Higher Education Institutions' Credit Loss Recognition

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The current expected credit loss (CECL) accounting guidance represents a forward-looking methodology for determining credit loss provisions by private colleges and universities' lending activities beginning with fiscal year 2023-2024. The discussion presents information regarding the types and amounts of lending activities private colleges and universities engage in and the rationale of their lending programs. Provisions of the accounting guidance together implementation decisions, processes, and disclosures are part of the review. The study concludes with the accounting guidance's impact on higher education fiscal decision making, financial reporting, and the ramifications of the guidance to provide useful information to both higher education management and financial statement users.

Keywords: higher education, CECL, credit losses, credit loss allocation

INTRODUCTION

Implementation of the current expected credit loss (CECL) model outlined in the Financial Accounting Standards Board (FASB, 2016) impacts private higher education institutions' financial statements and operating revenue. Public higher education entities are not impacted as they follow accounting guidance issued by the Governmental Accounting Standards Board (GASB). Private colleges and universities award donor and other nontuition funded loans to outstanding and qualified students to support their academic pursuits. Private higher education institutions award faculty and staff mortgages and educational loans to attract and retain faculty and senior staff. The mortgages include shared appreciation loans or loans that bear interest at the federal rate and are collateralized by deeds of trusts on properties concentrated in the region surrounding the university. The educational loans are primarily zero-interest loans.

Private universities report mortgages and loans made to students and faculty/staff in the annual financial report as loans receivable. However, they may report the loans receivable as part of the institutions' investments which obscures the lending activities although the institution appropriately accounts for the loans in accordance with generally accepted accounting principles (GAAP) for audit purposes.

Of the 1,640 US private colleges and universities, only 50 of the institutions have enrollments equal to or greater than 12,000 (NCES, 2024; CollegeSimple, 2024). To determine the extent of private college and university lending activities to students and mortgages to faculty/staff, a review of the annual financial report for 50 U.S. private colleges with the largest enrollment (CollegeSimple, 2024) was made to discover what, if any, loans were disbursed for student loans and employee mortgages. Of the 50 private colleges, only 17 report student loans or faculty/staff mortgages in their 2023 annual financial report (Table 1). None of the other 33 institutions include any data or disclosure about student loans or faculty/staff mortgages.

Three institutions reporting faculty/staff mortgages are in large metropolitan areas. Washinton University in St. Louis is the only institutions reporting loans to parents.

TABLE 1
SELECTED PRIVATE UNIVERSITIES 2023 STUDENT, PARENT AND FACULTY/STAFF LOANS RECEIVABLE (IN THOUSANDS OF DOLLARS)

Higher Education Entity		Student Loans (net)		Faculty/Staff Loans (net)		Parent Loans (net)
Boston University	$	19,425	$		$	
Columbia University		18,842				
Georgetown University		10,228				
Harvard University		71,842		300,531		
Johns Hopkins University		20,333				
Southern Methodist University		13,869				
Stanford University		29,809				
Syracuse University		11,375				
Tulane University		1,861				
University of Chicago		25,058				
University of Notre Dame		10,044				
University of Pennsylvania		24,550				
University of Rochester		3,758				
University of Southern California		18,633		27,948		
Yale University		37,447				
Vanderbilt University		832		1,314		
Washington University on St Louis		16,672				46,654

Source: Author

The net allowances in Table 1 are based on future credit losses and may be understated, therefore overstating the aggregate loans receivable (Pandey, 2021). The institutions in Table 1 must recalculate the loss allowance to the loan data to reflect the current credit loss CECL guidance to prepare their fiscal year 2024 annual financial reports. The loss recognition delay became a concern to financial statement users and managers during the CECL guidance deliberations as the inability to record only the expected credit losses that met the probable threshold overstated revenues and the assets in the financial reports.

The CECL reporting model became effective for colleges and universities, with the fiscal year beginning after December 15, 2022, i.e., fiscal year 2023-2024. The new guidance also makes major improvements to record credit losses on receivables, guarantees, and investments.

The CECL reporting provisions, disclosure requirements, and how the reporting of CECL impacts higher education financial statements are a part of this discussion. A comparison of previous loan loss reporting requirements in contrast with requirements of the revised reporting model highlights the effect of the reporting change. Findings indicate the CECL model simplifies US GAAP and provides more timely recognition of credit losses and other commitments to extend credit held by a university at each reporting date (McCarthy & Schneider, 2024).

CREDIT LOSS ACCOUNTING CHANGE CATALYST

In 2008, a rising number of student borrowers were unable to repay loans due to the unstainable growth in living costs (Hunter, 2013). Economists found financial loan valuation and business models were contributors to the global financial crisis (Klock, 2013). Specifically, the incurred loss guidance in place in the early 2000s did not recognize a credit loss until a probable loss was known. Thus, inadequate loss reserves were in place to provide for loan losses at the onset of the 2008 financial crisis (Gomaa, Kanagaretnam, Mestelman, & Shehata, 2021). That is, lenders were not establishing sufficient allowances to cover existing and/or future losses on a timely basis.

In response to the financial downturn, and critics of insufficient loss allowances using the incurred loss methodology, the Financial Accounting Standards Board (FASB) began a project to improve accounting guidance to provide financial information users with more useful information pertaining to financial assets and investments (McCarthy & Schneider, 2024).

The Financial Accounting Standards Board (FASB) and the International Standards Board (IASB) established a Financial Crisis Advisory Group (FCAG) to advise the Boards on improvements pertaining to financial reporting (Bloom & Schirm, 2010). During the financial crisis, financial institutions expressed concerns as future credit losses could not be recognized because they could not meet the probable threshold. The FCAG found the lack of allowances to cover the losses as a weakness in current financial reporting guidelines that has the potential to overstatement assets. As a result, amendments to CECL guidance (FASB, 2016), adds methodology to reflect expected credit losses, and mandates the consideration of a broad range of reasonable and supportable information to substantiate credit loss estimates (FASB, 2016). The new model, Current Expected Credit Losses (CECL), is codified as ASC 326 (FASB, 2009).

CECL GUIDANCE

The FASB Accounting Standard Update (ASU) amendments supersedes the Impairment of Loans and Receivables guidance (FASB, 2010) and requires higher education entities to immediately recognize the estimated credit loss over the life of loans receivable and certain off-balance sheet credit exposures. The estimate of expected credit losses must consider historical data but also current and future financial conditions, and events. Although many consider colleges and universities student loans are the primary credit held by the institution, the CECL potential loss allowance guidance applies to an extended list of financial instruments held by the organizations. Figure 1 identifies accounts held by colleges and universities for which an expected loss, if any, must be estimated at the initial date of the transaction. Figure 1 also identifies those accounts/transactions that are excluded from the CECL guidance. General accepted accounting principles (GAAP) indicate CECL provisions need not to be applied to immaterial items (FASB, 2016), although the entity is required to document the basis for concluding that the CECL does not have a material impact. Available-for-sale debt was initially excluded from the CECL guidance but the impairment model for these financial assets was modified in connection with the issuance and codification of the CECL guidance (FASB, 2009). The implementation of the CECL guidance reflects a methodology that is forward looking, reflects the expected credit losses, and mandates the presentation of a broad range of supportable information to inform the financial statement user.

FIGURE 1
CECL GUIDANCE

Accounts Included	Accounts Excluded
Accounts receivable	Contributions (pledges) receivable
Loans receivable	Federal research awards receivable
Held-to-maturity debt securities	Loans receivable that are held for sale
loan commitments	Available-for-sale debt securities
Repurchase agreements receivable	operating lease receivable
Reinsurance receivables	Equity method investments
Financial guarantees	Derivatives
Net investments in sale-type and direct financing leases	Investments ar fair value with changes in fair value reported via net assets (or for nonhealthcare NFPs
Purchased credit deteriorated assets recorded at amortized costs	Loans and receivable between entities under common control

Source: Author

CECL Recognition Versus Deferred Loss Recognition

Prior to the CECL guidance, higher education entities established an allowance for nonpayment when there was evidence of a credit problem sufficient to incur a loss by creating an allowance sufficient to cover losses over the subsequent years for impaired loans (Handorf, 2018). Previous GAAP required an incurred loss methodology for recognizing credit losses (FASB, 2010) by establishing an Allowance for Loan and Lease Losses (ALLL) reserve account based on past events and current conditions. The ALLL account was part of the restricted net assets that could not be utilized to pay operating expenses (Handorf, 2018). This allowance is an amount set aside to cover the estimated credit losses in the current loans receivable account, Under the incurred loss methodology, a credit loss provision was expended when it became probable that a credit loss exists.

To illustrate the incurred loss methodology, Sample University has a loan receivable portfolio consisting of student fee loans and faculty/staff mortgages. At the end of the semester, the University reviews the loan portfolio to determine if any credit losses are apparent. After reviewing the loan individually, the University determines that two student loans are not performing and concludes that it is probable that the students will be unable to pay their loans as scheduled. The University then considers all available information to measure the amount of the loss using macroeconomic, auditing, and discretional factors (Pandey, 2021). The additional investigation did not identify any other loans probable of nonpayment. Given these findings, Sample University measures impairment on the two loans found to be impaired and records an accounting entry to recognize the probable loss as an increase (debit) to the ALLL account and credit to the loan receivable contra account.

Under the CECL model, an allowance is recognized for an estimated credit loss based on available information and industry expectations at the inception of the student loan or faculty/staff mortgage loan with its recognition in a contra asset account. However, GAAP prohibits the Allowance for Credit Losses contra asset account to have a debit balance as favorable reversals may not exceed the initial credit loss (FASB, 2009).

The estimated credit loss recognition process has been amended for two key issues i.e., troubled debt restructuring and vintage disclosures (FASB, 2022). The debt restructuring issue results from the complexity of the disclosure involving measuring credit losses for troubled loans that need modifying. Rather than applying the recognition and measurement guidance for troubled debt, the amendment allows the entity to disclosure whether a modification is a new loan or a continuation of an existing loan.

The second amendment in the guidance requires an entity to disclose current period gross write-offs by the of year of the loan origination and/or lease investment. This amendment helps financial statement users have a better understanding of the origins of the loan and the rationale for the write off.

Figure 2 compares the components of loss recognition based on incurred credit losses to the CECL recognition based on expected credit losses.

The comparison between the incurred loss recognition and the CECL recognition reveals the total amount of net write-offs would not change under the CSCL guidance. In fact, the timing of an actual write-off of an uncollectable asset does not change. Write-offs continued to be recorded when the amounts are deemed uncollectible. Instead, the timing of credit loss provision changes. CECL requires an estimate of the entire expected credit loss to be recorded at the time of organization and then adjusted over the life of the asset as facts and circumstances change. This results in the college and university Statement of Financial Position reflecting the net amount that is expected to be collected.

FIGURE 2
INCURRED LOSS RECOGNITION VERSUS CECL RECOGNITION

Incurred Credit Loss Recognition	CECL Recognition
Based on incurred credit losses	Based on expected credit losses
Allowance for Loan and Lease Losses (ALLL) calculated using a probable threshold on an incurred basis	Allowance for Credit Losses (ACI) estimate of expected credit losses over the contractual term of the financial asset
Considers only past events and current conditions	Considers past events, current conditions and reasonable forecasts
Recognizes only when credit losses are probable	Recognizes credit losses at origination of the transaction
	Adjusts credit losses over the life of the asset as facts and circumstances change

Sources: BDO, 2022; PWC, 2023; FDIC, 2024

Factors Impacting Expected Credit Losses

Since the CECL model accounts for expected losses, assets measured at amortized cost are presented on the financial statement at the net amount expected to be collected. Developing the allowance for credit losses is a valuation account that is deducted from the amortized cost basis of a financial asset to present the net amount expected to be collected on such asset.

When calculating the valuation allowance, a variety of methods are available (Jacob, 2020). The standards do not designate specific method requirements. Instead, authoritative guidance provides considerations in measuring the allowance. Measurement of expected credit losses requires a high degree of judgment. It should be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount.

Colleges and universities should consider relevant and available information when determining their allowance for credit losses. Utilizing historical information can be an appropriate start in the credit loss valuation calculation. For example, incurred losses on collections provide colleges and universities with valuable insight into past trends. However, data mustn't be limited to historical information as historical information may not reflect management’s beliefs about future expectations. Changes may include variation in unemployment rates, property values, or other factors that are associated with credit losses on the financial asset or in a group of financial assets (Jacob, 2020). The CECL guidance states that an entity shall not rely solely on past events to estimate expected credit losses. Rather, historical information should be adjusted for changes and used with current conditions to prepare reasonable forecasts. Figure 3 lists several factors a college and university should consider when developing forecasts. The factors are meant to serve

as a guidance as they are not all-inclusive. Depending on the nature of the asset, not all factors will apply to every situation and some situations may warrant different factors not part of Figure 3.

The CECL guidance does not specify any quantitative method for calculating credit losses for the assets measured at amortized costs (Jacob, 2019). A college or university can calculate a credit risk collectively when similar risk characteristics exist. Otherwise, they can calculate credit risks on any individual basis. There is no need to calculate a credit loss if nonpayment of amortized cost basis is zero based on past events, current circumstances, or reasonable forecast. The following are some quantitative methods available for colleges and universities to use to calculate credit losses.

FIGURE 3
FACTORS PERTAINING TO ADJUSTING HISTORICAL RECEIVABLE DATA

Nature and amount of receivable
Amount and severity of past due amounts
Borrower's financial condition, credit rating or credit score
Borrower's ability to make payments
Environmental factors including market conditions
College and university credit policies and procedures

Source: FASB, 2016

The quantitative method most used is the aging methodology as financial management often believes that the historical loss information based on the receivable reporting is consistent with the expected credit loss amounts. That is, the borrower's risk characteristic and the institution's lending practices have not significantly changed over time. To implement the CECL guidance, the higher education institution's financial management adjusts the historical loss rates to reflect the current conditions and forecasted changes. Figure 4 illustrates the implementation of the institution's lending portfolio that includes student fee loans and faculty/staff mortgage loans using a semester 4-month term as the basis for aging the current expected credit loss estimate. Given this analysis, the institution debits the net asset account and credits the loan allowance account for $376,155 to bring the loan portfolio into compliance with the CECL guidance.

FIGURE 4
APPLICATION OF A CECL AGING MODEL

Past Due		Amortized Cost Basis	Existing Loss Rate			Existing Allowance	New Adjusted Loss Rate			Allowance Under CECL
Current	$	12,350,000	0.00	%	$	0	0.015	%	$	185,250
1 - 30 days		7,150,000	0.05			357,500	0.0601			429,715
31 - 120 days		3,900,000	0.25			975,000	0.2542			991,380
121 - 360 days		1,950,000	0.60			1,170,000	0.6481			1,263,795
Over 360 days		650,000	0.90			585,000	0.9131			593,515
Total	**$**	**26,000,000**			$	**3,087,500**			$	**3,463,655**

Source: Author

A college or university can calculate a credit risk collectively when similar risk characteristics exist. Otherwise, it can calculate credit risk on an individual basis. Figure 5 identifies some of the methods used to calculate credit losses. Given the various methods available to determine credit loss allowances, the CECL guidance creates an inconsistency across college and university allowances for credit losses (Jacob, 2019; 2020).

FIGURE 5
OTHER QUANTITATIVE METHODS FOR DETERMINING CREDIT LOSS ALLOWANCES

Loss-rate Approach	Items within the receivable portfolio are partitioned into sub-groups. Based upon credit risk characteristics. Each group is separately analyzed for their estimate credit loss based on relevant risk characteristic and the aggregate estimated credit loss is recognized. The disadvantage of this approach is it reflects only past information.
Vintage-year Basis	This valuation uses historical data to predict future losses for a group of loans with the same origination date. The analysis compares loan losses occurring during the future period to the original loan balance of the primary group (vintage). The analysis provides an average lifetime loss rate based on a forward-loss projection.
Discounted Cash Flow	This allowance projection reflects the difference between the amortized cost basis and the present value of the expected cash flows. It is considered a complex method because it projects the cash flow over the life of the loan which can be substantial.
Roll-rate Basis	This method uses historical data to predict credit losses by categorizing the loan portfolio based on risk ratings or delinquency. The credit loss analysis is referred to as the flow model or migration analysis of financial assets.

Source: Howard, 2024

DISCLOSURES

The primary goal of accounting information is to provide financial statement users with relevant and useful information that faithfully represents economic phenomena to assist in making informed decisions. Note disclosures should communicate information necessary for the fair presentation of the basic financial statements. The disclosure requirements under CECL retain many of the disclosure amendments in Receivables (FASB, 2021). However, disclosure amendments under CECL guidance (FASB. 2016) are updated to reflect the change from an incurred loss methodology to an expected credit loss methodology. Significant new disclosure requirements include financial assets measured at amortized cost, net investments in leases, financing receivables, and debt securities (Holzmann & Munter, 2016).

In addition to the disclosures prescribed by the CECL guidance (FASB, 2016), specific disclosures are prescribed its Codification (FASB, 2009) that highlights information about credit activities that must be a part of the college and university annual financial statement disclosures. To meet the disclosure requirements for credit loss allowances the following information must be a part of the financial statement disclosures.

- A description of how expected loss estimates are developed.
- A description of the college or university's accounting policies and methodology to estimate the allowance for credit losses and factors that influence management's current estimate of expected losses such as past events, current conditions, and reasonable forecasts about the future.
- A discussion of risk characteristics relevant to each portfolio segment
- Reasons for significant changes in the number of write-offs, if applicable.
- A discussion of the changes in the factors that influenced management's current estimate of expected credit losses and reasons for those changes.

- Identification of changes to the entity's accounting policies, changes to the methodology from the prior period, its rationale for those changes, and the quantitative effect of those changes.
- Additionally, disclosure of disaggregated information about the credit quality of net investments in leases and financing receivables for five annual periods is required.
- Disclosure concerning debt securities includes a roll-forward of the allowance for credit losses and an aging of past due securities.

FINANCIAL STATEMENT IMPACT

The CECL methodology does not specify a method for measuring expected credit losses. CECL guidance gives colleges and universities flexibility in measuring the allowance account by allowing entities to apply methods that reflect its expectations of the credit loss estimate. Because of this, a divergence among the colleges and universities financial statement presentation and format will continue to exist (Jacob, 2020).

Although business organization could implement the CECL guidance early during the Covid-19 health emergency, this unique point in time provided insight into management decision making in a crisis and revealed new credit loss guidance to satisfy the needs and expectations of users. Given the standards' freedom to select the credit loss methodology, it is apparent that macroeconomic trends will warrant management to make adjustments (Pinello & Puschaver, 2022). However, an adjusted credit loss can create risk when a CECL base line analysis suggests that a particular credit loss level is warranted but management deems a significantly lower level is more appropriate.

CONCLUSIONS AND IMPLICATIONS

Over time, there has been a call for greater disclosure and transparency concerning lenders' policies and procedures to establish an allowance for loan losses. Naysayers of the CECL model such as those entities affected by the provisions in CECL guidance express concern of associated costs tied to economic modeling and financial predictions. Proponents of the CECL methodology believe that the accounting guidance provides significant benefits. The financial crisis of 2008 is a great example. Rather than waiting for the next fiscal crisis, colleges and universities should seize the opportunity presented by CECL guidance to maximize credit loss allowances. That is, to get loan loss reserves up. If net revenues decrease during periods of an economic peak, that recognizes the reality of the poor management reporting (Handorf, 2018).

The CECL methodology gives colleges and universities flexibility in determining the measurement of the loss allowance provision. Accounting guidance should require colleges and universities to adjust the historical information for future expectations. The information can include, but is not limited to, qualitative and quantitative data, external information about the entity, information related to specific borrowers, or the broader community.

Financial instruments under the CECL model include accounts receivable, loans, leases, and a host of other financial instruments displayed in Figure 1. When credit is extended, it is reasonable to expect that a portion of the receivables will not be collectible. Colleges and universities should develop a credit policy that is not too conservative that can lead to excessive borrowing, or a policy that is too lax that results in excessive uncollectible accounts. On financial reporting dates, the allowance for doubtful accounts is analyzed and adjusted through an adjusting journal entry to report net accounts receivable at the amount the college and university expects to collect. To determine the appropriate balance in the allowance for doubtful accounts, colleges and universities should use a high level of judgment but employ discretion regarding which method is used for measurement. Entities should reflect losses expected over the receivable's life. For instance, if a college or university is exposed to losses on a receivable only in the latter part of the receivable's life, such as the last 30 days of an expected semester life (120 days), the risk should still be considered. Receivables should be considered as a pool when risks are similar. A way to pool receivables is based upon past due status. The aging of accounts receivable is used as a gauge to determine the financial health of a college and university's borrowers by categorizing individual receivables

by age or extent to which the accounts are past due. To calculate the allowance for doubtful accounts, each age category is multiplied by an expected credit loss rate for that category. This method applies a higher loss rate to older accounts. A critical question to ask when adjusting the historical loss rate to an expected credit loss rate should include whether historical loss rates reflect current, reasonable, and supportable forecasts. Finally, colleges and universities should reflect a loss even if a credit loss is remote. For example. If there is a 97% chance that a loss will be zero and a 3% chance of a total loss, the estimated loss should reflect the 3% likelihood of a loss (Pinello and Puschaver, 2018; Hintze, 2023).

It is important to recognize that the balance in the allowance for credit losses as an estimate determined by management guided by the requirements of the CECL guidance. The measurement of the allowance involves a high degree of judgment. Components of the judgement process should include, but not limited to, the identification of relevant factors that may affect the accounting estimate, the accumulation of reliable data on which to base the estimate, ensure the accounting estimate is presented in conformity with applicable accounting standards, and the disclosures are adequate.

US federal agencies were skeptical about lending institutions' policies and procedures to establish an allowance for loan losses and disclose information about the quality of loans. The basic objective of general-purpose financial reporting is to provide financial information about the colleges and universities that is useful to existing and potential lenders, creditors, and other financial statement users regarding decisions about providing resources to the colleges and universities (FASB, 2021). Additionally, useful information should contain information for predicting, comparing, and evaluating the entity's operating income. Accordingly, the FASB issued the CECL guidance whose main objective is to provide financial statement users with more decision-useful information about expected credit losses on financial instruments and other commitments to extend credit by the college and university at each reporting date.

There are many different entities involved in the standard setting process, but the FASB is given responsibility to establish and improve accounting standards that foster financial reporting and provide information to help financial statement users make decisions. The CECL guidance is dependent and impacted by the applied assumptions (Park, 2022). It is up to colleges and universities to utilize the CECL reporting model to their benefit.

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