

Responses to Discussion Draft on Charities

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Introduction

Our thanks to the Finance Committee staff for its thorough examination of nonprofits and its willingness to engage the nonprofit community in open dialog. Such discussions will be a benefit to the entire sector encouraging us to look at current practices, recognize where we can improve those practices and explain to the government where we think current practices are adequate.

Art museums in the US enjoy a high degree of public confidence. They exist in small towns, suburban and rural areas and in large cities. They serve as community gathering places, offer public programs to both children and adults, and at the same time protect and preserve over 15 million works of art – America’s artistic heritage. There is a strong bond of trust established between a museum and its community. Not only does a community support its museum financially, many of its leaders take positions on museum Boards, others volunteer to be trained for everything from lecturing on art to teaching art to children. The museum community works diligently to earn and protect the trust it is given.

We have examined the recommendations and have responded below to those about which we have been able to query our membership. Those to which we have not responded do not appear to impact museums, assuming we have correctly understood the recommendation.

It should also be noted that some recommendations in the Discussion Draft could be accommodated by large museums both in terms of time and cost but could not be accommodated by smaller institutions, even though there may be no argument with the recommendation itself. One museum director from a small museum with a staff of 15 said: “these recommendations would bring us to our knees – even enacting a few of them would do it.”

We offer the following as an indication of the impact of the recommendations on a specific sector of the nonprofit community and we offer them, like the Discussion Draft itself, as a draft to encourage further dialog.

The numbering of our responses follows that of the Discussion Draft.

A. Exempt Status Reforms

1. Five-Year review of tax-exempt status by the IRS

In the words of the director of a small Midwestern museum, the five-year review would be a "disaster" in terms of the work involved and the cost of legal fees to file for the museum.

The burden on smaller institutions to refile and pay the fee would be truly onerous, particularly when the staff time and expense to refile and the refiling fee is added to the other proposed recommendations. The Discussion Draft proposal includes filing and paying fees for accreditation, for an expanded 990 and for auditors to review the 990.

An alternative to asking every nonprofit to refile every five years would be to choose randomly a certain percentage of nonprofits to refile, with a guarantee that they will not be asked to refile again for at least 15 years.

3. Supporting organizations

This proposal needs more study by the AAMD to determine how it might affect the membership.

B. Insider Disqualified Person Reforms

1. Apply private foundation self-dealing rules to public charities and modify intermediate sanction compensation rules

While these issues may be appropriate for private foundations, in the case of a museum, they usurp the authority of the Board. If inducements are offered to museum directors when they are hired these become part of the directors' total compensation package. In the museum community the Board or a Board-appointed committee has full knowledge of the package and the director follows all IRS rules governing the package.

When one considers that the median salary for a museum director, as reported in the *AAMD 2004 Salary Survey*, is \$155,000 it is apparent that in some instances the Board will offer additional incentives. In a minority of cases one of the incentives offered is low-interest mortgage loans or actual housing, since the director in almost all museums is expected to use his home for museum purposes. This is not unlike the housing allotted by the federal government to a certain class of employees abroad who are expected to use their homes for government purposes.

C. Grants and Expense Reforms

4. Limit amounts paid for travel, meals and accommodation

It is not clear if this proposal applies only to foundations.

In the museum community many staff travel extensively both nationally and internationally. Travel budgets are prepared internally and carefully monitored by the museum staff and are in accordance with what the region, size and location of the museum would dictate. To ask the Board to approve any travel above the government limit would be asking the Board to micromanage the institution and would be a poor use of a valuable resource – the Board’s time.

E. Improve Quality and Scope of Forms 990 and Financial Statements

1. Require signature of Chief Executive Officer

Although on the surface this does not appear to be an unreasonable request it could have unintended consequences both for large and small museums. In the case of a small museum, where the director might be highly specialized in an art field and be an excellent manager, but not a financial expert asking the director to sign the 990’s might lead the Board to reconsider whether it should be hiring directors with financial expertise rather than art expertise. This would not be a happy trend in the museum community.

In a large museum, it is unfair to expect the director to attest personally to the accuracy of the 990 or know if it complies with the IRS Code. The director currently entrusts that responsibility to the person who is responsible for filing the 990.

Improved published standards and instructions for filing the 990 will yield better results than requiring the CEO to sign the Form 990.

2. Penalties for failure to file complete and accurate 990

Before penalties are imposed there should be an opportunity to “cure”. If not the penalties would/could fall most heavily on small institutions which are understaffed and in some cases rely on outside resources to prepare legal forms and notices.

3. Penalty for failure to file timely 990

While on its face this proposal does not appear unreasonable, there should be exceptions made for extraordinary circumstances which might occur in a small museum. Often, in a small institution it is the responsibility of one person to handle filing, or to arrange with an outside resource to file. If the person responsible unexpectedly leaves or is otherwise incapacitated it would put a severe strain on the institution.

5. Standards for filing

In general, it is always better to have published standards and we would encourage such for the 990, however, if part of this proposal would require financial statements of museums to conform to a standard format compliance would be difficult for museums..

Such a requirement previously existed for those applying for grants from the Institute of Museum and Library Services which required that all financial information be submitted in compliance with the agency format. This caused considerable anguish and prevented some museums from applying for grants. Each museum and its outside auditors have a format for financial statements which best suits the needs of the institution.

6. Independent Audits and Reviews

The cost to add an independent audit report to a 990 would be a difficult burden for a small institution particularly in light of the other costs associated with other proposals in the Discussion Draft. Furthermore, it is not clear what is gained by having both audited financial statements, which, in the case of museums, are made public, and an audited report of the Form 990.

Requiring a new auditor every five year would put a severe strain on most institutions and in some instances be unworkable. A museum director from a small Western town said: “I would soon run out of auditors – there just are not that many available.” In addition, museum auditing is not a niche in most accounting firms, in fact, except in a few instances in large cities, most firms probably only do one or at most two museums.

By the time the auditors fully understand how museums operate they would have to be replaced. Training auditors – not in tax law – but in the operation of the organization is time consuming, particularly for a small staff in a small museum. And because so few auditors are familiar with museums they need to educate themselves on IRS Code sections governing nonprofits and FASB rules as well.

8. Disclosure of performance goals, activities and expenses in Form 990 and in financial statements

The goals of a museum are spelled out in the museum’s mission statement which is always Board approved and does not change frequently. The mission statement is the heart and soul of the organization. It describes its public purpose and is publicly available

On the other hand performance goals and measurements for meeting those goals are internal and staff driven and would not serve to help the public decide where or if to make donations.

Many performance goals depend on empirical data and may pertain to everything from how much it might cost to do a program to how many people are expected to attend a special exhibition. Such information could serve as a disadvantage to an institution if the public came to value the institution or compare it to other nonprofit organizations based on quantity not quality of programming. For example, a specialized art program for disadvantaged children might only be able to accommodate 15 students, while a visit to the zoo for disadvantaged children might draw 50 to 100 children depending on how many busses were available. It would be a shame to value one program over the other based on the number of participants, but that could be the case if the public begins to expect number-related goals and measurements.

Being forced to disclose too much information in the Form 990 such as changes in activities, operations or structure, in addition to being intrusive into the internal operations of the organization, would overburden the 990 with information, thereby

making it useless for any purpose. It is not clear what constitutes material change in an organization that would require reporting.

9. Disclose investments of public charities

A charity should be judged by the work it does, its mission statement and the role it plays in the community. It should not be judged by its investments. The Board or a Board-appointed committee oversees investments of the organization. If the investments do not produce the desired affect, the Board must take corrective action.

Museums are very public institutions; they own buildings, they're open long hours-- some almost every day of the week -- and they maintain many public programs. How unfortunate it would be if a segment of the community decided it did not approve of the investments a board had made either for political or social reasons. This could cause a drop in fundraising; put the board on the receiving end of criticism from other community leaders and probably be responsible for the resignation of some Board members.

In addition, if there were a publicly-traded local company, some community leaders could exert considerable pressure on members of the museum Board to invest in the local company. Furthermore, if that local company were also a contributor to the museum, but then learned that the museum did not invest in the company, the pressure on the Board to so invest and the possibility of a *quid pro quo* arrangement could be catastrophic. The unintended consequence would be that Board members would resign rather than be subjected to such pressure and disputes --making the solution worse by far than the putative problem.

F. Public Availability of Documents

This section needs more study and discussion among the AAMD membership. Number 5 in particular needs more discussion across the entire nonprofit sector. It could have far-reaching ramifications on fundraising in some communities.

1. Disclosure of Financial Statements

Financial statements are included in annual reports filed by museums and available to the public.

G. Encourage Strong Governance and Best Practices for Exempt Organizations

1. Board Duties

Boards of Directors are governed by by-laws of the institution; they serve voluntarily; they are community leaders; they represent a wide cross section of the community and generally are good fundraisers. It would not serve the institution or the board well if those with special skills or expertise were held accountable should there be a perceived breach in that specialty area. Governance of the institution is a collective responsibility, it would be unreasonable to hold one person responsible, and additionally it would be extremely difficult to recruit people to serve on a Board.

In many instances a person like a CPA, for example, with very good connections in the business community and a gift for raising money might agree to join a Board and more than fulfill the required fundraising role, but be unwilling to sit on either the finance or audit committee, preferring instead to doing something entirely different from his/her professional life. Many art acquisition committees of the Board are made up of lawyers and accountants who want a new experience.

Rather than respond to each point about Board duties, see Appendix A for a description of Board obligations from an AAMD museum. In general museum Boards make policy, have a fiduciary responsibility for sound management and a fundraising role. The operation of the institution rests with the director and staff. The director reports to the Board.

2. Board Composition

Limiting a Board to 15 people could have a serious negative impact on an institution and its ability to govern and raise funds. Much of the work of a Board occurs through committees – if the museum has even just four committees there would be less than four people to a committee, not enough to do the governance work at hand.

More importantly most Boards are fundraising Boards that seek to engage as large a cross-section of the community and its leaders as possible. In addition, museums in smaller communities seek greater geographic diversity on a Board all of which takes Board seats. To limit the size of the Board would limit community participation and financial support.

3. Board/Officer Removal

Each museum has by-laws that govern the conduct of the Board and staff. If there is ever a question of an individual's ability to serve the removal should be left to the collective Board.

In a small community if the IRS were to require the removal of a Board member it would make it very difficult for the museum to continue to operate because it would call into question everything the museum did in the community.

4. Government Encouragement of Best Practices

Encouraging best practices and accreditation is a good idea; however cost and time often prevent small museums from seeking accreditation. It would be helpful to offer grants for small museums to seek accreditation.

I. Tax Court Equity Authorities, Private Relator and Valuation

It is not clear if this section applies only to a selected group, if not, it needs considerable further study.

4. Valuation Resolution

Although “baseball arbitration” may be useful in some context, the museum community depends on the IRS Art Advisory Panel and finds that it functions well -- it is a panel of experts from the field of art who look at the appraisals brought before it. The panel members, who volunteer their time, are museum directors, curators, art dealers and auction house personnel. If there is a dispute with a donor about the valuation the IRS has a procedure it follows to settle the dispute.

If there is an improvement to be made in the IRS Art Advisory Panel it would be that the IRS should be given greater resources to audit more returns, particularly those that claim a large art-related deduction. We would not recommend exchanging the Art Advisory Panel that works well in the art field, for a valuation resolution that is untested in the field.

Conclusion

Recognizing that the proposals are intended to generate discussion their cumulative affect, were they to be enacted, would bring the work of the nonprofit community to a halt. Even enacting only a small number of these proposals could be a serious impediment to the work being done by nonprofits both large and small.

The extraordinary costs and burdens of these proposals are eminently clear, the need for comprehensive change and the prospective benefits are not clear. Dramatically increased federal regulation of such matters as museum board size, the frequency with which institutions engage new auditors, and the number of times that they must renew their tax exempt status, have clearly negative consequences: they force museums to spend far more time and resources on matter unrelated to the institutional mission. Staff and money that could be devoted to education and exhibitions would instead be spent accumulating and filing ever-growing amounts of paper (to be reviewed --or not--by an already overburdened IRS). We must ask ourselves how the public would be better served. Museums, large and small, are already struggling with limited government support and diminished private giving.

The nonprofit community enjoys a special place in American society and is ever cognizant of the responsibilities that accompany the position it holds, but it must also be recognized that the nonprofit community fulfills enormous needs in society. It fulfills those needs even while it is, itself, in a precarious position and could easily be overwhelmed. As a community we need to take very seriously any accusation of wrong doing and ferret out the wrong doers. But we must take care not to develop a system that while attempting to cure perceived ills destroys the very mechanism we are trying to improve.

APPENDIX A

Trustee A Definition Governance

A trustee of the XXXX Museum joins a governing body of working professionals, community and business leaders, and philanthropists who have embraced the art museum as a focus of their commitment to the quality of life in this community. Through regular attendance at board meetings and service on committees or individual assignments, trustees gain information about the museum's operations and programs and contribute their own expertise to the work of the museum. Trustees review the museum's ongoing financial status and receive regular reports on the development of the museum's collections and programs. Trustees review the long range plans and policies that ensure a secure future for the museum.

Advocacy

A trustee of the XXX Museum is first and foremost an advocate for the art museum and its agenda to the XXX community and the Great Lakes region. Every trustee makes a commitment to advance the mission of the museum and support its development effort through personal and professional influence. By networking in the areas of social, political, and business constituencies, trustees convince their community of the lasting value of a quality art museum.

Personal Commitment

Each trustee is required to maintain an enhanced level of museum membership, that is a \$350 Sponsor level or higher, and is responsible for raising a minimum of \$5,000 through participation in the museum's annual benefit event, work on annual fund, securing exhibition and program underwriting, or direct personal giving. Trustees' names are placed on the lobby donor wall each year.

Trustees serve a 3-year term and may serve two terms consecutively. On completion of two terms, a trustee must rotate off the Board for at least one year. A trustee may choose to resign from the Board at any time by written notice to the President