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September 30, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Re: File Reference No. 1810-100

Dear Technical Director:

On behalf of the National Association of College and University Business Officers (NACUBO), we submit the following comments on the proposed Accounting Standards Update, "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities" (the ASU). NACUBO's comments on the proposal were developed with input from our member institutions and our Accounting Principles Council (APC). The APC consists of experienced business officers from various types of institutions who, collectively, possess a thorough knowledge of higher education accounting and reporting issues and practices.

NACUBO is a nonprofit professional organization representing chief financial and administrative officers at more than 2,100 colleges and universities. In its capacity as a professional association, NACUBO issues accounting and reporting guidance for the higher education industry and educates over 2,000 higher education professionals annually on accounting and reporting issues and practices.

Comments on the ASU

We have grave concerns about the scope, complexity and potential for inconsistent application of the guidance in the ASU as it is currently drafted. Rather than addressing all of the questions specifically, we would like to provide our overall observations and touch on key points that we feel are critical to the application of the ASU by higher education institutions, chiefly:

1) The applicability of the ASU to not-for-profit organizations (NFPs),
2) The measurement of liabilities at fair value,
3) The exception provided for measuring liabilities at amortized cost,
4) The measurement of loans receivable at fair value, and
5) The impracticality of the model for recognizing credit losses.

Applicability of the ASU to NFPs

The ASU appears to have been written with an eye towards the financial services industry. In fact, paragraph BC252 specifically states that the standard was intended for banks and credit unions. In practice, however, it will impact all industries, including

NFPs. We are very concerned that once again, the Board has included NFPs within the scope of a proposal that will significantly increase the amount of work required to implement the new guidance and will provide little, if any, benefit to the users of NFP financial statements. As we have with previously proposed standards, we strongly urge the Board to reconsider the inclusion of NFPs in the scope of this ASU.

Alternatively, if NFPs are not excluded from the scope, we ask the Board to consider offering measurement alternatives for organizations that hold financial instruments but do not leverage the fair value of assets and liabilities for growth or income generation. For example, an alternative methodology for calculating credit losses could be made available to organizations with loans receivable that are not a significant portion of income producing assets and do not generate a significant source of mission related revenue. A NFP with loans receivable would be allowed to estimate an allowance for doubtful accounts using collection experience rather than being required to use a complex formula based on interest income assumptions.

As it relates to hedging activities, we would like to point out that under current guidance NFPs (with the exception of health care entities) are virtually precluded from using hedge accounting. We would like the Board to clarify whether this exclusion will continue to apply under the new guidance.

Finally, while it may be useful in some instances to provide both amortized cost and fair value information, the cost of doing so would be prohibitive – especially for small NFPs that do not have sophisticated models for valuing financial instruments.

Measurement of Liabilities at Fair Value

Under the proposed guidance, many financial liabilities currently measured at amortized cost would require fair values to be measured based on models with unobservable inputs. The values derived from such modeling may be significantly different than the actual amounts that the organization expects will impact its future cash flows.

For higher education institutions, the most prevalent forms of financial liabilities within the scope of the ASU are debt (which is often related to capital activities) and liabilities under split-interest agreements. We believe that current standards for measuring these liabilities are sufficient. Debt is measured at amortized cost. Split-interest agreements are measured using present value techniques with interest rates remaining constant over the life of the agreement, and actuarial data and estimated cash flows updated for changes. The cost of measuring these liabilities at fair value would far outweigh any benefit to users of the financial statements. Moreover, users want to know how much the institution owes, rather than an amount owed plus or minus an adjustment for interest rates and credit standing.

Although interest rate and credit standing adjustments are applicable to financial institutions that hold customer deposits, the measurement methodologies and results do not make sense for NFP organizations with split-interest or debt-related liabilities. Credibility in our reported liabilities will be questioned when we try to explain to a user

that the reported debt decreased because our credit standing fell, or that our debt increased because our credit standing improved.

In addition, the use of fair value for certain financial liabilities could result in a measurement attribute mismatch. This is particularly the case where a NFP issues debt to fund capital projects. Although the Board recognized that this situation could result in a mismatch, the proposed solution—to exempt debt that is contractually linked to the capital asset—would not solve the problem in many cases. (We understand the term "contractually linked" to mean that the liability is collateralized by the asset or the debt agreement stipulates that if the asset is disposed of the debt must be repaid.) Although there are instances where debt is issued for a specific capital project, it is often the case that the debt is issued to fund many projects, none of which is contractually linked to the debt. In addition, long-lived assets such as buildings are paid for with a variety of funding sources including debt, gifts, grants and operating funds. In such a case, it would be inappropriate to collateralize the debt with the entire building, as the debt may only have funded a small portion of the construction costs.

We believe that the ASU is too prescriptive in determining the instances in which amortized cost and fair value should be used. Measurement should be based on the characteristics of the asset or liability, its relation to other financial instruments and the entity's intent in holding the instrument. As the Board moves toward concept rather than rules based accounting guidance, we are left wondering why the business strategy of the financial instrument is not the central concept that must be factored into the proposed guidance in the ASU.

Exception Provided for Measuring Liabilities at Amortized Cost

The exception provided in the ASU for consolidated entities with less than 50% of assets subsequently measured at fair value is inappropriate and not useful for colleges and universities. The 50% criterion assumes that liabilities are matched with assets if there is a large amount of financial assets. That is not true for institutions where endowment investments represent a significant portion of their assets. As the Board noted in paragraph 43 of FAS 124 (basis for conclusions), "Reporting unrealized holding gains and losses on only the investments, and not the related liabilities, could cause volatility in earnings that is not representative of how *financial institutions* are affected by economic events. The Board concluded that accommodations similar to those in Statement 115 were unnecessary for not-for-profit organizations because (a) the purposes for which not-for-profit organizations hold investments *generally do not relate investments to liabilities* and (b) the change in net assets is not a performance measure comparable to earnings of a business enterprise." (Emphasis added.)

NFPs, unlike financial institutions, do not borrow in order to invest for the purpose of making money on the spread. If the Board's objective in requiring the measurement of liabilities at fair value is to make sure that the volatility in earnings is representative of how an entity is affected by economic events, the Board should consider drafting the exception based on the relationship between financial assets and liabilities; excluding

donor restricted endowment assets from the total asset base when calculating the exception; and/or excluding NFPs from the requirement.

Further, the exception as currently drafted does not appear to consider future changes in economic conditions. In years when endowment investments are doing well, it is more likely that the 50% exception would not apply whereas in years when investments are declining, the exception may apply. A quick, non-scientific review of approximately 20 colleges' and universities' financial statements for 2009 showed that about 37% would not qualify for the exception; the number that would not qualify increases to approximately 53% when looking at the same group for 2008. This analysis highlights a serious flaw in the exception criteria – organizations could be flipping back and forth between fair value and amortized cost on an annual basis, rendering any comparative data meaningless to financial statement users. Such comparative inconsistencies would likely lead creditors, and other users, to ask for disclosures of debt at amortized cost, thus further contributing to disclosure overload. Again, we recommend that the Board draft an additional exception excluding endowments from the calculation of the 50% exception and/or excluding all NFPs regardless of their size or asset mix.

Measurement of loans receivable at Fair Value
Loan receivables that are long-term would be subject to fair value measurement under the ASU. For colleges and universities the vast majority of these loans relate to programmatic mission. Often they are issued at below market interest rates or have forgiveness options. Some loans are converted into grants based on performance or actions of the recipient. Loan amounts are insignificant to total assets and the related revenue is immaterial to mission related sources of revenue and support. Because an active market does not exist for most of these loans, the fair value assumptions needed to estimate the expected future cash flows could vary widely. There is no benefit to the financial statement user to see program related loans recorded at fair value.

It is also unclear how loans under the federal direct student loan program would be measured. Higher education institutions originate those long-term loans as an agent of the federal government, and they are on the books only temporarily. They are not sold to the federal government—rather they are transferred to the government when they are complete as the federal government provided the monies lent.

Impracticality of the model for recognizing credit losses
The ASU proposes to eliminate the "probable" threshold for recognizing credit impairments, essentially reducing the amount of a receivable at the time it is booked. Interest income is then reduced over the life of the receivable in an attempt to more accurately reflect the cash flows. In theory, this seems reasonable, but in practice it is likely to reduce current interest income revenue streams by arbitrary amounts. More importantly, and as previously noted, earning interest is not the primary purpose of most loans in higher education. Accordingly, periodic adjustment of loss provisions through what would otherwise be labeled interest income is unnecessarily confusing. Users of financial statements currently have a clear understanding of what is included in interest income and to arbitrarily adjust that amount would result in less decision-useful

information. For colleges and universities, the proposed model is overly convoluted and would require significant administrative time and resources to implement. The cost of implementing the guidance would far outweigh the benefit, if any, to the users.

Overall Observations

As noted in the summary section of the ASU, the main objective in developing the proposal is to provide more timely and relevant information to financial statement users and also to reduce the complexity in accounting for financial instruments. We believe that the "one size fits all" approach to valuing financial instruments does not necessarily lead to more relevant and useful information for users.

In general, we believe that measuring the value of financial instruments should not be dictated by a single model. Certain financial liabilities such as debt, for example, are best measured and presented at amortized cost as this is reflective of the amount that will impact the future cash flows of an organization. To measure such liabilities at fair value may result in values that would be misleading to a reader. In addition, when debt is issued to fund capital projects, different measurement methodologies for the asset and liability result in a mismatch. Lastly, the exceptions provided in the ASU are inadequate for NFP higher education institutions.

Financial instruments have varying characteristics and are held for a variety of reasons. These factors should be considered when determining the appropriate measurement attribute. For financial instruments that an entity intends to hold for collection or payment of contractual cash flows, fair value does not represent the amount that will actually impact the cash flows of the organization. In such cases, the presentation of fair value could be misleading and would not provide decision-useful information to a reader.

In closing, we wish to express our appreciation for the opportunity to comment. We hope that the Board will address these concerns. We look forward to answering any questions the Board or the staff may have about our response. Please direct questions to Sue Menditto at 202-861-2542 or sue.menditto@nacubo.org.

Sincerely,

Susan M. Menditto
Director, Accounting Policy