VOLUME IV

IN THE COURT OF COMMON PLEAS IN AND FOR
THE COUNTY OF MONTGOMERY, PENNSYLVANIA
ORPHANS' COURT DIVISION

IN RE: : NO. 58,788
THE BARNES FOUNDATION, :
a corporation :

PETITION TO AMEND CHARTER AND BYLAWS

Courtroom A
Wednesday, September 22, 2004
Commencing at 1:32 p.m.

AFTERNOON SESSION

Pamela M. Moran
Registered Professional Reporter
Montgomery County Courthouse
Norristown, Pennsylvania

Volume IV

BEFORE: THE HONORABLE STANLEY R. OTT, JUDGE

COUNSEL APPEARED AS FOLLOWS:

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for the Commonwealth of Pennsylvania as parens patriae for charities

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HOWARD MASON CYR, III, ESQUIRE
PAUL M. QUINONES, ESQUIRE
for the Intervenors, the Students of The Barnes Foundation

INDEX OF WITNESSES

PETITIONER'S EVIDENCE

THE COURT: Mr. Schwenderman, you remain under oath, you understand.

THE WITNESS: Yes.

THE COURT: All right. Very well.

... MATTHEW J. SCHWENDERMAN, still under oath, resumed on direct examination:

BY MR. WELLINGTON:

Q. Mr. Schwenderman, right before the break, we were going through table one and walking through those elements in the Deloitte report that changed over the six-year period. And as soon as the seconds count down, I think we'll resume with that chart. Wonders of modern science.

We were speaking right before the

lunch break, Mr. Schwenderman, about the differences between opening year and post-operating years and certain of the columns, and I think you had talked about the investment income already. You talked about admissions and related revenue. Talk to us about the development line, would you please?

A. The development line represents fund-raising and support to cover general operating expenses. So the components of that would consist of annual giving from

individuals, corporations, grants from government organizations and foundations as well as annual memberships for things such as the Barnes Society. That amount goes down slightly between the two years largely because there's an expected increase in memberships in the opening year due to the interest in the facility, as well as it's traditionally easier to get people to give in the first year of operations.

Q. When you get past opening year to the post-operating year, what percentage of the overall total income is represented by the development?

A. The development number represents, I believe, approximately, 37 percent of the budget.

Q. It's in your report somewhere, I know, to either look it up or if you recall. What is the dollar number currently represented by the development number? And we'll go back to the baseline years as compared to the four million two fifty that's projected here.

A. Back to the baseline years, the current amount

needed to balance the budget is, approximately, 55, in the high 50 percent.
Q. What's the dollar amount of that?
A. The rough dollar amount is about two-and-a-half-million dollars per year.

Q. That's in these numbers here, the 3.7 and the 2 --
A. Yes.
Q. Why are the development numbers in the baseline higher than two and a half?
A. Particularly, in the '03 year, actual, that includes the bridge financing that was offered by the petition supporters as well as revenue to cover petition-related expenses, which are included in the expense line item.
Q. There's been testimony at a prior hearing from Ms. Camp about the fact that a development staff has recently been added to the Foundation. What is the most, in terms of development funds, on an annual basis that the Foundation has raised in any year before now?
A. Our analysis concluded that on a cash basis in, I believe it was, 2002, the Foundation secured, roughly, a million five in donations; but that included 200,000 from the DeMazia trust, which goes away at the end of this year. So I think in our analysis we concluded that the highest year between '99 and 2002 was in the neighborhood of a million three eighty.
Q. You understand that another witness, John Callahan, will come in and testify concerning this development number?
A. Correct.

Q. And its reasonableness?
A. Yes.
Q. I wanted to talk about the expense lines down here in the opening to post-operating -- post-opening years. Can you just walk us through any significant changes there?
A. Between opening year and post-opening year, almost all of the changes in the expenses are related to variable costs associated with visitation. So if you notice the salary, wages and benefits line, it goes down. That's largely because the seasonal or part-time staff needed to accommodate a greater attendance is no longer needed or the hours from that staff is not needed in a greater demand. Same with guards and security.
Merchandise purchases goes down by, approximately, a hundred thousand dollars because merchandise sales has gone down by, approximately, $200,000. The costs that are primarily fixed, such as insurance, professional fees, etc., capital equipment replacement have remained constant.
Q. Going to the proverbial bottom line of these six years, Mr. Schwenderman, can you walk us through from left to right over those six years what this proforma shows?

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A. Yes. The proforma shows from left to right primarily break-even operations for years minus two through the move year and years two and three with the modest surplus of, approximately, $750,000 in the opening year due to the, you know, excess interest.

Again, the scope of the engagement was to determine the impact of a 3-Campus Model and, therefore, what the net bottomline at the end of years two and three is. A 3-Campus Model estimates that, roughly, an 11.3-million-dollar annual budget.

Q. Mr. Schwenderman, after Deloitte had prepared the consolidated 3-Campus Model forecast for the six years, did you do anything to test these numbers?

A. Yes. Our process was such that, as I mentioned, we attended the charrette. We understood what the program was going to be. We understood the financial history of the organization. We began to develop a financial analysis.

As part of the process in the analysis, we did two levels of benchmarking above and beyond, you know, applying our own professional background to that. One was to develop a custom survey, which was sent to probably somewhere in the neighborhood of 20 to 24 organizations, and the other was to go out

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and acquire industry-level data to support the analysis. The purpose of the benchmarking was not to get definitive numbers to use in the analysis.

The purpose of benchmarking, similar to how many Deloitte's clients use it, is to understand where you are operating within the peer group.

So that it's a good way to check the reasonableness of whether or not you're operating similarly or you have a chance to improve or you're exceeding maybe your peer group's performance. It, basically, was a way for us to test the reasonableness of the numbers that came out of the analysis.

Q.   Is there a summary chart in your report of doing this benchmark comparison?

A.   Table seven in the appendix shows many of the major benchmark ratios and statistics that we used.

Q.   We're going to focus in a little bit on this and talk about a few of these, if we could. First of all, can you tell us -- the first column, I take it up here is the Barnes 3-Campus Model, and it says year three; is that correct?

A.   That's correct.

Q.   Is that the right-hand column that we were just looking at?

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A.   Yes. It's the farmost column.

Q.   The third year of operation, second year of normal operation, I'll put it?

A.   Yes.

Q.   Tell us what the custom survey is.

A.   The custom survey is a questionnaire. I'm going to guess that it's, roughly, 30-odd questions regarding financial performance, financial operations of, as I said, about two dozen organizations. Those organizations came into several categories and are listed in one of the

appendices -- appendix. But they were selected because they contained one or a variety of characteristics, that they had a similar operating model to the Barnes and that they were both an educational institution, as well as a viewing collection, that the experience offered to the collection was very much of an immersion experience, which requires a longer period of time by the visitor to really get the mission that the organization is trying to achieve across. Or, in some cases, we dealt with organizations that are local to Philadelphia on the Parkway.
Q. Does this Page 40 of your report reflect the custom benchmark institutions that you reviewed and included?
A. Yes. This, actually, represents the organizations

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that responded to the survey. As I said, that while we included them all in the information, that we also used certain institutions for specific items only. For example, for the arboretum at Merion, we only used the four aarboretums that responded for attendance ratios, and things of that nature.
Q. Going back to Page 42, the AAM profile, can you tell us what information was included there?
A. Yes. AAM is the American Association of Museums. And, again, while the Barnes Foundation is unique in its operating model, many of the organizations that the Barnes works collaboratively with or competes against or is similar to our respondents of that organization as well. The 90th percentile represents the respondents across the entire group of that survey. Several hundred

organizatons, I believe, responded to that survey that were in the 90th percentile in terms of size.
BY THE COURT:
Q. Meaning top ten?
A. Yes, top ten. Because once you got down into median, you were looking at organizations that had, you know, 40,000, 50,000 visitors a year, staff of 20 people or 10 people, and it just really -- we didn't feel it was a comparable level of statistics.

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Q. Moving over to AMDA on the final right column, which is that?
A. It's the Art Museum Development Association. And that was primarily used for a couple specific metrics around endowment and membership that really weren't provided very well in the AAM survey. And we felt that we wanted an industry measured to compliment the custom survey.
Q. There's some additional information that you obtained from certain other sources?
A. Yes.
Q. If we look at Page 40, does this reflect the information that you obtained from those organizations and sources you just indicated?
A. It does.
Q. Back to Page 42 again, I want to go down to the funding sources, mean value section, and walk us through this particular portion of the comparison chart and tell us what level of comfort or discomfort that gave you.

A. One of the things we wanted to do, after we developed this financial analysis, was to see the distribution of the income sources, if that was consistent with the general industry, if that was consistent with the custom survey and what risks or

opportunities that presented to the organization.

As you can see there, the development, as we mentioned, was 37 percent in the 3-Campus Model. Earned revenue is 41 percent in the 3-Campus Model versus 46 percent today. And endowment income represents 22 percent of the budget; and that, basically, is nonexistent today.

The custom survey showed that fund-raising -- an interpolated fund-raising number because we had a variety of responses here; but breaking out earned and endowment income, insolvent for fund-raising, was in the high 50 percent. That was not necessarily unanticipated either. Earned revenue was about 25 percent, and investment income, 19.

Across an industry slice of the major organizations responding to AAM, they were in the low 50 percent for fund-raising. They were a third earned and, roughly, 16 percent endowment.

Clearly, one of the things that we noted was that it's a higher percentage of earned income and a lower percentage of development income.

Q. Talk to us about the higher percentage of earned income. Even after doing this benchmarking, do you have a level of comfort concerning that or not?

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A.   What we did to determine that we thought the number, as it stands today in the state or the portion of the process the Barnes is in, appeared reasonable was to go back and look at some of the specific earned line items, make sure that the assumptions there were reasonable, in fact, potentially even conservative-based on what the Barnes does currently as well as, you know, look at some of the organizations that were doing higher percentages versus lower percentages of earned revenue.

In general, that is higher than the benchmarks. But considering the fact it's about 5 percent or 10 percent on a relative basis, 10 percent less reliance on earned income than the Barnes has today, and then it's being driven predominantly by retail sales and attendance, we were comfortable that that was reasonable.

BY THE COURT:

Q.   Between those two, attendance is more significant than retail sales, is it not?

A.   Yes.

Q.   Hence, the accuracy of the model, if you will, is heavily dependent on the accuracy of your attendance predictions?

A.   In part, yes. How accurate or how appropriate the

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attendance prediction is will, ultimately, change what

percentage of contributed support the Barnes needs. So if five million dollars was a reasonable number for the Barnes to raise versus four and a quarter, the accuracy of the attendance --
Q. Or, stated differently, as the attendance figure dropped in actuality, other areas would have to increase to make up the difference, and vice versa?
A. Yes.
Q. If you had more attendance, if you had a hundred instead of 80 percent, the other areas could decrease?
A. Correct. I would say it's probably also not a one-to-one ratio though because, as attendance decreases, there are certain variable costs that will decrease just as in year one to year two the operating expense budget reduced as the attendance reduced.
BY MR. WELLINGTON:
Q. With respect to the endowment was assumed here, the 50-million-dollars assumption, and tell us how the 22 percent -- excuse me -- the investment income of 22 percent compares with other organizations.
A. On a percentage basis, it's higher. Obviously, it's about 3 percent higher than the custom survey and about a third higher than AAM on a percentage basis going from 16

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to 22 percent. The 50-million-dollar endowment, as a whole, you know, however, you can see, we've compared that to AAM and AMDA statistics, and those organizations that are similar to the Barnes have helped the endowments to survive. To our conversation about attendance as well, obviously, the size of the endowment is an integral part of the reliance on earned and annual fund-raising as well. If the endowment was 10 million dollars higher, the Barnes would generate $500,000 more.

BY THE COURT:

Q. If you earned five percent?

A. Right. The five percent draw assumption was based on looking at the industry standard of what organizations are doing today both across AAM's population as well as AMDA's. We chose five percent because it's more of a middle point number as opposed to the four percent. That's more of a policy issue that the Barnes would decide as to what percentage that would be.

Q. When you say policy, you mean in terms of an investment strategy?

A. Correct.

Q. In order to maximize income, some expense to growth?

A. Correct. Organizations, typically, have investment policies and investment committees, which look at the

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appropriateness of the draw percentage, how they calculate the draw percentage, how they calculate the principal balance that they're going to measure that against and whether they are looking for an income stream, a gross earnings or a combination of the two.

BY MR. WELLINGTON:

Q. And your analysis does not assume any increase in this endowment principal at any time, does it?

A. No. To be conservative, we didn't assume anything other than five percent draw.

Q. That if other donors contributed to endowments to increase it beyond 50-million dollars, obviously, the draw down rate on that could increase as well?
A. Or if it earned 8 percent in any one year, we didn't include the increase in the corpus as well.
Q. When you had completed this analysis, Mr. Schwenderman, did you reach an opinion to a reasonable degree of professional certainty as to whether this reasonably projected the proforma for the Barnes Foundation, given the assumptions that you've identified over the next six years with the assumption of a newly constructed gallery on the Parkway?
A. When we issued the report, we felt that, based on the assumptions laid out in the report and we talked

about today, that this was the reasonable estimate at this stage of the planning process of what the financial impact of adding a third facility in Center City would be; and that would, roughly, increase the operations from four million to eleven million.
Q. Did you review, Mr. Schwenderman, a report submitted by a witness for amici, a Mr. James Abruzzo?
A. I did review it, yes.
Q. I'm going to hand you a copy of that document, Mr. Schwenderman.
Bear with me a second, sir.
(Pause)
BY MR. WELLINGTON:
Q. Would you turn to page one of Mr. Abruzzo's document, Mr. Schwenderman? Mr. Abruzzo suggests here

that a capital fund-raising feasibility should be undertaken. Do you see that?
A. Yes, I do.
Q. Such a fund-raising feasibility study has not been done, has it, sir.
A. Not to my knowledge.
Q. Do you know why?
A. I don't know why. I know why Deloitte has not done it. That's not our level of expertise.

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Q. You are aware there's testimony sworn that the projected numbers of a hundred and fifty million dollars are pledged?
A. I'm aware that there's sworn testimony to that, as well as, for the purpose of our engagement, specifically, the 50-million dollars, we received representation from the Foundation and petition supporters that that in fact was still a valid assumption.
Q. Can we go to page three of Mr. Abruzzo's report?

THE COURT: Is there an extra copy of that? I'd like to be able to follow along.

MR. WELLINGTON: I apologize.

MR. BARTH: Your Honor, we can hand up our exhibits, if that helps.

THE COURT: That might be helpful. That way I could reference them by number. If you've got an extra binder, that would be helpful.

That's student exhibit number what?

MR. QUINONES: One.

THE COURT: I think the binder I have begins at 50.

This document is what number, if we know, the Abruzzo report?

MR. WELLINGTON: We don't have our set yet, so I don't know.

MR. CYR: Sir, it's Exhibit 51.

THE COURT: Thank you.

MR. WELLINGTON: We haven't been given a copy of the exhibits yet.

THE COURT: Okay. I've got it. You were at page three, by the way, in case you were wondering.

MR. WELLINGTON: Page three.

BY MR. WELLINGTON:

Q. I'm going to go down to the last paragraph of page three where Mr. Abruzzo makes the statement, "In the author's opinion, benchmarking is unreliable because, A, the sample used is often too small to have any statistical validity, and, B, there are dozens of conditions that exist in each benchmarked institution that have a material bearing on the results."

Do you have any response or reaction to that? He's criticizing your use of benchmarking.

A. I think, considering the scope of this engagement, what we were asked to do, in developing the reasonable of the analysis, that benchmarking was appropriate.

Deloitte uses benchmarking in concert with their clients from nonprofit organizations up to global one hundred organizations, specifically, for the purpose of determining the reasonableness of that organization's operating model or specific areas of their organization.

I've worked with very large companies who use benchmarks to determine whether they have the right number of people, if they're spending dollars in the right areas, etc.

So if I told you I was relying on benchmarking for a detailed business plan, then you might have some concerns about the level of detail of the work that I did. To suggest that what we did is an unreasonable report because it incorporated benchmarking, I think, is to assume that we had a charge different than what we did.

Q. You mentioned the scope, what was the scope of your project; and then you talked about a detailed business plan, I think. Tell us the difference between those two as Deloitte would understand and approach this plan.

A. I think Mr. Perks outlined this morning appropriately kind of the continuum for strategic planning process that includes capital and business, etc. You know, as he mentioned, in his world, you start with a

cost estimation. You move to schematic drawings, and then you move from there to detail architectural and engineering.

There's much the same process on the financial side. You develop an idea of the overall financial impact of an initiative, and that initiative could be as significant as the Barnes moving to Center City. It could be the zoo opening the primate exhibit.

Once you get to a point that analyzes what the overall impact is and the stakeholders in that can determine the risks associated with and the achievability that they see that, then you also move to the next stage in financials, which would be more detailed business planning. That would be in addition to a statement of revenues and expenses, including cash flows, balance sheets. It might be monthly in basis. It would be more line item detail.

And, you know, based on that, then you begin to refine your operating model, much as Mr. Perks would refine his capital build.

I think that the state of the project suggests that we are both kind of in the same continuum, and both of those projects are relying on the other one being at the same stage. Even if I wanted to

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do a detailed business plan, it would be a somewhat flawed analysis if I didn't have schematics from Mr. Perks to understand how many students I could put in each classroom or to take out to a market survey to ask people would they visit an institution that offered these programs and looked like this and acted like this and what price points would you pay for that.

So, as we understood it, as it was communicated to us was the responsibility of the Foundation's response, is that we were at that first stage of planning to get a reasonable estimate of the impact of taking this initiative.

Q. Turn to the next page, if you would, Section 1, Page 4, and this page is a specific reference to the Deloitte Touche financial analysis 3-Campus Model; correct, sir?

A. That's correct.

Q. And Mr. Abruzzo raises, I think what he says, are a couple of serious flaws with your analysis. One is that he says you have not considered that -- in his view, the new gallery could only survive, in essence, with blockbuster changing exhibits like Phantom of the Opera. Let me just ask you first, does this going-forward analysis include either the revenue or the expenses of blockbuster-changing exhibits?

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A. It does not.

Q. Now, Mr. Abruzzo also says at the end of this analysis that he would recommend adding a hundred thousand to a hundred and fifty thousand dollars annually because he says these would be net losses for the Barnes Foundation. Is that your understanding of what he says?

A. That's correct.

Q. Even if he was correct about there should be such blockbuster exhibits and they would lose money, is the hundred or hundred and fifty thousand dollars material in

this analysis?
A. You know, working backwards, a hundred to a hundred and fifty thousand dollars, I don't think is significantly material to this estimate. There are probably other line items that are too conservative or potentially aggressive by that amount that probably will offset themselves.
The recommendation that it's a hundred thousand to a hundred and fifty thousand incremental costs, however, does not give me any information as to whether that's a -- on a full cost-accounting basis, is he taking costs that are currently absorbed by the Foundation and allocating it to that exhibit? Is it purely incremental costs? What size

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exhibition is that? That would all go into play by saying whether that's a reasonable number.
The Barnes at a hundred and eighty thousand general visitors a year doesn't require the same -- if they embark on a changing exhibit program, which, you know, had not been discussed at length does not necessarily need to bring in Manet in the Sea or van Gogh. They have van Gogh. They have Cezanne.
To the people we talked to in the market and the professionals, the Barnes itself is the equivalent of the traveling exhibit; and, therefore, they may require a less, quote, unquote, significant traveling exhibit, much of what the art museum displays in their secondary gallery on their first or bottom floor.
If the Barnes were to miss by 10

percent, they need 20,000 visitors from a traveling exhibit. If the art museum misses by 10 percent, they need almost a hundred thousand visitors. That changes this estimate accordingly.
Q. And the one hundred to one hundred fifty thousand dollars is about one percent of this cost analysis, in any event, isn't it?
A. Yes. And when we discussed the impact of that with the Board management of the Barnes, their intention is

that that incremental hundred thousand would be sought from corporate sponsorships and underwritten external to the annual operating budget.
Q. Another criticism that Mr. Abruzzo levels has to do with the absence of capital replacement costs in this cost analysis. Can you respond to that?
A. Yes. As we stated in our report, this analysis does not include capital or nonoperating revenues or expenses. That was specifically excluded from the scope of the analysis.
Q. Capital projects are often raised by specific fund-raisers by cultural institutions?
MR. CYR: Objection; leading.
BY MR. WELLINGTON:
Q. How are capital costs often raised, in your experience, by cultural institutions?
A. Actually, I think that's a matter of the organizational structure of the organization, how they're funded, etc. Many not-for-profits, many cultural

organizations' buildings are owned by municipalities. The Philadelphia Museum of Art, the Philadelphia Zoo are two prime examples where much of their capital replacement funds comes from the City's capital program. There are other organizations that are built solely from

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dollars that are raised, you know, privately or for government sources, but owned by the organization; and, therefore, they need to develop a capital reserve, you know.

Leading organizations that are looking at that will typically have a combination of a capital reserve as well as explicit capital campaigns for major improvements.

Q. On page five there's another criticism of Mr. Abruzzo, which I think says that the report -- quote, the report unrealistically assumes that all of the pledges will be received immediately upon pledge, period. Most pledges are multi-year promises or a combination of immediate contributions and planned giving, end quote.

Can you respond to this criticism and what your reaction is?

A. I don't think it's necessarily a criticism. It's a valid point. Most major contributions are given in multi-year pledges.

My experience is having to, you know, manage bridge financing of capital programs as pledges come in, so we specifically asked that question during our analysis and were informed that most, if not all of the pledges, that are there are to be paid in a

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single installment. And, therefore, to be conservative with the endowment draw number, we assumed that those pledges would come in single installments but not all in the same year. So I think we've somewhat hedged our bet a little bit.
Q. We're putting your report back up. If I can find it here, am I looking at the development line?
A. Yes.
Q. Excuse me. The investment line. Walk us through here and tell us how your assumptions are built in here.
A. For the purpose of where we are and not knowing what the Barnes' investment policy will be, we, I think, somewhat simplistically said, take a beginning and end of year balance of pledge dollars in hand. Take the average of that and apply a five percent draw.
After reviewing Mr. Abruzzo's report, I went back and applied his methodology of a three-year rolling average, but, also, took the assumption from the individuals who are giving the representations on the pledges as to how quickly they might come in; and recalculating his method with a more aggressive receipt schedule, I came out with virtually the same aggregate number in the years minus two and minus one. There's just a few hundred thousand dollars

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less in minus two and a few hundred thousand dollars more

in minus one, which would mean that the bridge financing and development requirement would be the same for that period, but it just might come slightly differently over the two-year period.
Q. So this minus two pre-opening year, minus one pre-opening year is a reflection that pledges -- that there's not 50-million dollars out of the box starting year one?
A. Correct.
Q. There's some pledged in, and by the third year you have it pledged in?
A. Right. And I think year minus two, if you did the math, would assume, at the end of minus two, 25 million in hand. The beginning of year minus two, zero, keeping in mind again that we're using minus two because we don't know if the move here is 2007, what-have-you.
But if I use Mr. Perks' assumption that 2007 is mid-year of construction, that would make the move here, roughly, 2008, which would roll minus two back to 2006, which the representation to us would be that it's likely that all 50 million would be in hand by 2006. So by either calculation, I think the endowment number that's represented based on the assumptions that

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we did appears to still be conservative.
Q. So you don't necessarily disagree with that comment of Mr. Abruzzo's, but you feel it's been built into your cost analysis?
A. That was my investment policy when I was at the zoo, that was my practice, was a three-year rolling average,

and I had, roughly, 4 to 5 percent draw rate.

Q. I'm going to move to Page 6. It makes a recommendation down at the bottom of Page 6, "I recommend, and the D&T report implies, that a statistically valid market survey be conducted to accurately determine attendance figures."

Does your report imply that, and do you know what's meant by that?

A. I believe in our report that we mentioned that that was not done, and that in fact to get the most accurate attendance and pricing figures, you would want to do that. We did discuss that as part of our scope. It was determined and agreed that the planning process is not far enough along.

When we came out of the charrette, it was pretty clear that while we could take a statistical sample that would be valid statistically, it might not represent in fact what the Barnes would

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ultimately be building or running and, therefore, would be significant time and money, you know, doing that in the absence of having the schematics and the program plan that Mr. Perks relayed.

MR. WELLINGTON: Excuse me a second.

(Pause)

BY MR. WELLINGTON:

Q. Mr. Schwenderman, there's also, I think, several references in Mr. Abruzzo's report to a 2002 Deloitte

report and, I think, some comparisons that he makes between some things that Deloitte said or found there and some things in this cost analysis. First of all, can you remind us and the Court what the 2002 report was that he's referring to?
A. Yes. In 2002, we were asked to do an overview of the Barnes' financial position at that point in time primarily centered around quantifying the current cash position, the potential for the Barnes to run out of cash, how long that might be, and then the Barnes provided a couple operating scenarios for which we quantified what the net impact on their working capital or cash position would be, if they decided to embark on any of those initiatives.

Q. If they decided to embark?
A. On any of those initiatives.
Q. What is the relationship of that report or analysis to this analysis?
A. Other than the fact that I conducted both for the Barnes, they're entirely different reports. One was to look at the history, the current position of the finances, and have the Barnes give very specific assumptions and have us run out a cash position so that the Board could decide on a course of action. This was more of a financial analysis around a particular initiative, forward looking, with a request for us to do more external benchmarking review to provide the Barnes with an estimate of the financial impact of doing that. So, I mean, in one sense, they both deal with revenues

and expenses of the Barnes. Other than that, they were two different charges and not meant to be brought together.
Q.   Is there anything in your view inconsistent in the 2002 report with the 2004 cost analysis?
A.   No, not in my opinion.
Q.   Mr. Abruzzo says --
BY THE COURT:
Q.   Or anything consistent either, since they're

completely unrelated; right?
A.   Yes, for the most part.
THE COURT: Just to keep it balanced.
BY MR. WELLINGTON:
Q.   One of the things Mr. Abruzzo points out is that the 2002 overview assumes a five-dollar admission fee while the 2004 report assumes an average nine-dollar fee, what you talked about earlier. Can you tell us why those assumptions changed or are different?
A.   Well, the five-dollar admission fee in the 2002 report is for admission of all visitors at Merion. As I understand it today, there is still a cap on the admission fee. If you look at our financial analysis that we did in 2004, the nine-dollar blended admission fee is for the Center City location, which would not have a cap. We are still assuming a five-dollar admission fee in Merion for the arboretum. So I think it's very consistent, actually, between the two.

Q. He also says that the 2002 report assumes sharply reduced unearned income while the '04 report shows significant fund-raising income. Do you have any comment on --
A. Could you direct me to the line?

Q. Yes. Page 8, Overview of the Financials, Page 8, middle paragraph, fourth sentence, second paragraph, fourth sentence.
A. Yes. In the 2002 report, in working through assumptions with the Barnes, they were particularly of the opinion that some of the initiatives they were considering would thwart fund-raising in the short term and what impact would that be to their financials.
In the '04 report -- in essence, what the '04 report does is look at what level of fund-raising income is required to balance the operations and then looks at the reasonableness in the industry. It's, you know, oversimplifying the equation. It's somewhat of a solid form in the fund-raising side in the '04 report where the assumptions on fund-raising were actually dictated in the '02 report.
Q. I don't have the '02 report in front of me at the moment, but do you recall why that report assumed reduced unearned income?
A. I think that, to the best of my recollection -- I'm not sure of all the discussions that went around those, but, in large cases, if you look at some of the scenarios, the as-is scenario was, what happens -- for the most part, what happens if we can't replenish

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restricted gifts that exist today because unrestricted gifts had not been increasing?

The other two scenarios, which included closing to the public and closing down completely to the public and students and purely conserving, I believe those discussions were around the fact that, in addition to those restricted grants, you are now reducing the appeal of the organization from a mission perspective to donors who would give in an unrestricted version or an unrestricted variety to the organization annually.

Q. The next paragraph, Mr. Schwenderman, he says that the '02 report assumes the collections assessment program will incur a net loss of 2.1 million over three years, but no explanation for that. Do you --

A. I think that's part of the last answer I just gave, which is, it was more of an -- it was more along the lines that if the collection assessment restricted moneys could not be replaced, the Barnes was of the opinion that it was not prudent to eliminate that program and to stop the work on conserving the collection.

Q. The '02 report reflected specific grants that had been given for collection assessment; correct?

A. Correct.

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Q. And those had dollar limits and time limits; is that

correct?
A. Correct.
Q. There was an assumption they may not be renewed?
A. Correct.
Q. After reviewing Mr. Abruzzo's comments on the Deloitte & Touche report, did you change your opinion at all about the reasonableness of the projections in that cost analysis?
A. No.
MR. WELLINGTON: I have nothing further, Your Honor. Thank you, Mr. Schwenderman.
THE COURT: Mr. Barth?
MR. BARTH: Thank you, Your Honor.

CROSS-EXAMINATION

BY MR. BARTH:
Q. Mr. Schwenderman, in Mr. Abruzzo's report he made several suggestions and recommendations that Mr. Wellington touched upon.
THE COURT: Mr. Barth, could I recommend again we get that a little closer to you? It's touchy, I understand, because it's, apparently, not well maintained. We've got a lousy capital maintenance program.

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MR. BARTH: At least we have electricity, Your Honor.
THE COURT: We do have electricity.
BY MR. BARTH:
Q. Mr. Schwenderman, I'll begin again. In Mr.

Abruzzo's report, he made several recommendations, some of which were touched upon by Mr. Wellington, for example, that an experienced capital campaign consultant could undertake a report that a statistically valid market survey be conducted and a more detailed plan should be presented and professional cost estimator used. Can you give us some idea of how long it would take to undertake those plans?

A. I think Mr. Perks talked about the cost estimation. I don't necessarily feel qualified on the development study. But on the market analysis and the detailed business plan, if we were to incorporate that level of scope into what we did, I think, at a minimum, it would have doubled our time and level of effort as well as the Barnes. So it would probably be in the six- to eight-month range and, costwise, a quarter of a million dollars or so.

Q. As a person who has reviewed the financial

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statements in some detail, what is the current financial status of the Barnes Foundation?

A. As I understand it, that those dollars would have to come from some outside funding source. The Barnes could not afford to do that.

Q. So it could not independently survive this additional period of time?

A. As we noted in our report for the Barnes going forward, there requires still bridge financing.

Q. Do you know whether or not the bridge financing

would continue if such a report or studies were undertaken?
A.   No, I do not.
MR. BARTH: I have nothing else. Thank you.
BY MR. CYR:
Q.   Good afternoon, Mr. Schwenderman.
A.   Good afternoon.
Q.   Can you hear me all right?
A.   Yes.
Q.   Okay. In listening to your direct testimony, you and your team of Deloitte consultants spent a great deal of time in reviewing the financial records of the Barnes and preparing this analysis; is that correct?

A.   I believe we spent an adequate level of time, yes.
Q.   Could you tell me what it is that you -- what record you reviewed for preparation of this report?
A.   I'm not sure if we list them, but we reviewed audited financial statements, internal budgets. We held specific interviews with Barnes' management members. We've requested specific data on particular items, not all of which I can recollect directly. But attendance records or attendance numbers for the last five years or four years, things of that nature.
Q.   So in reviewing the records of the Barnes, you saw information that gave you the actual results for the last couple of years; is that correct?
A.   In some cases, yes.
Q.   Your report includes some of those actual results as

well as some forecasts or predictions for the future; correct?
A. Correct.
Q. Now -- and you don't have any problems with the veracity or accuracy of any of those financial records, do you?
A. We did not audit them, so I couldn't say definitively; but we were comfortable with what we received upon request.

Q. But they were audited financial results; correct?
A. To the extent that we reviewed audited financials, they were audited by Cogen Sklar.
Q. I'd like you to turn to, again, Page 30 of your report there. Do you have that in front of you?
A. I do.
Q. And this contains a number of projections. The first column is 2003 actual; correct?
A. Correct.
Q. By "actual," you mean those are the results that occurred in year 2003; correct?
A. Correct.
Q. You looked at the audited financial statements for that year; correct?
A. We did, but these are not necessarily audited numbers because this is a cash-basis statement and the audit is an accrual. So there might be slight differences between some of the numbers to adjust them for cash.

Q. But you're satisfied that you made adequate adjustments?
A. We think that what we're representing there is reasonable, yes.
Q. And like most financial statements, you have one

group, it's called income, and that is listed as five million one hundred forty thousand; correct?
A. That's correct.
Q. And then there's an expense side, which is sort of the other side to the balance sheet; correct?
A. Correct.
Q. And the total expenses were listed as, roughly, 4.7 million; is that correct?
A. That's correct.
Q. Then at the bottom you list that -- where it says surplus or deficit, you list 357,000; correct?
A. That's correct.
Q. So there was -- for 2003, on a cash basis there was a surplus of 357,000; correct?
A. That's correct.
Q. Now, we know, if you'd go down and look at your footnotes, that baseline years for 2003 and 2004 show a break-even performance only after including annual bridge financing of, approximately, 1.5 million; correct?
A. That's correct.
Q. That means, does it not, that on the income side of the balance sheet up here, there's, roughly, 1.5 million dollars of bridge financing?
A. That's correct.

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Q. And it shows up in the income somewhere, presumably, in --
A. In development. I'm sorry.
Q. Presumably, in the development number?
A. Correct.
Q. And so you would agree with me that if we took that 1.5 million dollars, if we removed that from the surplus, that we would then have a net deficit of, roughly, 1.2 million dollars; is that correct?
A. Yes.
Q. So we know that the actual results for 2003 after we take out the bridge financing was, roughly, 1.2 million dollars; correct?
A. That's correct.
Q. All right. And that is consistent with references in other parts of your report. If you turn to Page 12, we talk about current operations baseline; correct?
A. Yes.
Q. Okay. Now, these numbers are, actually, an average of 2003 actual results in 2004 operating budget; correct?
A. That's correct.
Q. And they exclude the petition-related expenses; correct?
A. Yes.

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Q. That's the expenses associated with this proceeding;

correct?
A. That's correct.
Q. Those run, approximately, 500,000 a year; is that correct?
THE COURT: What runs?
Q. (Continued) The petition-related expenses.
A. I don't know how much per year it runs; but in that particular year, that's probably around the magnitude.
Q. So with your baseline operations average of 2003 and 2004, which we know from this footnote, we end up with a surplus or a deficit of 1.134; correct?
A. Yes.
Q. And that's pretty similar to the 1.2 that's shown for the actual results from the 2003; correct?
A. That's correct.
Q. 1.2, let me highlight it, so we're all on the same page. Down here, you reference that in the text that it's, roughly, a structural deficit of 1.1 million dollars; correct?
A. Yes, that's correct.
Q. Now, Mr. Wellington asked you about the report that was done back in 2002, and you said you were involved with that; correct?

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A. I was.
Q. And that was submitted to this Court back in the proceeding in December, Petitioner's Exhibit 2, the Barnes Foundation, Overview of Financial Position, and it was authored in September of 2002; correct?
A. Correct.

Q. Now, in that report that was submitted to the Court for the Court's consideration, there was something called an as-is scenario; correct?
A. That's correct.
Q. Do you need another copy?
A. No. I can see.
Q. Now, that looked at 2002 a revised forecast. I guess because the report was offered in September of 2002 and they didn't have all the numbers in for 2002, there was some forecasting for 2002; correct?
A. Yes.
Q. What they did or what you did, you looked at the revenue again, and you came up with a revenue number, roughly, 3.7 million dollars; correct?
A. Yes. That was the Barnes' forecast number for the year.
Q. You came up with your expenses of, roughly, 4.4 million dollars; correct?

A. Yes.
Q. And you came up there with a deficit of 1.4 million dollars; correct?
A. Yes.
Q. Have you compared, in your review of the records of the Barnes, whether that forecast of 1.4 million dollars actually proved to be the case?
A. I don't know that we specifically did that, no.
Q. Well, then this as-is scenario included a projection for 2003; correct?

A. Yes.
Q. It projected, again, revenue of, roughly, two million dollars; correct?
A. That was the assumptions, yes.
Q. And it projected expenses of 4.3 million dollars; correct?
A. Correct.
Q. And it projected and was submitted to the Court that the deficit that could be forecast was, roughly, 2.2 or 2.3 million dollars; correct?
A. Yes.
Q. You would agree with me that that forecast did not come to bear; correct?
A. No, I would not. I would agree with you that this

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is an estimate based on the assumptions that were provided at that time, which are different from the operating assumptions that the Barnes worked under in 2003.
Q. We're not talking about a few dollars here. You're off a million dollars. This is 2.3, and the actual forecast came in at -- the actual results came in at 1.2; correct?
A. Right. And, to my knowledge, the Barnes was able to retain some of the financing that they told us to assume they would not retain, so they could see the magnitude of the loss should that go away.
Q. So you would agree with me that this as-is scenario did not prove to be a very good forecast of the financial results with the Barnes at least with respect to 2003;

correct?
A. I would agree with you that it's not a comparable forecast to the actual results of the Barnes because the assumptions in this as-is scenario were different from what the Barnes actually did. If the Barnes actually had the assumptions that are in this report come to bear, then it may or may not have been more accurate.
Q. Mr. Schwenderman, this was important information for the Court, was it not?

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A. I assume that it was.
Q. Because then you go onto 2004, and you project a deficit of 2.7 million dollars; correct?
A. That's correct.
Q. Do you think that's a reliable forecast, what's going to happen in 2004, based upon the financial information you've seen today?
A. I don't think it's a relevant forecast because it was done for a different purpose, and it's not relating to today's operations.
MR. WELLINGTON: Your Honor, my only objecttion to this line of questioning is that this is not an exhibit in this case. It never was. If he's trying to impeach Mr. Schwenderman on credentials basis, he's waived that right. And it has no relevance to any cash forecast. This is a scenario based upon assumptions that didn't happen because --
THE COURT: I suspect that this is being offered as a result of your eliciting that, to the

extent it's necessary, the two reports are consistent, which I pointed out that they're equally inconsistent because they're not at all the same. And I imagine this is offered to, perhaps, cast a different light on it.

MR. WELLINGTON: All right.

THE COURT: I think it, therefore, is a fair scope of direct; and I'm assuming that's what you're talking about.

MR. WELLINGTON: It really was, Your Honor.

THE COURT: All right. I will allow it.

BY MR. CYR:

Q. Mr. Schwenderman, the average of these numbers for 2003, 2004, two two and two seven, roughly, two-and-a-half million dollars, and that coincides with the Court's opinion that an endowment of 50-million dollars is required because that generates two-and-a-half million dollars in endowment income; correct?

A. It may. I can't speculate as to the Court's opinion as to how much endowment is needed to balance the budget. I can comment on what we did, which is take assumptions of the Barnes at a particular point in time and we calculated a cash analysis for them. If I were to go and look at the '03 results in this report and the '03 actual results and reconcile them, what I would need to do is undertake what operational changes the Barnes decided to make. That was not part of our scope and part of the request.

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Q. Mr. Schwenderman, you would agree with me that everything else stayed the same on this as-is scenario and there was endowment principal of 50 million and we assume a five percent return, that equals two-and-a-half million dollars, and that would largely -- would erase the deficit as projected by Deloitte back in 2002; correct?
A. If everything else stayed the same in 2003, they would break even. In 2004 they'd have an operating deficit of $300,000.
Q. But we know that, at least with respect to 2003, that we only had a deficit of 1.2 million dollars after we take out the bridge financing; correct?
A. That's correct.
Q. And if we -- if you added in the bridge financing, it would be a deficit of 2.7 million. I'm sorry. No. Your calculation is right.
Q. Right. If we assume that the deficit was 1.2 million dollars, what kind of endowment principal would we need to provide investment income or endowment income to run into a break-even situation?
A. If you use the same five percent draw assumption, approximately, twenty-five million dollars.
Q. Twenty-four, twenty-five million dollars and five

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percent?

A. Uh-huh.
Q. So if the Barnes stayed where it was and it ran a deficit 1.2 million dollars, we'd only need twenty-four or twenty-five million dollars in income; correct?
A. All other assumptions being equal, yes.
Q. Well, suppose the assumptions contained within those reports are that the admission fees stay the same, correct, five dollars a head?
A. That's correct.
Q. So if we have a 1.2 million deficit, say, we doubled the admissions from five dollars to ten dollars, there's, roughly, 300,000 visitors a year -- or, I'm sorry, 60,000 visitors a year, that would generate another $300,000 in income; correct?
A. In income, yes.
Q. Now we're down to a deficit of 900,000; correct?
A. That's correct, on income only.
Q. Now, again, what if we increased the annual giving --
THE COURT: I couldn't hear that, sir.
BY MR. CYR:
Q. What if we increased the annual giving? How would

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that affect the deficit number?
A. That would depend on what assumption you want to increase the annual giving by.
Q. Well, we know in your as-is scenario the development number that you listed projected for 2003 was $643,000; correct?

A. In the as-is scenario in the 2002 report, the Barnes asked us to project development not related to the collections assessment at 50 percent of the forecast for 2002.
Q. But we know that it actually turned out to be 3.7 million dollars, subtracting 1.5 from that for the bridge, it actually came out to 2.2 million dollars; correct?
A. No, it did not. It actually came out at 1.5 million dollars, and then you have the DeMazia trust, which runs out this year, at 200,000. So, as I stated earlier, the maximum the Barnes has raised in any one year, separate bridge financing, the DeMazia trust, is, approximately, 1.3 million. That would be the aggressive number to use.
Q. Right. So --
A. For all giving.
Q. So it wasn't six hundred forty-three. It was, actually, one, two or three, correct, 1.2 million

dollars?
A. Correct.
Q. Have you noticed a trend in the Barnes development income since the year 2000 when this camp instituted a formal development program?
A. Our numbers suggest a moderate growth on an annual basis, yes.
Q. Did you quantity that on a percentage basis?
A. No, I did not, largely -- to which analysis? Are we talking about 2002 or 2004?

Q. Did you chart out what the --
A. Well, in 2002 the scope was to take assumptions provided specifically by the Barnes and to calculate the impact for that. In 2004 we were asked to take the assumptions around the program and offering and to develop a reasonable estimate.
So in the 2002, no, I would not have done that because the assumption was provided specifically by the Barnes Board.
In 2004 we did not do that because the most aggressive number is the 1.3 million. As I did with most other numbers, we did some sort of averaging or analysis of what their trend was so as not to attempt to inflate the results.

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Q. Now, the 3-Campus Model -- I'm trying to remain organized here. As we heard during your direct testimony, you did a calculation two years pre-opening, one year of the move, and then sort of the blockbuster first year, and then you go to years two and three where, as you say, things normalize; is that correct?
A. Well, yes.
Q. Okay. The revenues in the sort of normalized is, roughly, 11.3 million dollars; correct?
A. That's correct.
Q. All right. And you're projecting, are you not, a surplus in those years going forward of $25,000; correct?
A. Yes. The analysis estimates a break-even scenario.
Q. So you would agree with me that that $25,000 is, roughly, 2.2 percent of 11.3 million; correct?

A. That's why it's represented as break even.
Q. That's a pretty tight margin of error on revenues of 11.3; correct?
A. If you consider that your margin of error.
THE COURT: I think you unintentionally misspoke your math there. I don't think 25,000 represents 2.5 percent.
MR. CYR: .02 percent.
THE COURT: That's better.

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MR. CYR: I forgot to move the decimal. That's why I went to law school, Your Honor.
THE COURT: You didn't have a core requirement for a year of math? Just kidding.
BY MR. CYR:
Q. Now, in looking at the assumptions to support these projections, you looked at various benchmarks, and so forth, and you discussed some of that on cross-examination. The first is development income, and I'd just like to go through those numbers again. The number of 4.25 million dollars, that's what you decide will be the annual giving; correct?
A. Yeah. That was the amount that's required to balance operations at 11.3 million.
Q. And that's based upon memberships, unrestricted giving towards just annual expenses; correct?
A. It's, basically, a combination of memberships, unrestricted gifts, sponsorships and restricted gifts that go to offset operating expenses as opposed to

incremental programs.
Q. That's a pretty dramatic increase, is it not, from the 1.2, 1.3 million dollars that it's currently getting; correct?
A. It's, approximately, three times what the Barnes

raises today and, approximately, 1.7 more than what they currently need to balance the budget.
Q. So that's a pretty aggressive number, isn't it?
A. You'll have to ask Mr. Callahan if that's aggressive for an organization of this size and scope.
Q. Well, you cited some benchmarks; and if we look at those benchmarks -- which I believe that was in table seven; correct?
A. Yes.
THE COURT: Yes. It's Page 42.
BY MR. CYR:
Q. Do you see the numbers? Okay. This is your chart where you look at various benchmarks for various aspects of the operation; correct?
A. That's correct.
Q. And the annual or development numbers, that's in this column; correct?
A. That is correct.
Q. And so Barnes, you're projecting at 4.25 million dollars?
A. That's correct.
Q. Then your custom survey was almost the same number, a little shy of that, four two two five; correct?
A. That's correct.

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Q. Then the American Association Museums, you have a number of 3.9; correct?
A. That's correct.
Q. Let's look at the American Association Museums. You're comparing yourselves -- you're comparing the Barnes to institutions in the 90th percentile; correct?
A. Actually, for the most part, yes. For the development numbers, because they did not segregate them that way, I believe it's for budgets greater than two-and-a-half-million dollars, at least for the percentage numbers above, which is how we interpolated the four million for the AAM number.
Q. You got your information out of Museum of Financial Information?
A. Uh-huh.
Q. 2003?
A. That's it.
Q. We know from that book that the survey that you were looking at, the 90th percentile were institutions that had annual visitors of, roughly, 350,000 visitors; correct?
A. That's correct.
Q. And we know that the Barnes is projected to be, roughly, 200,000 visitors; correct?

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A. Yes; two hundred and twenty for the three campuses.

Q. How did you decide that that was a -- that the 90th percentile institutions was a reasonable benchmark to use looking at annual giving?
A. By looking at the individual responses that were stratified that way, the larger grouping appeared to be more relevant to the Barnes' operation than the next grouping, which was 75th precentile, which was organizations of about a hundred and twenty thousand visitors.
Q. You agree that that's a hundred and fifty thousand more average visitors, and that's a significantly larger institution than the Barnes is projecting; correct?
A. Which is why we use the benchmarking to understand where they were relevant to the peer groups as opposed to taking absolute values and applying them to the report.
Q. Even though the 90th percentile, they're only generating 3.9 million dollars in annual giving; correct?
A. Well, as I mentioned, for the grouping above it, funding sources, and this line item, total operating funds, I believe those numbers were presented on a size of budget by the AAM report as opposed to 90th percentile. So, parenthetically, I think it says -- parenthetically, I think it says a 10-million-plus

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budget, which the Barnes projects for an 11.3-million-dollar budget. That was deemed an appropriate number.
Q. Well, if we look at your custom survey, those institutions had an even higher average number of visitors. That's 490,000 visitors; correct?

A. That's correct.
Q. That's almost 300,000 over projected attendance for the Barnes; correct
A. Yeah; two hundred seventy. That's the median number, which is the mid-point of all the organizations surveyed.
Q. Well, that number is -- that's correct, two hundred seventy, you're right.
A. So that may mean, because it's the median number, that maybe, you know, half of them are a hundred and fifty thousand and half of them are, you know, five hundred thousand, and the one directly in the middle is four seventy.
Q. Mr. Schwenderman, you would agree with me, would you not, that in light of those attendance numbers for the peers, that your projection of four and a quarter million is a pretty aggressive number, isn't it?
A. Four and a quarter million?

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Q. Four and a quarter for the annual giving.
A. I think you'd have to discuss with a fund-raising expert whether four and a quarter million is a lot. The reasonableness test that we apply to it is whether or not that number is out of the range for an organization that has a budget in excess of 10 million dollars, whether that was an unusual percentage of the operating budget based on where the Barnes does and might get its revenue from and, you know, kind of what's happening in the market.

And our conclusion was that the Barnes currently has an ability above and beyond organizations of its peer size to raise income because of the uniqueness of its collection as well as, you know, the desire for individuals to pay to see or experience that.

We also think that the endowment number that's been pledged and secured is a significant one, particularly, in the Philadelphia marketplace.

And, in my personal experience, I've seen organizations run with 25 to 30 percent of their budget from fund-raising and the rest from earned; and I've seen organizations who have had 60 to 65 percent. So for this type of analysis at this point in

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time, without a detail development study, the Barnes has what you would consider a balanced portfolio of revenue.

THE COURT: Mr. Cyr, would this be a convenient time to break?

MR. CYR: Sure.

THE COURT: Good. Let's take 10 minutes.

(At 3:00 p.m. a recess was taken.)

(The following afternoon proceedings were stenographically recorded by Court Reporter Amy Boyer.)

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I HEREBY CERTIFY that the proceedings and evidence are contained fully and accurately in the notes taken by me in the above cause and that this is a correct transcript of the same.

____
PAMELA M. MORAN
Official Court Reporter

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Received and directed to be filed

this _______ day of ______________________, 2004.

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STANLEY R. OTT, JUDGE

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