Grant Thornton

Snapshot

AUGUST 12, 2025
SNAPSHOT 2025-10

Measuring credit losses on current accounts receivable and current contract assets

The FASB recently issued ASU 2025-05, *Measurement of Credit Losses for Accounts Receivable and Contract Assets (Financial Instruments – Credit Losses (Topic 326),* to simplify how entities measure credit losses on current accounts receivable and current contract assets. The amendments provide a practical expedient that allows all entities to assume that conditions at the balance-sheet date will remain unchanged for an asset's remaining life when estimating credit losses on current accounts receivable and current contract assets arising from transactions under ASC 606.

In addition, entities other than public business entities that apply the expedient may also make an accounting policy election to consider subsequent collection activity occurring after the balance-sheet date in estimating expected credit losses on these assets.

Scope

The guidance applies *only* to accounts receivables and contract assets that meet both of the following criteria:

- They arise from transactions accounted for under the revenue guidance in ASC 606 by the reporting entity or acquiree. This includes such assets acquired in a transaction accounted for under ASC 805 on business combinations or recognized through the consolidation of a variable interest entity that is not a business.
- They are classified as current assets as of the balance-sheet date. When determining whether these assets qualify as current, entities should use a one-year period unless an entity's operating cycle exceeds 12 months, in which case, the longer operating cycle period is used.

Practical expedient

Under ASC 326-20, entities estimating expected credit loss must adjust historical loss experience for current conditions and reasonable and supportable forecasts if those differ from historical conditions.

The amendments in ASU 2025-05 introduce a practical expedient for ***all qualifying assets*** that allows entities to assume that current conditions at the balance-sheet date remain unchanged for the remaining life of an asset when estimating credit losses on current accounts receivable and current contract assets. Entities electing this expedient will therefore adjust historical loss experience only to reflect current conditions, without the need to incorporate forward-looking forecasts.

However, entities still need to consider if adjustments to historical loss experience are necessary to capture both (1) differences between current conditions and those conditions existing during the period when historical loss experience is measured, and (2) asset-specific differences.

For example, say that an entity elects to apply the practical expedient to determine the historical loss experience for a pool of similar current accounts receivable and current contract assets over a historical period during which the unemployment rate was 5 percent. Currently, the unemployment rate is 8 percent. In this scenario, the entity would (1) adjust the historical loss experience to reflect the increase in the unemployment rate (that is, the current condition), and then (2) presume that the 8 percent unemployment rate remains constant throughout the remaining life of the current accounts receivable and contract assets.

Accounting policy election

The amendments in ASU 2025-05 also allow entities, other than public business entities, that elect the practical expedient to make an accounting policy election to consider collection activity after the balance-sheet date, but before the entity's financial statements are available to be issued (or any alternative date selected by the entity that is after the balance-sheet date but before the date the financial statements are available to be issued), when estimating expected credit losses. Therefore, the allowance for credit losses on balances that are collected should be zero.

Entities should also evaluate any remaining uncollected amounts based on their delinquency status as of the date the entity has selected to consider subsequent collection activity.

The amendments permit, but do not require, entities using an aging schedule to update historical loss rates for collection activity that occurs after the balance-sheet date when determining the allowance for credit losses on uncollected amounts. In addition, any change in the date through which an entity considers subsequent collection activity is not considered to be a change in accounting principle in accordance with ASC 250, *Accounting Changes and Error Corrections.*

Disclosures

The amendments require entities to disclose the election of the practical expedient and, if applicable, the accounting policy election. Entities that elect to apply the accounting policy election should disclose the date through which subsequent collection activity was considered in estimating expected credit losses.

Transition and effective date

The amendments in ASU 2025-05 should be adopted prospectively to estimate the allowance for credit losses. If an entity, other than a public business entity, adopts the accounting policy election in a period after the effective date of ASU 2025-05, it is not required to perform a preferability assessment in accordance with ASC 250.

The amendments are effective for fiscal years beginning after December 15, 2025 and for interim reporting periods within those fiscal years. Early adoption is permitted for both interim and annual adoption periods if the financial statements have not yet been issued or been made available for issuance.

Entities adopting the guidance in an interim reporting period should adopt the amendments as of the beginning of the annual reporting period that includes the interim reporting period in which the entity adopted the guidance.

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