NACUBO

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May 31, 2013

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

Re: File Reference No. 2012-260

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, "Financial Instruments – Credit Losses (Subtopic 825-15)" (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 independent and public 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.

Overall Comments on the ASU

We appreciate the effort that the Board has put into deliberating the various components of financial instruments. We reiterate, however, the sentiments expressed in our previous letters to the Board – that the guidance appears to be focused on financial institutions, but is applicable to all entities. This observation is supported by the basis for conclusions in each of the exposure drafts.

As discussed in our letter of April 1, 2011, although the Boards are committed to general rather than industry specific guidance, it is difficult to move in this direction when issues relevant to the financial services industry are driving the need for new guidance. Consequently, the Boards are creating standards that are, in fact, aimed at a specific industry but required to be followed by all entities. This, then, results in undo effort and irrelevant disclosures for entities that are not within the industry that is targeted by the standards. As we have expressed to the Board on many occasions, readers of financial statements are interested in information relevant to the preparer's industry and, irrelevant disclosures mask the truly important information in the statements. In addition, we do not think that requiring all entities to provide the proposed disclosures is in keeping with the spirit of the Disclosure Framework project.

The proposed guidance, in our opinion, does not broadly meet the Board's primary objective of improving the decision usefulness of reporting credit losses as it is focused on lending activities within the financial services industry. We suggest that the Board strongly consider, as it did in its most recent proposal on recognition and measurement of financial assets and liabilities, the cash flow characteristics of the debt instruments and the entity's business model for managing the assets in order to determine the appropriate model for assessing credit losses. For those assets that are issued for the purpose of earning a profit on the spread the current expected credit loss (CECL) model would be used. For all other debt instruments, the incurred loss model, currently in use, would be more appropriate. Further, perhaps the threshold could be lowered from "probable" to "more likely than not."

Finally, the fact that the guidance is specific to "credit losses" is problematic for not-for-profit organizations (NFPs). By their very nature, NFPs do not consider credit risk when providing credit. They exist for the benefit of society and provide their products and services in fulfillment of their mission to those who will benefit from them. Credit is extended based on need, not credit-worthiness. Unlike financial institutions, NFPs do not lend for the purpose of making money on the spread.

In addition to our overall observations, we offer the following feedback on specific questions posed in the ASU.

Question 1: Do you agree with the scope of financial assets that are included in this proposed Update? If not, which other financial assets do you believe should be included or excluded? Why?

We do not believe that promises to give (pledges) or programmatic loans made by NFPs should be included within the scope of the ASU. Regarding promises to give, we would like to highlight the following items that we believe make it inappropriate to include pledges within the scope of the ASU:

- Pledges do not arise as the result of exchange transactions as is the case with all other debt instruments that are within the scope of the ASU.
- When an NFP accepts a pledge no credit is being extended. There is simply a promise from the donor to provide funds to the entity at some point in the future.
- A higher education institution accepting a pledge does not negotiate the terms or check the credit worthiness of the donor. Absent specific communication from the donor, information about donors' ability to pay is based on historical data and demographics.
- For many NFPs, and higher education in particular, pledges are rarely written off. More likely, the payment terms are renegotiated with the donor to allow them the opportunity to fulfill their promise. Only in the case where a donor has confirmed that they will not be honoring the promise is the pledge written off. As such, the expectation at the time that a pledge is received is that all cash will be collected.
- We believe requiring a loss allowance to be recorded at the time a pledge is received would be misleading. It would create volatility in the pledges receivable balance by increasing reserves sooner than would be appropriate and then decreasing reserves when payments are received. This would portray an uncertainty regarding the quality of pledges that, in fact, does not exist.

- The disclosures required are incompatible for pledges receivable as they require a discussion of the credit factors that were considered in determining the allowance for credit losses. Since no evaluation of creditworthiness is required when accepting a pledge, the proposed disclosures are meaningless for pledges.
- Finally, if realizing promised gifts is a significant issue for the not-for-profit sector, then we urge the Board to add a project on pledges to its agenda rather than requiring burdensome and contradictory disclosures.

As with pledges receivable, programmatic loans made by an NFP are made without regard to the creditworthiness of the borrower. These loans are extended not with a profit motive, but to facilitate the NFP's fulfillment of its mission. For higher education institutions, the most significant programmatic loans are those made to students. Within the student loan portfolio there are two types of loans: those that are funded and guaranteed by the government and those that are funded by the institution. By far the largest of these are the government-funded loans such as the Perkins and Direct loans. Because these loans are guaranteed by the government, institutions typically do not record any allowance for uncollectibility.

Loans funded by the institution are generally immaterial in comparison to government funded loans. These loans are typically need-based and, in many cases, have provisions for cancellation or forgiveness if the student meets certain requirements such as working in the public sector or economically distressed areas for a given period of time. For loans that require repayment, the institution may place a hold on student records such as transcripts and diplomas until the balance is paid. This "incentive" tends to result in a fairly high collection rate and, as such, allowances on these types of loans tend to be very small (perhaps 0.5% to 1% of the total outstanding balance).

Lastly, the CECL model does not seem appropriate for use with short-term receivables such as trade receivables. For receivables collected within the reporting period, the results of operations would be understated by the amount of the loss allowance applied to them at inception. This does not accurately reflect the economics of the transaction. As such, we believe that debt instruments with a term of less than twelve months should be scoped out of the proposed guidance.

Question 9: The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectability of the financial assets' remaining contractual cash flows. Do you foresee any significant operability or auditing concerns or constraints in basing the estimate of expected credit losses on such information?

We are apprehensive about the requirement to consider reasonable and supportable forecasts in determining an expected credit loss. It is unclear what auditors might expect in the way of support for forecasted information. We are concerned that the time and effort required to provide adequate documentary evidence could result in a significant administrative burden which would outweigh any value in considering this information.

Question 12: The proposed amendments would require that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly. Methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of the amortized cost amount written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic to the amortized cost balance as of the reporting date to estimate the portion of the recorded amortized cost basis that is not expected to be recovered because of credit loss. Such methods may include loss-rate methods, roll-rate methods, probability-of-default methods, and a provision matrix method using loss factors. Do you foresee any significant operability or auditing concerns or constraints with the proposal that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly? If time value of money should not be contemplated, how would such an approach reconcile with the objective of the amortized cost framework?

The methods for determining the expected credit losses as described in the ASU seem overly burdensome for organizations, such as NFPs, that lack the resources to undertake such calculations. In addition, were colleges and universities to apply the proposed approaches, we do not believe that the results would be materially different than those that are determined today using a best estimate approach.

Question 14: As a practical expedient, the proposed amendments would allow an entity to not recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost basis of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. Do you foresee any significant operability or auditing concerns or constraints in determining whether an entity has met the criteria to apply the practical expedient or in applying it?

Most NFPs carry their financial assets at amortized cost, so the proposed practical expedient would be of no value to them. In fact, under the proposed guidance in the Board's most recent exposure draft on the recognition and measurement of financial assets and liabilities, the option to carry certain assets, such as pledges, at fair value has been eliminated. It seems inappropriate that the practical expedient be applicable only to items carried at FV-OCI. We request that the Board extend the practical expedient to financial assets carried at amortized cost.

Question 15: The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this proposal will change current practice? Do you foresee any significant operability or auditing concerns with this proposed amendment?

We do not believe that the requirement to put financial assets on a nonaccrual basis should be applicable to NFPs. As there is no interest accrual on pledges, those would obviously be outside the scope of this requirement. As previously noted, programmatic investments are made by NFPs with the purpose of furthering their mission as opposed to realizing a return on the investment. As such, we do not believe that the decision to put them on a nonaccrual status should be mandated by accounting standards but rather should be decided by the NFPs management and board.

Question 18: Do you foresee any significant operability or auditing concerns or constraints in complying with the disclosure proposals in the proposed Update?

We are concerned about the additional administrative burden that would be required to implement the proposed guidance. Specifically, the requirement to consider reasonable and supportable forecasts is of concern as the ability to document and defend, for audit purposes, any such information used in the determination of losses could be onerous.

The proposed disclosures are significant and, as we have pointed out, of no real value to the users of an NFPs financial statements. Should the Board move forward with the CECL model, we request that consideration be given to an abbreviated form of accounting and reporting guidance for certain entities.

Question 19: Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient? If not, what additional guidance or examples are needed?

We do not believe that the implementation guidance and illustrative examples are sufficient in that they do not address a broad enough array of transactions. Examples specific to the unique transactions of NFPs should be included if the Board intends them to remain within the scope of the guidance.

Question 24: How much time would be needed to implement the proposed guidance? What type of system and process changes would be necessary to implement the proposed guidance?

A minimum of three years should be allowed for implementation with a possible extension of at least one year for nonpublic entities. For NFPs, the required system and process changes would be determined by the complexity of the entity and the sophistication of current operations.

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

Sincerely,

Susan M. Menditto
Director, Accounting Policy