# Re-Thinking Risks:

# The Business of Museum Governance

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The past quarter-century has seen fundamental shifts in the public sector, the theoretical underpinnings of which are rooted in agency theory, market economics and the `new managerialism'. This movement has brought with it an emphasis on

- accountability, the monitoring of performance and incentives for good performance;
- separation of strategy from delivery, and a focus on management rather than policy;
- an inclination to introduce market mechanisms for delivery, including competition and contracting-out;
- responsiveness to customer preferences; and
- disaggregation of large bureaucratic structures, but with autonomy having to be earned within a framework of strong central control.

Many of these themes have followed trends in business management, mirroring the theories and fashions of the moment. The ideas of management gurus such as Michael Porter, constructed on a foundation of commercial experience, have exerted a major influence. Although the public sector has recognised the risks inherent in any commercial operation, they have received less attention than the perceived benefits of `reform'. Yet, of course, the world of commerce is hardly flawless, as the recent corporate turmoils of Enron, WorldCom and others have shown. Big-business corporate failures may appear, on first sight, to have very little to do with museum management. However, there is ample evidence that the causes of the difficulties faced by global corporations are also found in museum and heritage organisations. The purpose of this paper is to identify some of the key risks, and to suggest how they may be addressed.

## Accounting Issues

The cause of the Enron's collapse was financial misconduct, reflected by misrepresentations in the company's accounts. The public sector ethos of museums diminishes the risk of fraud for personal financial gain, but aspirations for reputation, status, achievement, influence and power can be equally-powerful drivers of deception. Indeed, a conviction that the museum's mission is of supreme importance coupled with a strong commitment to professional values and ethics can lead to an attitude that justifies false accounting, especially when coupled with a belief that, ultimately, the museum is so important that it will be rescued from any financial difficulties, so that to behave in this way carries a low level of risk.

Although the growth of international accounting standards and fund accounting in the not-for-profit sector has increased the transparency of the accounts of many museums, good practice is not universal in the sector. There have been examples during past years of the following practices in the museum sector in Europe and North America:

- inappropriate or unlawful transfers/borrowings between general and restricted/defined purpose funds to fund cashflow;

- adding the value of capital expenditure to the Balance Sheet, but applying the external grants that funded that expenditure to the revenue account, using the difference between the actual capital expenditure and the annual depreciation charge to offset operating losses;

- using the museum's collections to add value to the Balance Sheet so as to compensate for diminishing levels of current assets, or to act as collateral for current liabilities; and

- over-valuing the museum's retail stock to increase the value of current assets on the Balance Sheet to exaggerate levels of liquidity.

Just as with their commercial equivalents, none of these practices is sustainable for an extended period of time. However, delays in publishing annual accounts can hinder the comparison and trends analysis that demonstrate poor practice, and can result in a gap of up to five years before deceptions can be detected. Providing the museum can manage its cashflow in a way that avoids insolvency (and museums, especially those that are in receipt of central or local government funding, are deemed to be good risks by banks), there will be no reason for outside intervention. By the time the difficulty is recognised, the senior management that initiated this practice may have moved on, and it will be their successors who will have the difficulty of resolving matters. Trustees may also escape censure as, if they include local politicians and business people, their co-operation may be vital to the development of a rescue package to save the museum.

The requirements of the General Accepted Accounting Principles (GAAP), which guides the adoption of international accounting standards, are leading to a general requirement that the value of all assets should be recorded on Balance Sheets. This is resulting in a growing pressure for collections to be valued in museum accounts, with the implication that these are realisable to meet the museum's liabilities. This places a higher duty of care on museums to maintain the most prudent financial arrangements. The number of museums that have failed financially, and their collections sold to meet the demands of creditors, has been small, but may grow if high levels of fixed assets on the Balance Sheet encourage their use as collateral for unsustainable development projects.

## Board organisation and membership

An examination[1] of the boards of Enron, Tyco and WorldCom reveal that their boards followed most of the accepted standards: each board was neither too big nor too small, nor too old or too young, and `non-insiders' were strongly represented; their meetings were well-attended; audit and remuneration committees were in place, and codes of ethics had been adopted. They passed all the external tests that might normally be applied to board effectiveness. Yet still the quality of governance was not sufficient to ensure the interests of their owners and stakeholders.

Some would argue that museum boards (like those of other not-for-profit organisations) differ from those of their commercial counterparts. Business boards tend to be small in size - between eight and twelve members - with their non-

[1] such as in Sonnenfield (2002)

executive membership appointed for their experience in similar businesses, or knowledge of relevant technologies, or an investment banking background, or useful political contacts. Museum governing bodies tend to be larger because, besides including a range of relevant skills, they frequently feel the need to represent the many constituencies that have a stake in the organisation - benefactors, funding bodies, support groups, learned societies, education bodies, and (usually local) government. Such voices can enhance connections with, and be a source of accountability to, the communities of interest they serve.

Yet these benefits are often offset by disadvantages. In particular, when making decisions, their size reduces the likelihood of reaching a quick consensus, and there is a higher risk of potentially-damaging leaks when difficult issues or sensitive topics are discussed. Big boards can also discourage candid debate. One of the most common means of tacking these difficulties has been the creation of an `executive committee' - a small number of senior Board members - empowered to deal with business between Board meetings

Yet the whole board is responsible for the governance of the organisation, and the `executive committee' approach risks the creation of a `them and us' situation, with the executive committee members heavily involved and in the know, but the remainder of the Board uninformed and marginalised. In such a situation Board meetings can be little more than a forum where the executive committee's decisions are reported. Individual board members, museum members and other stakeholders can feel their active participation is discouraged. Both management and board may look on misgivings as threats; the louder such concerns are expressed, the greater the likelihood that those voicing them will be shut out in fear of a challenge for control. The consequence can be introversion, secrecy and distrust. This problem is exacerbated when the Board meets less than frequently, and has little opportunity to work together as a team.

Another much-used alternative has been to involve all the members of the larger board within a structure of supporting committees, each reporting to the full Board. It is argued that overseeing key development and operational areas can be a useful means of engaging Board members in a museum's work, and improving their knowledge of its activities. While all organisations of any size should have an audit committee to oversee the internal audit process and monitor the performance of the external auditors, the case for other committees is less persuasive. The benefits of increased participation can often be offset by fragmentation of effort or, unless there is regular rotation of committee membership, committee members losing their broad perspective and becoming champions for a single area of activity. In any case, the successful operation of a committee structure inevitably increases the proportion of resources deployed in administration rather than delivering programmes.

Thus the disadvantages of both executive and supporting committees will always make them second-choice to a small board. While it is possible to mitigate the disadvantages of a larger group, it is unlikely that it can ever replicate the effective working relationships that can be developed in smaller boards, leading to lower levels of risk.[2]

**External Audit**

Much of the blame for some of the big commercial catastrophes has come to rest on their external auditors, who have been treated as culpable for not having recognised

[2] For further discussion on this topic, see Babbidge (2002).

malpractice during the audit. It has become clear that the nature of the relationship between company and auditor was compromised by the other business services provided by the auditor, including provision of consultancy, other financial advice, and acting as reporting accountants.

Many museums have similar relationships with their auditors. Given that the role of auditor is as watchdog, though not as guard-dog, the wisdom of this approach must be questionable. The purpose of the external audit is to check the key figures in the accounts, the way they have been arrived at and the way they are presented, based on the information provided by their client. Their job is to test whether the accounts give a reasonable impression of the museum's financial position. In doing this they have to maintain a sense of proportion, deciding what is relevant or material to providing a true and fair view of the activities summarised in the accounts.

Changing accounting practice, together with the need to account for government funding so it matches central policy objectives makes the role of the auditor more difficult. An audit report for one department of a national government reads as follows:

> *The analysis of most of the expenditure is derived from returns from grant-receiving bodies who are required to attribute their grant expenditure across the Department's objectives. For many of these bodies, the relationship of the Department's objectives to the bodies' own objectives demands judgmental interpretation such as to defy any meaningful precision in that attribution. . . The level of interpretive latitude unavoidable in the overall exercise . . . means that significantly different, yet still defensible, attributions could have been reported. Interpretation of comparisons between years requires corresponding caution.'*

Such lack of clarity damages the transparency of annual accounts, and limits their utility to a statement that the books balanced. As much as secrecy, uninformative or minimalist presentation of accounts, or difficulties of access (how many museums publish their accounts on their website?[3]) diminish both transparency and accountability. The long-term purpose of museums requires that they should aspire to a higher standard, and be clear and precise in their outcomes.

## Conclusions

The issues described above are examples of the difficulties that need to be faced to sustain museums' corporate responsibility during a period when they are expected to behave in a more `businesslike' way and adopt the practices of commercial management. One of the sources of the problem is the lack of a well-developed, widely-accepted framework that relates to standards of board behaviour, auditing and corporate reporting. ICOM's own ethical code[4] only touches on governance issues in the most general of terms, and some of its guidance - especially in terms of the

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[3] In England and Wales, the Charity Commission publish details of income and expenditure of museums that are registered charities on its Central Register of Charities ( available at www.charity-commission.gov.uk) though the detail given is far less than that on www.guidestar.org, which lists financial information for over 850,000 not-for-profit organisations in the United States of America.

[4] ICOM (2002)

financial treatment of collections - is unclear, or is at odds with other international standards.

Such an framework would make it difficult for museums (or their auditors) to bluff in this area, and problems could be identified while the difficulties are still manageable. Well-designed international standards would reduce the room for museums and their auditors to manoeuvre while still allowing them the flexibility needed to respond to different business, ethical and legal circumstances. Organisations such as the Organisation for Economic Co-operation and Development (OECD)[5] are already taking good governance initiatives that span the commercial and public sectors. However, if museums are to sustain the view that, in the words of the ICOM definition of a museum, they are `permanent institutions', they will need to take their own actions to ensure that they continue to be seen as achieving the highest standards of governance and propriety. They have some way to go before that aspiration can be met.

## Bibliography


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[5] OECD (1999)