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BERKSHIRE MUSEUM

STEPHANIE ZOLLSHAN — THE BERKSHIRE EAGLE

A banner outside the Berkshire Museum in Pittsfield thanks supporters for their visits and boasts of new, upcoming programs. Today, museum trustees who specialize in financial matters have a far different kind of problem: how and where to invest art sale proceeds.

How to invest art sale money?

With $47M in hand, trustees must decide on applying it to ensure growth, cover budget gaps

By Larry Parnass
The Berkshire Eagle

PITTSFIELD — As newly filed documents make clear, the month of April will go down as a turning point for the Berkshire Museum, when it muscled up financially after taking in $47 million from art sales.

Consider what became of the nonprofit's $2 million line of credit, on which it owed $1,852,426 as of June 30, 2017, costing it tens of thousand of dollars in interest costs.

A CLOSER LOOK: The museum's finances, by the numbers. **A5**

"The Organization paid off its line of credit balance … in April," the museum's auditors wrote in small print in a new report.

Just like that.

During months of litigation and an investigation by Attorney General Maura Healey, museum leaders and lawyers pointed often to budget deficits and a shrinking donor base.

The institution is now positioning itself to cover what it calculates as a more than $1 million yearly deficit without any outside help, thanks to art sales.

Reacting to what they termed a financial crisis, trustees pulled 40 works from their collection last July, intending to bring them to market. This May, the museum sold 13 of the most valuable deaccessioned works in auctions and private transactions, with additional sales ahead.

Today, museum trustees who specialize in financial matters have a far different kind of problem: how and where to invest art sale proceeds, to ensure growth and the ability to use endowment earnings to cover budget gaps.

It's a new era for the board.

Critics of the art sales, meantime, continue to question whether the museum's finances were really so dire, despite the fact that Healey's office in the end backed the sales.

Documents recently filed with authorities offer the most up-to-date look into the museum's finances, up until days before art sales were announced July 12, 2017. The reports do not account for the latest proceeds, but the museum says it has updated financial models to include its new cash.

PHOTO PROVIDED BY THE BERKSHIRE MUSEUM

An architectural rendering shows an expanded lobby and entrance into the Berkshire Museum.

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Museum

FROM PAGE 1

Like earlier filings, these documents — an IRS Form 990 and the museum's audited financial statements — bolster the museum's case that it faced a crisis. They were provided by the museum to The Eagle upon request.

They also show how expenses mounted through the year as trustees continued work on a master plan that called for a shift in how the museum uses its collection to shape exhibitions. That interactive and multimedia venture is called the "New Vision."

A new budget line for "work in progress" added $339,582 to costs in 2017; the auditors' notes define that as money spent on "conceptual and schematic design costs incurred towards the proposed renovation of the facility."

The audited statements for the year ending June 30, 2017, prepared by Adelson & Co. PC of Pittsfield and Great Barrington, show where the museum stood at that point in time, when trustees already had set a plan to sell art but had not announced it.

While not yet approved in a board vote, attorney Mark S. Gold notified Healey's office in June 2017 that the museum planned to sell works.

Stephen Bayne, a trustee who serves as board treasurer, said that when the 2017 fiscal year closed, total contributed income (from grants, fundraising, memberships and other sources) and total earned income (from things like admissions, museum shop sales, programs and traveling exhibitions) came up well short of expenses.

Those revenues amounted to $1,482,412, while total expenses came to $2,808,622. That is a shortfall of $1,326,210.

"If you add those two together, that's the funds we have. … and the $1.3 million, which is the problem we have," Bayne said. "You can start shaving the $1.3 million down a little bit, but that's the problem that we have."

Not any longer, given art sale proceeds.

The new documents offer a look back and final accounting of the situation that sparked a continuing national debate over the laws and ethics that apply to museum collection management.

Healey's office and leaders of the Massachusetts Cultural Council continue to meet on the issue, hoping to draw up a statement on what constitutes proper care of collections.

Anita Walker, the council's executive director, opposed the Berkshire Museum's plan, based on her group's financial analysis. She questioned, for example, why the museum had not calculated higher revenue from its new exhibition strategy.

And others, including Williams College economics professor Stephen Sheppard, who reviewed years of financial documents for the museum, said it could fix its problems with far less money raised through art sales. People suggested that the museum's expenses were inflated by a charge of $515,065 for depreciation. That accounting practice involves marking an expense to cover loss of value in assets due to wear and tear.

DEPRECIATION DEBATE

Bayne, in a joint telephone interview with fellow Finance Committee member Michael Christopher, conceded that the depreciation amount differs from other expenses like salaries, marketing or payroll taxes.

Without it, the deficit for 2017, before the museum shifted $1,272,558 from its endowment, would have been $811,145.

"You can get into philosophical debates about depreciation," Bayne said. "Fundamentally, you can't not spend anything on your building and facilities and capital expenses over time, so you have to be reinvesting close to $500,000 — or what that depreciation represents — back into the business."

"So, your challenge is definitely bigger than $800,000 a year, though maybe it's not as high as the $1.3 million a year. You can say it falls between those numbers," he said.

The draw from the endowment was not sustainable, Bayne said, echoing museum statements over the past year.

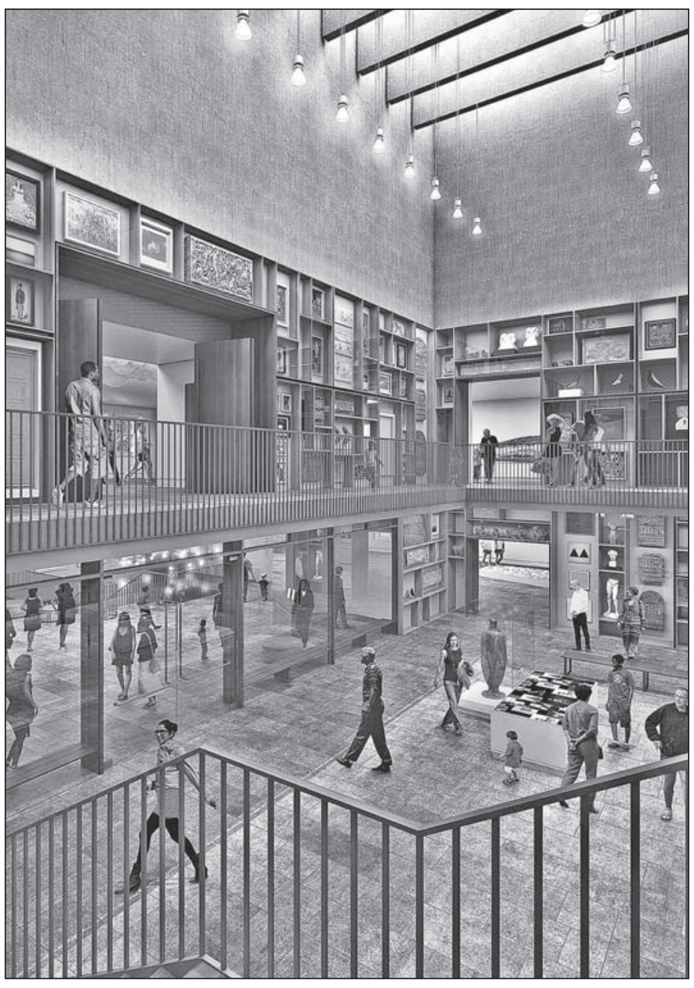

IMAGE BY ARCADE ARCHITECTS PROVIDED BY THE BERKSHIRE MUSEUM

An image of the planned new atrium of the Berkshire Museum in Pittsfield, as envisioned by Arcade Architects. The atrium would replace the museum's auditorium and Crane Room.

The museum shifted $659,298 from its endowment in 2017 to cover operating costs, and even more the previous year — $797,259, according to its financial statements.

Bayne said trustees spent time with staff examining whether it could find new sources of income or reduce expenses. "There's not the level of opportunity in those two lines that can make us sustainable," he said. That conclusion led trustees to pursue art sales, over initial objections on the board, including a vow from Elizabeth McGraw, the panel's president, that she would quit rather than orchestrate a deaccession.

McGraw said in an earlier interview that, in time, she changed her mind.

On the revenue side, a few factors contributed to creating the financial hole.

Support from foundations and corporations dropped by $57,983 in 2017, to a total of $373,263, a decline of 13.4 percent from the year before.

The museum's annual appeal also flagged, falling $52,284, to a total of $76,284, a drop of 40.5 percent. Other contributions rose about $10,000.

Those elements fall under "contributed" income. As for money the museum took in through its programming, things were a bit brighter, rising $17,000, or 3.8 percent, from the $440,394 it took in during 2016.

The museum's IRS Form 990 for the fiscal year ending June 30, 2017, tallies things differently. It states total revenues of $2,358,252, with expenses of $3,117,319. In that accounting, the museum came up short by $759,067, closer to the actual "cash" shortfall that would be shown in the audited statements without the depreciation expense.

TRACKING EXPENSES

On the expense side, the numbers related to museum operations — that is, covering the cost of mounting programs, paying salaries and fundraising bills — were about the same in 2016 and 2017.

One growing cost, though, was related to the museum's master plan, listed in the audited statements as "strategic planning expense." That came to $266,943 for 2017 and $142,006 for 2016, adding up to a two-year total of $408,949.

Not all of that resulted in a higher budget gap, according to the audited statements. The museum lists two grants that it applied to the master plan project totaling $257,567 over two years.

The museum's IRS Form 990 for 2017 digs a bit deeper into where it spent money.

Work on the New Vision triggered payments of $193,283 to TDC, a Boston consultant that helped trustees shape their master plan, including sessions held during retreats.

The IRS form also required the museum to state "business transactions involving interested persons." That phrase refers to business dealings with insiders.

For 2017, the museum paid $115,171 to Hill Engineers, Architects, Planners Inc. of Dalton for engineering work. Trustee Jeffrey Noble is the company's president. The year before, it paid $1,428 for those services, according to the audited statements. From 2011 to 2015, earlier filings show, Noble's company was paid a total of $578,000.

Elsewhere, the IRS form shows legal expenses for the year of $1,900. The audited statements offer a different total in connection with "related party" dealings. Note 17 says the museum incurred expenses from two firms that employed one of its trustees, for total of $3,575 in 2017 and $725 in 2016. That trustee is identified in Form PC as Ethan Klepetar, now the board's vice president.

NEW LEGAL COSTS

Four months after the 2017 fiscal year closed, the museum was named in the first of two civil lawsuits opposing the art sales. Trustees have declined to say how they are paying legal bills from WilmerHale, which successfully defended against the suits in three courts. Oral arguments are expected soon in a remaining appeals court case.

William F. Lee, a WilmerHale partner, said in a May 31 letter to Healey's office that the $47 million it took in from the sales in April and May was a net amount minus legal costs.

If those costs include his firm's billings, the amount paid for legal representation might not ever be publicly known.

The federal tax form requires the museum to recap its public support, a figure meant, in part, to justify its tax-exempt status. Over the past five years, the amounts taken in through gifts, grants, contributions and membership fees have bumped around, but landed with a total of $8,935,725.

For 2017, public support added up to $968,821, down 44.1 percent from the year before, and 67.9 percent less than 2014, the year with the highest total of public support.

Critics of the art sales have questioned whether the museum eased off on fundraising to exacerbate a budget problem. The museum's lead development staffer, Laurie Werner, was dismissed in early 2016 and a campaign was put on hold.

The museum says its general fundraising appeals continue. Trustees said in a May 31 open letter that they plan to restart a capital campaign in 2019 after completing plans for renovations related to the New Vision.

"It's part of what makes the museum the museum," Bayne said of fundraising. "We continue to do fundraising today and continue to fundraise through this process. We continue to have very strong support with our operational fundraising, which is a great sign for us."

The audited financial statements offer a tally of all monies held in endowments. While the value at the end of fiscal 2017 came to $14,690,923, a significant portion, $6,077,438, is held in the Keep Crane Fund. That money can only be used for the "enhancement, care, preservation and protection of collections," according to the auditors.

That still left $8,613,485 in unrestricted endowment money. One endowment account, known as the Annual Operations Fund, the auditors reported, "was exhausted" during the 2017 fiscal year — and shows up as a blank at year's end, erasing the $534,749 value posted for 2016.

Bayne said that the credit line debt of about $1.8 million — later wiped out with sale proceeds — meant trustees had fewer resources than the $8.6 million figure suggests.

MONEY MOVES

Windfall in hand, the museum has worked out special deals with banks for short-term deposits as the board prepares to roll out a longer investment strategy.

Along with the $47 million taken in so far, the museum anticipates receiving $8 million from the sale of additional works, all of them listed among the 40 pieces decommissioned last July.

"We'd like to begin the process as soon as possible," Christopher, the board trustee and Finance Committee member, said of those investments. He said that once a plan is set, it could take two to four months to shift from short-term deposits to more lucrative placements.

But first, trustees will get expert help.

Bayne said the museum is moving to hire an independent financial expert to advise them on picking money managers.

The museum's initial goal is to find investments that will return at least 4.5 percent in earnings. That is the figure trustees used to calculate how much they needed to raise from an enhanced endowment to cover shortfalls, Bayne said.

The museum's agreement with Healey's office calls for $40 million in art sale proceeds to flow into the endowment.

One of the hired expert's assignments will be to test the museum's assumption on what it can earn on the new endowment principal.

Documents show that the museum traditionally has split its investments between stocks (about two-thirds) and bonds.

Bayne said the adviser will provide guidance on whether that makes sense.

"We don't know yet what we'll target. We'll get some expertise in that field to advise us as to best way to invest," he said in a recent conference call with The Eagle and Christopher. "We don't know yet."

OUTSIDE REVIEW

In an analysis he did last year after reviewing more than a decade of Berkshire Museum finances, Sheppard, the Williams College economist and expert in nonprofits, questioned the museum's claims about the size of a structural deficit and its claims that it needed as much as $60 million in new resources.

Sheppard, like Walker of the Massachusetts Cultural Council, concluded that the museum could fix its finances with less.

He still feels that way.

"The $47 million they have realized from the sales so far is more than enough to sustain the museum and keep its doors open," Sheppard said by email from Russia, where he was traveling. He reviewed the 2017 financial statements and IRS Form 990 at The Eagle's request.

"It might not be enough to hire some new consultants, hold more retreats for the board, make field trips to visit other little museums in the region, and remodel the building with new exhibits," Sheppard said.

"But the $47 million should, if properly managed, produce well over $2 million per year in endowment earnings. This would more than cover the claimed $1.15 million 'structural deficit' which was already exaggerated. Declaring the existential crisis solved and suspending any future art sales would go a long way towards the 'healing' that the museum says is now a top priority," Sheppard said.

Sheppard also picked apart the museum's claims about a "structural deficit."

He observed that the new audited financial statements incorporate a line he felt was missing in earlier statements, but used by the same accounting firm in reports about the Clark Art Institute.

The 2017 statement includes, on Page 5, the value of "investment support for operating activities." That sum comes to $1.2 million. The same page includes a comparative figure for 2016 of $755,255.

Without adding that line, Sheppard said, earnings drawn from the beefed-up endowment would not "solve" the deficit issue.

"Now they have added a new line to the budget … where these earnings can be entered to demonstrate how the sale 'saved' the Museum," Sheppard said.

Sheppard also said, as he did in last year's report, that the museum should reconsider how it is managing long-term investments, looking for ways to increase the yield.

"This will be increasingly important as the endowment grows," Sheppard wrote in a paper posted to the Center for Creative Community Development website. While cautioning that he did not do an in-depth study, he said it appeared that the museum was losing out with "an average return that is substantially less than could be achieved by investing in a simple portfolio of [Standard & Poor's] 500 index funds. It is an unfortunately common mistake of institutions who have modest endowments to place those funds with active managers who then proceed to underperform broad market indices."

NEW BIDS

The museum's new financial consultant will be hired through a competitive bid, Bayne said.

"I think it's instrumental that we have a competitive process for choosing advisers to support us on this," he said.

That spirit of open competition also will apply to work on the New Vision itself. In a May 2 letter, Healey's office asked the museum to report on how it is working to resolve possible internal conflicts of interest.

In a May 31 letter back, Lee, the museum's lead lawyer, said the museum would prepare a new request for proposals for architectural and engineering work. It's unclear if that means designs and plans the museum paid nearly $340,000 for in 2017 now lack value.

The new request for proposals is expected late this year, Lee said, when the museum has hired a business planning consultant and firmed up its timeline for construction.

Van Shields, the executive director who led staff preparations for the New Vision, left his job June 28. He has been replaced on an interim basis by David W. Ellis of Cambridge.

Shields was paid a salary of $138,571 in 2017, along with $1,692 in other compensation, according to the IRS form.

The museum said Shields decided to retire. A spokeswoman declined to say whether he received financial incentives to retire, but any such lump-sum payments should show up in a future Form 990.

The museum recently switched to a calendar fiscal year, meaning it is now halfway through its 2018 fiscal year. Its next Form 990 filing would be due in about a year.

The museum is earning more than standard passbook interest rates on the short-term deposits.

Christopher said investors with significant cash can negotiate better rates. The museum asked several local banks to bid on what they would be willing to pay and selected institutions.

"Because of the significance of the amount of money," Christopher said. "But we can't lock it in there because we have other plans for that money. So, it's very, very short-term investments."

As it lays the groundwork for getting the most out of its new money, the museum is tending to practices that came in for criticism from Healey's office during its investigation.

In his May 31 letter to Healey's office, Lee, the museum lawyer, said it is revising how it purchases goods and services, guided by a new financial governance subcommittee.

It is setting rules on when it should seek competitive bids, all part of an effort, Bayne said, to make sure its financial practices are sound.

"We think we have strong controls … but we're not so arrogant to think that we have the best controls in the world or are the best in class," he said. "So, we want to take this opportunity, at this inflection point to the museum, to be more aggressive at going out and benchmarking others and trying to learn from other institutions what we may be able to improve on. Just seeing what we might be able to do better."

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Berkshire Museum finances by the numbers

The following data are drawn from the Berkshire Museum's IRS Form 990 filing and its audited financial statements for the fiscal year that ended June 30, 2017, as well as its Form PC filing to Massachusetts authorities:

$47,000,000: Proceeds to date from art sales. (Net after costs, including legal fees).

$1,326,210: Size of deficit in 2017, including charge of $515,065 for depreciation.

$811,145: Size of deficit 2017, without depreciation charge.

$1,272,558: Amount shifted from endowment investments to cover deficit.

$1,852,426: Line of credit debt paid off in April with art sale proceeds.

$8,613,485: Value of unrestricted endowment as of June 30, 2017.

$14,690,923: Total value as of that date, including restricted funds.

$339,582: Spending on "New Vision" "work in progress" in fiscal year 2017, for conceptual and schematic designs related to proposed renovation.

$408,949: Spending on strategic planning in 2016 and 2017.

$216,234: Amount allocated to Experience Design for New Vision architectural designs on Form PC.

$193,283: Amount allocated to TDC, Boston-based master plan consultant, in 2017 on Form 990. Note, that sum is listed as $190,620 on Form PC.

$115,171: Amount allocated to Hill Engineers, Architects, Planners Inc. of Dalton, whose president, Jeffrey Noble, sits on museum board on Form 990.

$140,263: Total compensation paid to former Executive Director Van Shields: (Form 990); Note, that compensation is listed as $141,500 on Form PC

Other top employees earned the following salaries, according to Form PC:

$77,267: Chief Support Services Officer Jon Provost.

$74,304: Chief Engagement Officer Nina Garlington (now chief of staff).

$55,710: Chief Experience Officer Craig Langlois.

$53,641: Communications Manager Leslie Beck.

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