Dear Technical Director:

The Association of Art Museum Directors (“AAMD”) understands that the Financial Accounting Standards Board (“FASB”) is considering an amendment to Topic 958 whereby the definition of “collections” as used therein would be changed to conform to the American Alliance of Museums (“AAM”) Code of Ethics, thereby allowing an additional exemption for the use of funds derived from the sale of collection items for costs related to the “direct care” of collections. The AAMD represents 220 art museums nationwide, including large, small, university-based and encyclopedic institutions. By way of background to these comments, the AAMD acts as a spokesperson specifically for art museums, while the AAM represents all manner of museums, including zoos, aquariums, children’s museums, historical houses, botanical gardens and art museums.

In its request for comments, FASB has posed four questions, as follows:

- **Question 1:** Should the definition of the term collections include the concept of direct care? If not, why not?
- **Question 2:** Should there be a requirement to disclose an entity’s policy for use of proceeds from deaccession to collections? If not, why not?
- **Question 3:** Would the proposed transition requirement of prospective application with retrospective application permitted be operable and would it
provide decision-useful information? If not, please explain why and what you would recommend.

- **Question 4:** Should the effective date of the proposed amendment be upon issuance of a final Update? If not, why not?

I. **Summary**

While the undefined term “direct care” may be appropriate in the AAM context due to its inclusion in an ethical standard, the accounting context requires a clear definition of “direct care” to ensure that organizations fully understand what funds fall under such a term. We hope to make clear why this is the case by examining the following: (i) how “direct care” came to be used as a broad concept open to interpretation in the AAM context, (ii) why this type of usage would be inappropriate in the FASB context and (iii) how a clear definition of “direct care” would effectively harmonize the AAM and FASB standards while still providing the consistency necessary in the FASB context.

II. **Question 1: Should the definition of the term collections include the concept of direct care? If not, why not?**

The AAMD has significant concerns with the very concept of broadening the term “collections” to include direct care, but has particular concerns if that term is adopted without definition.

A. **“Direct Care” in the AAM Context**

In 1991, the AAM adopted a version of its Code of Ethics that restricted “the use of proceeds from the sale of collection materials…to the acquisition of collections.” After further consultation with the museum community, it revised this provision in 1993 to the current formulation, which states that the proceeds may only be used for the “acquisition or direct care of collections.” Since that time, the museum community has struggled to interpret uniformly the “direct care” standard. In response, the AAM issued a white paper in April 2016 in which the
group attempted to clarify the meaning of “direct care.” The AAM admitted that “because that term has never been defined or clarified, museums lack guidance in their decision-making and, consequently, standards often are applied inconsistently.” The white paper is instructive in explaining why direct care was included in the AAM standard and how the language might be interpreted by the museum community.

The AAM makes clear that it did not intend the phrase to capture proceeds “used as a substitute for fiscal responsibility.” The AAM emphasizes that “museum collections are considered cultural – not financial – assets, to be held for the public benefit.” The AAM also highlights the policy of the Association of Art Museum Directors (“AAMD”), which does not permit any “direct care” expenses and states that funds received from a deaccessioned work “shall not be used for operations or capital expenses. Such funds, including any earnings and appreciation thereon, may be used only for the acquisition of works of art in a manner consistent with the museum’s policy on the use of restricted acquisition funds.”

While the AAM white paper states that it did not intend the “direct care” standard to cover operating expenses, the white paper demonstrates the difficulty in differentiating between costs that should fall into the “direct care” basket and costs that should fall into the operating or capital costs baskets. AAM guidance on this point states that “direct care” costs are those used to “invest in the existing collections by enhancing their life, usefulness or quality and thereby ensuring they will continue to benefit the public.” This vague language does not allow the museum community to make simple, straight-forward decisions on this point. The AAM acknowledges this issue and asks each museum to create its own guidelines on how “direct care” should be utilized in the deaccession context (“Use of funds for some purposes seems more or
less acceptable as a ‘direct care’ depending upon a museum’s mission, discipline and specific circumstances”).

Instead of providing bright-line rules on this point, the AAM opted for a more flexible approach in which institutions can, within very wide parameters, make their own ethical decisions. In its white paper, the AAM provided the museum community with certain tools, including a matrix and guiding questions, but left the decision-making to the individual museums. Some examples of these guidelines include asking whether the decision to use funds is based on an institutional plan, whether the use of funds will improve the physical condition of an item and whether the decision can be clearly explained to stakeholders and the public. From this approach, one can only conclude that the AAM views the “direct care” issue as a purely ethical one in which museums must take many factors into account and arrive at a decision in line with their internal policies. Furthermore, the AAM white paper implicitly acknowledges that the concept of “direct care” is difficult of precise definition.

B. The AAM “Direct Care” Standard in the FASB Context

When FASB last considered its rules on the capitalization of museum collections, the museum community strongly argued that valuations would be highly onerous and, regardless of this fact, collections should not be considered financial assets as any proceeds from the deaccessioning of an item from a collection should only be used to obtain other items for such collection. Based on this understanding, FASB adopted its current rule in June 1993, which exempts items “subject to an organizational policy that requires the proceeds of items that are sold to be used to acquire other items for collections” from the requirement to be recognized as assets in an entity’s financial statements. The test was simple and objective (as accounting standards should be).
The current rule is an exception to an otherwise clear mandate – capital assets are to be listed on the balance sheet. At the same time, operating expenses are reflected in the income statement. To the viewer of a museum’s financial statements, there is a clear understanding that collections are not on the balance sheet because the proceeds of their sale are not used for operations. If the “direct care” standard currently utilized by the AAM is adopted by FASB, thereby creating a new and undefined exception to an existing exception, readers of financial statements will no longer be able to conclude that collections do not support operations. Only the most careful reader would be able to tell when sale proceeds are diverted for operations pursuant to a loose interpretation of the AAM “direct care” standard. Effectively, by adopting the AAM standard wholesale, FASB would abdicate its rulemaking to the individual entity that is empowered to make independent decisions on whether or not to report certain items as financial costs. By doing so, the very purpose of an accounting standard is frustrated.

Worse, what was an objective standard capable of review by any accountant will now become a subjective standard. The result? Either accountants will have to defer completely to how a museum interprets “direct care” pursuant to the vague AAM guidance described above or they will have to interpose their judgment as to when an expense is or is not for direct care even without any specific knowledge of a museum’s collections and operations. Either situation does not promote presentation of accurate and transparent financial statements.

Following the AAM guidelines described above, one can think of many ways where an individual entity’s decision to place some costs in the current AAM “direct care” basket would violate the spirit of the FASB rule. For example, a museum may believe that any method it employs to enhance the life of its works is direct care. It could take the stance that more conservators or a security system or a new fireproof building enhance the life of the
museum’s collection. As a result, the museum can sell a collection item or even part of a whole collection – asset(s) not on the balance sheet – and use the proceeds to pay ongoing expenses (conservators) or acquire unrelated assets (an addition or a new building). Such an application is currently feasible under the AAM standard and there is no reason to believe that it would not be utilized by entities in the FASB context if available. To the casual reader, the extent of the subsidy or the effect of selling collection items on the collection as a whole will be unknown.

In fact, in its proposal, FASB concedes that individual determinations will take place and explicitly states that “an industry should be able to determine what it considers direct care, rather than the Board determining a policy within GAAP for what constitutes direct care.” By allowing each organization to create its own definition of “direct care,” FASB will simply add to the confusion already apparent in the AAM context. The natural consequence of such a policy will result in multiple definitions of “direct care” being used inconsistently throughout the museum community. Further, museums with multiple types of collections that file financial statements on a consolidated basis will be forced to apply several different variations of the “direct care” standard. For example, a museum operating an art museum and a natural history museum will need to apply separate and distinct “direct care” standards for each museum depending on each industry’s determination and then file a consolidated financial statement that will be inconsistent on its face. Such a scenario cannot be FASB’s intention.

C. Clearly Defined Standards

While we appreciate FASB’s desire to harmonize its own standard with that of the AAM, we believe that some additional clarity on the definition of “direct care” is required in order to avoid the negative consequences set forth in this letter. On one hand, the AAM “direct care” definition and white paper provide some guidance and tools of interpretation for AAM
members to utilize as they see fit. On the other hand, the FASB “direct care” definition should require entities to report financial events in a clear, predictable and consistent manner in order to allow accountants to fulfill their role.

Taking one of the examples above, if an institution does use proceeds from a deaccessioned work for a wing or new building with all manner of modern technologies, the institution may argue that it does not run afoul of the AAM standard as this cost relates to the direct care of the collection. The AAM can then follow its own internal processes to determine whether withdrawing accreditation would be appropriate because such a use violates the AAM’s view of what is direct care. Such a process may work for an ethical standard administered by the AAM, it does not work for accountants in the field attempting to audit financial statements.

If FASB elects to adopt the modification of “direct care”, then FASB must provide a definition of what is direct care. Not to do so would lead to myriad issues, including inconsistent financial statements throughout the field, an inability to audit fairly and fully entities and potentially large variances in accounting policies and procedures, including the GAAP standard. Such outcomes cannot be what FASB intends with its proposed change.

We are happy, along with other interested entities and organizations, to discuss the approach and parameters for a proper definition of “direct care” with FASB, but we believe that simply adopting the current AAM standard without further consideration would be an error. We are also concerned that if FASB fails to adopt a definition, time will almost inevitably lead to a predictable result. Museums strapped for cash will push the envelope of “direct care” in order to shore up a shaky financial situation. There will be an outcry from the public (as there has been with institutions that have violated the existing restriction) and FASB’s solution will be to return to its originally desired position – collections should be carried on the balance sheet. For
the many institutions that will not travel the road of an expanding definition of direct care, this would be a real injustice.

III. Question 2: Should there be a requirement to disclose an entity’s policy for use of proceeds from deaccession to collections? If not, why not?

Absent an entity’s clear and transparent disclosure of its policy for use of proceeds from deaccessioned collections, those reviewing the financial statements of collecting institutions will be unable to determine how the proceeds from deaccessioned collection-items have been used. Both the source of the funds for “direct care” and their actual use will either not appear on the financial statements or will be subsumed in more generic line items, such that an institution can expend deaccessioned proceeds for operating expenses or capital improvements without ever divulging that such was done or what was the rationale for doing so. As a result, disclosing the policy is critical, but to reiterate the reasons set forth in response to Question 1, the very asking of the question by FASB points out the fallacy in an undefined direct care standard. By abdicating its role to provide clear and understandable accounting definitions, FASB is proposing to delegate that responsibility to individual institutions to develop individual policies with variants not only across disciplines, but even within disciplines, especially for those that have no clear definitions of what constitutes direct care.

IV. Question 3: Would the proposed transition requirement of prospective application with retrospective application permitted be operable and would it provide decision-useful information? If not, please explain why and what you would recommend.

The AAMD fails to see how retrospective application would provide “decision-useful information”, as this will simply be a methodology for institutions to adopt policies today in order to justify actions of the past. One can easily see an institution developing a policy to subsume prior use of deaccession funds because FASB would permit retroactive application,
thereby validating what had previously been a violation of the pre-existing FASB definition of collections.

V. **Question 4: Should the effective date of the proposed amendment be upon issuance of a final Update? If not, why not?**

The AAMD has no position with respect to the effective date of any proposed amendment.

For the reasons set forth above, the AAMD urges FASB first to delay implementation of any proposed amendment in order to allow time for discussion with relevant interest groups on a definition of direct care. Those discussions should inform FASB as to whether or not an amendment to the rule is appropriate at all, but, perhaps more importantly, to allow interested groups to assist FASB in developing a definition of direct care that would inform all collecting institutions in general and, perhaps more important, the readers of financial statements about what is and is not an acceptable definition of “collections.” The AAMD is happy to work with FASB to develop definitions if FASB elects to move forward with an amendment at all.

We hope that the above clearly shows how the proposed change would have an adverse effect on the museum community’s ability to follow the FASB standard consistently unless the proposed change is accompanied by much needed clarity on the definition of “direct care.”

Very truly yours,

Association of Art Museum Directors

By: Christine Anagnos, Executive Director