

**Deaccessioning Proceeds:
Legal requirements, ethical responsibilities, and best practices
Legal Issues of Museum Administration 2016**

Making the Case: FASB's accounting standards should be re-aligned with AAM's long-standing guidance on the use of sale proceeds

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Summary.

For more than twenty years, the accrediting body for U.S. museums, the American Alliance of Museums (AAM)¹ has allowed proceeds from the sale of nonliving collections to be used for both acquisition and direct care,² and the collections policies of many museums have adhered to these AAM standards. However, questions have arisen concerning the possible misalignment of AAM's long-standing position on the use of such proceeds with the accounting standards promulgated by the Financial Accounting Standards Board ("FASB" or the "Board") originally in FASB *Statement 116*³ ("FASB 116") and currently found in Topic 958 "Not-for-Profit Entities" in the FASB Accounting Standard Codification (ASC), specifically section 958-360-25, and the ASC definition of "Collections" (the "Definition") (collectively "ASC 958" or "the Standard"), which provides conditions for determining when a museum need not capitalize its collections for accounting purposes.⁴ On its face, the Standard appears to suggest that if a museum does not capitalize its collections, then it may use proceeds from the sale of collection items only for new acquisitions and not for direct care. At least three museum experts have agreed with this surface reading.⁵

However, a holistic reading of the Standard and consideration of its history and overall purposes suggest, instead, the following:

- 1) FASB 116's drafters intentionally aligned the Standard with AAM's contemporary standards and best practices, as embodied in AAM's then-current *Code of Ethics*, but subsequent policy revisions by AAM have resulted in a misalignment between FASB and the museum field which bears correcting; and
- 2) Direct care is consistent with a holistic reading of the Definition and the Standard's overall purpose to provide conditions that demonstrate museum collections can and will be maintained and are held in furtherance of public service rather than financial gain.

Therefore, the Definition should be revised to bring its language back into alignment with

AAM's standards—allowing use of proceeds from the sale of collections to be used for both acquisition and direct care—as this is consistent with its drafters' intent, the Standard's purpose, and the museum field's ethics, best practices, and expectations.

Discussion.

In his 2006 book on collections management policies, *Things Great and Small*, John E. Simmons writes:

The museum's use of funds gained from deaccessioning will determine whether it must capitalize its collections (i.e., assign a monetary value to all the collections and report that value as capital assets on the institution's financial documents). Statement 116 of the Financial Accounting Standards Board (FASB) specifies that if deaccession proceeds are used for anything *except* the acquisition of new collections, the museum is required to capitalize its collections or risk a qualified audit^{6,7}

Similarly, in 2007, Julie Hart, then AAM's Assistant Director of Accreditation, wrote in handouts for the one day seminar, "Legal, Ethical and Professional Guidelines for Collections Stewardship," that, for museums that choose not to capitalize their collections, FASB 116 requires that proceeds from sales of collection items must be subject to an organizational policy requiring proceeds be used *only* to acquire other collection items.⁸ Hart went on to explain, "In other words, if you do not capitalize, your collections management policy cannot say proceeds can be used for direct care or maintenance or preservation, etc. – only acquisitions."⁹

At issue is whether the requirement that limits museums that do not capitalize their collections to using proceeds from the sale of collections only for the acquisition of new collections is as absolute as Hart and Simmons state. A careful reading of FASB 116's history and language shows that it is not. Additionally, reading the Standard in such a strict manner creates a disconnect between accounting standards and museum best practices—a problem for museums that FASB did not intend. Considering FASB's current work on revising other portions of its standards and AAM's forthcoming guidelines on direct care, this is an opportune time to revisit this issue and to encourage the Board to realign the Standard with long-standing museum best practices.

- 1) FASB 116's drafters intentionally aligned FASB 116 with AAM's contemporary standards and best practices, as embodied in AAM's then-current *Code of Ethics*, but subsequent policy revisions by AAM have resulted in a misalignment between FASB and the museum field which bears correcting.**

FASB 116's purpose was to distinguish assets held for financial gain, which must be capitalized, from "collections" which are objects "held for public exhibition, education, or research in furtherance of public service" and need not be capitalized.¹⁰ In order to make this distinction, the accountants at FASB looked to the museum field itself as the expert, relying on AAM policies to ascertain what conditions would demonstrate a commitment to

maintain collections. As FASB 116's "Basis for Conclusions" states:

This Statement's definition of a collection is based on the American Association of Museums' *Code of Ethics for Museums* (1991) and its "Accreditation: Self-Study" (1989). *The definitions in those documents are widely used by the kinds of organizations for which the Board believes the relevant cost and benefit problem exists.* The Board decided that having an organizational policy that requires that the proceeds from collection items sold be used to acquire other items for collections demonstrates a commitment and a probability that the collections will and can be maintained. The Board believes that commitment is particularly relevant to its considerations about both the benefits and costs of providing information about those assets.¹¹

AAM's policy documents, particularly its *Code of Ethics*, was (and remains) an appropriate basis for FASB's criteria. AAM represents all¹² of the many and varied institutions in the American museum field—zoos, science museums, planetaria, natural history museums, historical houses and museums, children's museums, botanical gardens, art museums, and aquaria—each of which have different collections and concerns, but all of which look to AAM's *Code of Ethics* as a source of best practices and professional expectations. Additionally, some types of institutions have more logistical difficulties with capitalization than others. While capitalization of its collection may be neither desirable nor appropriate, it is at least generally possible for an art museum, which may have thousands of objects with ascertainable fair market values; however, capitalization of, for example, a natural history museum's collection of tens of millions of specimens is nearly impossible, as many of its objects (jars of mites, study skins of endangered species, fossils excavated from government lands, bird nests, etc.) have no intrinsic fair market value or cannot be legitimately sold on the open market. FASB was promulgating one standard for the entire, diverse museum field, and so it looked to AAM because AAM's policies took this diversity into account and were widely accepted in the field as an authority.

FASB 116 was published in 1993, and, as noted above, it specifically relied on the then-current 1991 AAM *Code of Ethics for Museums*, which restricted the use of proceeds from the sale of collections to the acquisition of collections.¹³ However, a year later, in response to strong push back from museum professionals, AAM modified its ethics code in 1994 to allow such proceeds to be used for direct care as well as acquisition:

Disposal of collections through sale, trade or research activities is solely for the advancement of the museum's mission. Proceeds from the sale of nonliving collections are to be used consistent with the established standards of the museum's discipline, but in no event shall they be used for anything other than acquisition or direct care of collections.¹⁴

Had FASB promulgated FASB 116 two years later, it is quite probable that it would have followed AAM's policies and included direct care, as well as acquisition. FASB wanted to reflect the museum field's best practices, not impose new policies where it lacked expertise,

as long as those existing practices were consonant with FASB's goals and principles.

Even though AAM has revised its ethics code since 1994 (most recently in 2000), the provision allowing direct care has not changed since 1994 and remains in effect today.¹⁵ Many museums have aligned their collections policies with this position. And, while the exact definition and boundaries of "direct care" continues to engender much discussion within the museum field, direct care is and is likely to remain widely accepted as an appropriate use of sale proceeds.¹⁶

Notably, the Association of Art Museum Directors ("AAMD") requires that proceeds from the sale of collections be used only for the acquisition of collections and not for direct care.¹⁷ AAMD's *Policy on Deaccessioning* provides extensive criteria and sound rationales for deaccessioning for the health of a museum's collection, but it, somewhat strangely, offers no such discussion of its limitation on the use of sale proceeds to acquisitions only.¹⁸ The policy does, however, specifically reference and incorporate the language of FASB 116, which may be the origin of AAMD's limitations on the uses of sale proceeds.¹⁹ Thus, AAMD's deaccessioning policy relied on FASB 116, which, in turn, had relied on AAM's 1991 *Code of Ethics*, even though the Standard was already misaligned with the museum field's standards with regard to direct care as a suitable use of sale proceeds. AAMD may have valid reasons for requiring its members to use proceeds from the sale of collections only for new acquisitions, but the Standard should not be the foundational justification for such a stricture. Rather, AAMD should articulate its policies regarding the use of sales proceeds based on its expertise and its sound ethical and museological rationales, not accounting standards.²⁰

FASB drew from contemporary AAM standards in 1993, explicitly adopting AAM's position on the disposition of proceeds.²¹ FASB should continue to rely on AAM's policies as the authority for museum best practices for the wider museum field. The Standard was properly aligned with the state of the field in 1993, but it has failed to evolve. Direct care has been entrenched in AAM policy for more than twenty years because AAM and the museum professionals it represents have recognized that direct care is necessary for the preservation of a collection in perpetuity. Revising the Standard to allow for both acquisition and direct care would bring it back into alignment with long-standing AAM policy and the expectations of the many museums that adhere to these best practices.

2) Direct care is consistent with a holistic reading of the Definition and the Standard's overall purpose to provide conditions that demonstrate collections can and will be maintained and are held in furtherance of public service rather than financial gain.

Bringing the Standard back into alignment with AAM's current *Code of Ethics* and best practices by revising part (c) of the Definition to explicitly include direct care A) is consistent with a holistic reading of the Definition; B) promotes FASB's collections maintenance and reinvestment goals; and C) addresses FASB's concerns about financial gain.

A) *A holistic reading of the Definition supports the inclusion of direct care.*

FASB's definition of "Collections" referenced in ASC 958 establishes conditions under which collections need not be capitalized. These conditions are ones that demonstrate that the collections are held for the purpose of public service rather than financial gain; as FASB 116's Summary statement provides: "Contributions of works of art, historical treasures, and similar assets need not be recognized as revenues and capitalized if the donated items are added to collections held for public exhibition, education, or research in furtherance of public service rather than financial gain."²² These conditions, as stated in the Definition, are

Works of art, historical treasures, or similar assets that meet all of the following criteria:

- a. They are held for public exhibition, education, or research in furtherance of public service rather than financial gain.
- b. They are protected, kept unencumbered, cared for, and preserved.
- c. They are subject to an organizational policy that requires the proceeds of items that are sold to be used to acquire other items for collections.²³

The Standard requires that each of these three conditions be met. However, the relationship between parts (b)—requiring protection, care, and preservation of the collection—and (c)—requiring an organizational policy that requires sales proceeds to be used for acquisition—is ambiguous and, possibly, conflicting. Given that museums have limited resources, it is not in their best interests to require organizational policies that prioritize acquisitions over collections care and preservation. Allowing use of proceeds for direct care specifically satisfies part (b) of the Definition and resolves the potential conflict between parts (b) and (c). Further note that the organizational policy requirements of part (c) do not state that proceeds may be "used *only* to acquire other items for collections" or "the organization *may not* apply proceeds from the sale of collection items to any other purpose." The language does not explicitly exclude the use of proceeds from the sale of collection items for other activities; the expression of one acceptable use (i.e., acquisitions) does not necessarily exclude all other possible uses (e.g., direct care). A holistic reading of the Definition resolves ambiguity between the sections and is also consistent with FASB's original intent for the Standard.

FASB's original intent was not to promote new acquisitions or to prevent direct care—its intent was to distinguish between items held for financial gain and those used for public service. FASB specifically sought conditions leading to the maintenance of and reinvestment in collections, which is the essence of the mission of collections-based organizations; investment in collections and their protection, care, and preservation is at the core of direct care. An organizational policy that allows the use of proceeds from sales of collection items for both direct care and acquisition should fall within a broader reading of ASC 958 that is inclusive of Definition conditions (a), (b), and (c). Such a reading is appropriate given the Definition's language and construction and is consonant with the overall goals of the Standard and with the interrelated history of FASB 116 and AAM's *Code of Ethics*.

B) *Inclusion of direct care promotes FASB's collections maintenance and reinvestment goals.*

Again, FASB's main goal is to distinguish assets held for gain from collections held for public service. FASB finds collections maintenance and reinvestment to be particularly relevant in determining whether a collection should be capitalized. It explains that

The Board decided that having an organizational policy that requires that the proceeds from collection items sold be used to acquire other items for collections demonstrates a commitment and a probability that *the collection will and can be maintained*. The Board believes *that commitment is particularly relevant* to its considerations about both the benefits and costs of providing information about those assets.²⁴

And, in specifically discussing the non-capitalization conditions contained in paragraph 11(c) of FASB 116, it states that

Some museums that endorse the provisions of paragraph 11(a) and (b) but are not committed to reinvesting proceeds for sales of collection items to acquire other items for collections (paragraph 11(c)) asked the Board to allow nonrecognition of their collection items. *Having an organization policy and demonstrated commitment to reinvest in collection items is particularly relevant to the Board's conclusions about collection assets.*²⁵

These statements demonstrate FASB's goal of promoting reinvestment in and maintenance of collections, both as a whole and in the items that make up those collections. However, expanding a collection through acquisitions is only one way in which museums maintain and reinvest in their collection; the other is to engage in the direct care of existing collections, which is reinvestment in individual collections items. Being limited only to expansion through acquisition may actually make it more difficult for an organization to properly maintain its collection, stretching resources for care and conservation ever thinner. Acquisition *and* direct care are appropriate, complimentary means of reinvesting in collections. A broader, holistic reading of the Standard (or the explicit inclusion of direct care in the Definition) would allow museums to choose between acquisition or direct care or pursue both, depending on their specific and evolving collection maintenance needs.

C) *Inclusion of direct care addresses concerns about financial gain.*

FASB is firm in its belief that collections items are assets, which normally should be capitalized.²⁶ But it allows an exception for collections items held "in furtherance of public service rather than financial gain."²⁷ Allowing use of proceeds from the sale of collections for direct care would not run afoul of this concern. The reinvestment of proceeds into direct collections care, like the reinvestment of proceeds into an acquisition fund, does not lead to "financial gain" by the institution. Rather, investment in collections care allows for the furtherance of public service by ensuring that collections items are accessible to the public and preserved for generations to come.

Conclusion.

To distinguish between assets that must be capitalized and collections that need not be, the Board sought evidence demonstrating a commitment and probability that a museum's collections can and will be maintained in furtherance of public service. Museum policies that adhere to AAM's current *Code of Ethics* can and do demonstrate such a commitment; FASB's Standard should be realigned with this long-standing best practice. Specifically, part (c) of FASB's definition of "Collections" should be revised as follows: "c. They are subject to an organizational policy that requires proceeds of items that are sold to be used only for direct care or to acquire other items for collections."

Revising the Definition to specifically state that proceeds from the sale of collections may be used for both acquisitions and direct care would bring FASB's Standard back into alignment with current, long-standing AAM standards and best practices and with expectations common in the museum field. Moreover, inclusion of direct care is consistent with ASC 958's intent and overall purpose because it promotes FASB's goal of ensuring collections are protected, unencumbered, preserved, and cared for in furtherance of public service, encourages reinvestment in and maintenance of existing collections as an alternative and compliment to collections growth, and preserves FASB's prohibition on using non-capitalized collections for financial gain.

¹ Formerly the American Association of Museums.

² *Code of Ethics for Museums*, AM. ALLIANCE OF MUSEUMS (adopted 1991, revised 1994 and 2000), <http://www.aam-us.org/resources/ethics-standards-and-best-practices/code-of-ethics-for-museums>.

³ *Accounting for Contributions Made and Contributions Received*, Statement of Financial Accounting Standards No. 116, FIN. ACCOUNTING STANDARDS BD. (June 1993) available at http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1218220128831&acceptedDisclaimer=true.

⁴ FASB reorganized all of its existing accounting standards into the Accounting Standards Codification (ASC) in 2009, in order to consolidate its standards and make them more easily accessible. All standards specifically for not-for-profit organizations are now contained in Topic 958. While the ASC superseded FASB's previous Statements, including FASB 116, the substance of FASB 116 was not changed. We will refer to the Standard as "FASB 116" when discussing the Standard's history, original promulgation, and its accompanying material, such as its "Basis for Conclusions."

⁵ See Marie C. Malaro & Ildiko Pagany DeAngelis, *A LEGAL PRIMER ON MANAGING MUSEUM COLLECTIONS*, 264-65 (3d ed. 2012); Julie Hart, *An Overview of Field Wide Guidelines on Deaccessioning*, LEGAL, ETHICAL AND PROFESSIONAL GUIDELINES FOR COLLECTIONS STEWARDSHIP SEMINAR (March 13, 2007), <http://southphillyblocks.org/pacscl/docs/deaccession/JulieHartFieldwideGuidelines.pdf>; John E. Simmons, *THINGS GREAT AND SMALL* 56 (2006).

⁶ FASB does not take any enforcement action with regard to its standards. However, if an auditor finds a museum to be in material violation of accounting standards, he or she may issue a qualified audit report. A qualified audit may have a number of financial ramifications, such as compromising an institution's eligibility for competitive grants, damaging its credit rating, or placing it in violation of bond covenants. To the best of the authors' knowledge, no museum has ever received a qualified audit for utilizing deaccession proceeds for direct care; however, several museums have been sanctioned by the Association of Art Museum Directors (AAMD) for such use, including the Delaware Art Museum (sanctions ongoing), *Association of Art Museum Directors Sanctions Delaware Art Museum*, ASS'N. ART MUSEUM DIRS. (June 18, 2014), <https://aamd.org/for-the-media/press-release/association-of-art-museum-directors-sanctions-delaware-art-museum>; Randolph

College's Maier Museum of Art (sanctions ongoing), *Association of Art Museum Directors' Statement on Randolph College and Maier Museum of Art*, ASS'N. ART MUSEUM DIRS. (March 12, 2014), <https://aamd.org/for-the-media/press-release/association-of-art-museum-directors-statement-on-randolph-college-and>); and the National Academy Museum (sanctions suspended), Robin Pogrebin, *Sanctions Are Ending For Museum*, N.Y. TIMES, (Oct. 18, 2010) http://www.nytimes.com/2010/10/19/arts/design/19sanctions.html?_r=0.

⁷ Simmons, *supra* note 5 at 56 (emphasis added).

⁸ Hart, *supra* note 5.

⁹ *Id.*

¹⁰ FASB 116, *supra* note 3 at 4; *see also* ASC Master Glossary, "Collections" and ASC 958-360-25.

¹¹ FASB 116, *supra* note 3 at 37 (emphasis added).

¹² As compared to the AAMD, which limits membership to the directors of art museums meeting certain criteria. AAMD has promulgated its own *Code of Ethics for Museum Directors* and standards and best practices, but these are specific to art museum and AAMD's reach does not extend nearly as far as that of AAM: as of early 2016, AAMD has 242 members, while AAM has accredited 1,054 organizations and claims more than 30,000 individual, institutional, and corporate members. *See Membership*, ASS'N OF ART MUSEUM DIRS. (last visited Feb. 24, 2016), <https://www.aamd.org/about/membership>; *The Alliance Announces Five Newly Accredited Museums and Six Museums Re-Accredited*, AM. ALLIANCE OF MUSEUMS (Nov. 19, 2015), <http://www.aam-us.org/about-us/media-room/2015/the-alliance-announces-five-newly-accredited-museums-and-six-museums-re-accredited>.

¹³ FASB 116, *supra* note 3 at 37.

¹⁴ *Code of Ethics for Museums*, AM. ALLIANCE OF MUSEUMS (1994).

¹⁵ Compare *Code of Ethics* (1994), *Id.* with *Code of Ethics* (2000), *supra* note 2.

¹⁶ Since May 2014, AAM's Direct Care Task Force has engaged in a project to provide "clarity on the use of deaccessioning proceeds, specifically on what is generally accepted as a definition of direct care." The Task Force plans to issue a white paper before AAM's 2016 annual meeting. AAM's intent is not to move away from direct care, but rather to provide guidance as to the meaning and scope of direct care. AAM anticipates that the white paper will clarify the ethical issues surrounding the topic of direct care and provide guidance for museums in their decision-making. *See generally Task Force on Direct Care*, AM. ALLIANCE OF MUSEUMS (last visited Jan. 7, 2016), http://aam-us.org/resources/ethics-standards-and-best-practices/direct-care-task-force?utm_source=MagnetMail&utm_medium=Email&utm_campaign=Direct%20Care%20Survey%20Now%20Open.

¹⁷ *AAMD Policy on Deaccessioning*, ASS'N OF ART MUSEUM DIRS. (2010), <https://aamd.org/standards-and-practices> (interestingly, AAMD specifically refers to FASB 116, not the ASC). However, the other major national museum association, the American Association for State and Local History (AASLH), like AAM, allows deaccession proceeds to be used for collections care, stating "[h]istorical resources shall not be capitalized or treated as financial assets," and "[c]ollections shall not be deaccessioned or disposed of in order to provide financial support for institutional operations, facilities maintenance or any reason other than preservation or acquisition of collections, as defined by institutional policy." *Statement of Professional Standards and Ethics*, AM. ASS'N OF STATE & LOCAL HISTORY (June 2012), https://docs.google.com/viewerng/viewer?url=http://download.aaslh.org/AASLH-Website-Resources/AASLHProfessionalStandardsandEthicsStatement.pdf&hl=en_US.

¹⁸ *See AAMD Policy on Deaccessioning*, *supra* note 17. Compare the policy's Preamble and section II, both discussing reasons underpinning and criteria for deaccessioning decisions with the two sentences of section I(B) limiting use of sale proceeds to acquisitions of works. Nor is a discussion or explanation of this limitation offered in AAMD's *Code of Ethics for Museum Directors* (revised 2011) or its *Professional Practices in Art Museums* (2011), both available at <https://aamd.org/standards-and-practices#>.

¹⁹ *AAMD Policy on Deaccessioning*, *supra* note 17 at 3, ¶D.

²⁰ For example, the National Trust for Historic Preservation thoroughly discussed its rationale for the use of proceeds from the disposition of collections objects for direct care as when it proposed to modify its collections management policy to allow for the accessioning of historic structures and landscapes. *When Buildings and Landscapes are the Collection*, NAT'L TRUST FOR HISTORIC PRES. (Aug. 19, 2014), <http://blog.preservationleadershipforum.org/2014/08/19/collections-enhanced-content/#.VstikCmLRak>. Additionally, the AASLH has promulgated a thorough and persuasive position paper regarding the impropriety of capitalizing museum collections. *Ethics Position Paper #1: The Capitalization of Collections*, AM.

ASS'N OF STATE & LOCAL HISTORY (June 2003), <http://resource.aaslh.org/view/ethics-position-paper-1-the-capitalization-of-collections/>.

²¹ FASB 116, *supra* note 3 at 37.

²² *Id.* at 4. *See also* ASC 958-360-25-1 (“[A] not-for-profit entity (NFP) need not recognize contributions of works of art, historical treasures, and similar assets if the donated items are added to collections.”); ASC 958-360-25-2 (“Works of art, historical treasures, and similar items that are not part of a collection shall be recognized as assets in financial statements.”); and ASC 958-360-25-3 (“An NFP that holds works of art, historical treasures, and similar items that meet the definition of a collection has the following three alternative policies for reporting that collection: a. Capitalization of all collections items[;] b. Capitalization of all collections items on a prospective basis (that is, all items acquired after a stated date)[;] c. No capitalization.”).

²³ ASC Master Glossary, “Collections.” This definition is, nearly verbatim (with only minor grammatical changes), the conditions for non-capitalization stated in paragraph 11 of FASB 116. *See* FASB 116, *supra* note 3 at 7.

²⁴ FASB 116, *supra* note 3 at 37 (emphasis added).

²⁵ *Id.* at 42 (emphasis added). Again, note that using proceeds from the sale of collections for activities other than acquisition is not explicitly foreclosed.

²⁶ *Id.* at 37-38; *see also* ASC 958-360-25.

²⁷ ASC Master Glossary, “Collections.”