of 2001 -2003, the Barnes had annual operating deficits in excess of $2 million annually. After cross-examination, Mr. Schwenderman agreed the ongoing deficits were in reality, closer to $1.3 million. But were they actually that high and did that level reflect a "built-in" institutional deficit*? [It is not unusual for museums to experience periodic annual deficits. Because of accounting standards, income is accounted for when received and expenses are accounted for when spent. If a contribution for a new building is received in one year it could cause an operating surplus for the year; if the building is constructed in the next year that would cause an operating loss in the year the grant was spent. The grant from the prior year covered the expense but a loss would be recorded in the second year].*

The Deloitte & Touche report and the testimony of Mr. Schwenderman regarding the financial operations of the Barnes for 2001 through 2003 paint a picture of an institution that was losing approximately $1.3 million per year, reducing its endowment. By extension, it was posited that the Barnes Foundation would burn through its cash and eventually be forced to file for bankruptcy protection, even perhaps, liquidate and disperse its collection. Therefore, the argument was made, the Foundation could no longer fulfill its mission of remaining intact in Merion as Dr. Barnes' will stated. Since it seemed the lesser of two evils (move the collection in a piece or have the Foundation lose control of the collection), the court permitted relocation.

Mr. Schwenderman's testimony did not reveal some simple facts regarding the financial condition of the Barnes at that time (see the attached financial statement and accompanying graph). There are three extraordinary and non-recurring costs, not ongoing operating costs that caused losses during this period

Expenses

Legal Fees

For a museum with an operating budget of between $4 million and $5 million, professional fees were extraordinarily high and non-recurring: they grew to over $2,000,000 for legal fees over the three-year period. Legal fees are not ongoing operating expenses and should not be considered part of the operating budget for predicting future performance.

Endowment Losses

There are two sources of income from an endowment that can be reflected in a financial statement: income from endowment and income from increases in the endowment through growth of the corpus (through increases in the value of the investments). In 2001 and 2002, the losses on the endowment (after gains on interest, etc.) were $316,000 and $600,000 respectively – these losses, unrelated to ordinary museum operations, contributed to the operating deficits. While there is no guarantee that endowments generate income, it is fair to speculate that endowments, conservatively invested, will produce annual increases in the principal, depending on indices in the stock market, interest rates and the skills of investment advisors. The losses on the endowment are not normal operating costs and the temporary losses do not give a true picture of annual operations.

Depreciation Costs

- Depreciation is a reserve, a "rainy day fund' set aside to insure that when buildings and equipment require replacement and repair there are funds available to fix or replace them. The operating statements reflect a non-operating charge of almost $500,000 per year for depreciation ($493,000 and $496,000). While best practices would require a museum to reserve for depreciation, that depreciation is usually recorded on the balance sheet, not the operating statement. And, only a few years prior, the Barnes embarked on a major capital repair program. In 2001 the condition of the collection and the building that houses the collection were recently repaired, most building systems were replaced and reserves for depreciation were not urgently required. For the three year period, 2001 through 2003, expenses not related to operating costs were "loaded" into the financial statement giving a very inaccurate and dire view of a an fairly healthy institution.
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- In addition, at that time, the Barnes Foundation had almost no long-term debt and no pension obligations. (In contrast, the Philadelphia Orchestra has a healthier financial picture but crushingly high pension obligations, which caused it to file for bankruptcy protection.) The Barnes had a professional museum director in place, an expanded board, had hired a fundraising staff and had been given some operational freedom by the court to improve its earned income streams.

Income

Earned Income

The Foundation was not maximizing its earned income potential. At the time of the hearings, there were restrictions on the number of visitors by Township Ordinance and a limit on the price of admissions imposed by the County Court. The Foundation's witnesses portrayed those two factors as unchangeable. It is now known that the Foundation did not apply to the Township for a change in the Zoning Ordinance governing public visitation to the galleries. A community group did apply for a change after the earlier hearings and the Township Zoning Board made changes that allowed for a substantial increase in visitation. In the years following the Court's permission for the Foundation's petition to change its By-Laws and move the collection, the Foundation instituted numerous increases in its admission price. It rose from $5 to $15, plus a $2 service fee. If fully implemented earlier, these changes alone could have significantly improved the Foundation's operating income.

In combination with increases in ancillary income, such as gift shop sales, audio rentals and parking fees, these changes could have completely covered the operating deficit it was experiencing at the time of the previous hearings. The visitors would also have become natural prospective donors to the Foundation.

Fundraising

Foundation witnesses proposed that donors would only contribute to the Foundation if the collection were moved to Philadelphia. [2][3] This argument is an insult to the hundreds of thousands of donors who contribute to house museums, historic sites, orphan collections housed in universities and other nonprofit institutions that are not located in major urban centers.

The first rule of fundraising is to solicit; one must ask. Yet there was little if any evidence of the solicitation for funds by the Foundation, although there was some history of receiving bequests and contributions. However, until recently, there was no annual giving campaign, no alumni solicitation, no members' program and no planned giving program. Influential board members may be necessary to raise large major gifts but the other forms of fundraising require only the infrastructure to develop a campaign and the willingness to ask.

The Barnes collection is one of the greatest single collection of 19th and 20th century European masterpieces, a collection that likely will be supported by both individuals and foundations.

Conclusion

"The lesser of two evils", the move to Philadelphia, was predicated on a set of assumptions that did not materialize. Predictions made by this consultant in his earlier testimony have materialized: The cost of the facility will far exceed the costs projected by the cost estimator. The rate of collection of the endowment pledges and therefore the income from the endowment is not yet available to support ongoing operations and, while there is no business plan that this author is aware of, the cost of servicing debt was not anticipated in the original pro forma. Not only does the move to Philadelphia break the intentions of Dr. Barnes, it creates the risk of bankruptcy for the Barnes in its new facility. As demonstrated in the case of the American Folk Art Museum, ironically, designed by the same design team as the Barnes on Benjamin Franklin Parkway, a move to a new facility creates unintended consequences and could lead to severe financial threats.

Since the ruling, the Township of Lower Merion has demonstrated its willingness to accept conditions that would allow the Foundation to expand, the court has allowed for flexibility in ticket pricing, and other improvements to visitor services have been made. A Members' Program is established and other indications of increased public support are evident. These facts add to the previous argument regarding the sustainability of the Foundation in Merion, and they continue to convince this author that the Foundation is viable in Merion and that for reasons of relevance and mission, it should remain there.

But what of the new facility on Benjamin Franklin Parkway? The situation referenced above provides the court with a ready- made solution to the "pink elephant." The Museum of Modern Art in New York City has agreed to purchase the American Museum of Folk Art building on East 53rd street and the American Museum of American

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Folk Art has agreed to return to its smaller and more suitable facility further north in NYC. The Museum of Modern Art will add the facility it to its next building expansion. Perhaps one of the equally great Philadelphia Museums can utilize the additional space as well.

James Abruzzo is a cultural business consultant. He has consulted to arts organizations and their boards for 30 years. His clients include the Newark Museum and the George Eastman House, and they range from the Royal Opera House in Oman to the Te Papa Museum in New Zealand. In 2004 he was retained by the board of the Terra Foundation for American Art to assist in their transformation from two museums, in Chicago and Giverny, France, into the largest foundation for American Art in the United States.

Mr. Abruzzo is also the Co-Founder of the Institute for Ethical Leadership at Rutgers Business School where he also teaches in the graduate school, and he teaches Arts Leadership in the Graduate School of Economics at the University of Bologna. He is the author of Jobs in *Arts and Media Management* and is currently under contract to complete a book, *Arts Leadership,* for Routledge, Inc.

Sincerely,

James Abruzzo

James Abruzzo, President
Abruzzo Associates