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To the Point

FASB — proposed guidance

FASB proposes guidance for measuring credit losses for private companies and certain NFPs

The proposal would address challenges in estimating expected credit losses for certain current accounts receivable and current contract assets.

What you need to know

- The FASB proposed guidance that would allow private companies and certain NFPs to elect a practical expedient and an accounting policy for measuring credit losses on current accounts receivable and current contract assets arising from transactions accounted for under ASC 606.
- The practical expedient would allow entities to assume that current economic conditions as of the balance sheet date will persist through the forecast period in the development of reasonable and supportable forecasts.
- An entity that elects the practical expedient would be allowed to make an accounting policy election to consider cash collection activity after the balance sheet date in its estimate of expected credit losses for those same assets.
- Entities electing the practical expedient and accounting policy would apply them prospectively.
- Comments are due by 17 January 2025.

Overview

The Financial Accounting Standards Board (FASB or Board) proposed amendments[1] to Accounting Standards Codification (ASC) 326, *Financial Instruments — Credit Losses*, that would provide a practical expedient and an accounting policy election that private companies (as defined in the Master Glossary)[2] and not-for-profit entities (NFPs),[3] excluding NFPs that have issued or are conduit bond obligors for securities that are traded, listed or quoted on an exchange or an over-the-counter market, could use to develop their reasonable and supportable forecasts when estimating expected credit losses for current accounts receivable and current contract assets arising from transactions accounted for under ASC 606, *Revenue from Contracts with Customers*.

The FASB issued the proposal in response to challenges private companies and NFPs encountered when applying ASC 326-20, *Financial Instruments — Credit Losses — Measured at Amortized Cost*, to current accounts receivable and current contract assets. Specifically, private companies and NFPs said the identification, analysis and documentation of the macroeconomic data needed to develop reasonable and supportable forecasts can often be costly, and such data generally does not have a material effect on the estimate of credit losses for these short-term assets. Macroeconomic data may include unemployment rates, property values and commodity values.

Private companies and NFPs also noted that significant effort and documentation are required even for assets that were collected before the financial statements are available to be issued.[4] The current guidance does not allow entities to consider cash collection activity after the balance sheet date in developing the estimate of expected credit losses.

Key considerations

The proposal would apply to current accounts receivable and contract assets of private companies and certain NFPs. The proposed amendments would require entities to use a one-year period as the basis for determining whether a receivable or contract asset is a current asset, unless their operating cycle exceeds 12 months, in which case the longer period would be used.

Practical expedient

ASC 326-20 requires companies to consider available and relevant information in determining credit loss allowances for financial assets. An entity that uses historical loss information in estimating expected credit losses is required to adjust that information to reflect the extent to which management expects current conditions and reasonable and supportable forecasts to differ from the conditions that existed over the historical loss period. Such adjustments often require assessment of macroeconomic data (e.g., unemployment rates, property values, commodity values).

The proposal would allow entities to elect a practical expedient to assume the current economic conditions as of the balance sheet date will persist throughout the forecast period in the development of a reasonable and supportable forecast for current accounts receivable and current contract assets arising from transactions accounted for under ASC 606.

An entity electing the practical expedient would still be required to adjust historical loss information to reflect current economic conditions when they are different from the historical loss period. Customer- and company-specific factors that are expected to have an effect on the collectibility of cash flows would still be considered in the expected credit loss estimate. For example, an entity would need to consider in its expected credit loss estimate the information about individual customers that are experiencing financial distress, even if the customers are current on existing receivables as of the balance sheet.

Accounting policy election

Under the proposal, entities electing to apply the practical expedient would also be allowed to make an accounting policy election to consider cash collection activity that occurs after the balance sheet date but before the financial statements are available to be issued in the estimate of credit losses for current accounts receivable and current contract assets. An entity would be allowed to select a date for this purpose that is after the balance sheet date but before the financial statements are available to be issued.

Under this accounting policy election, an entity would record a credit losses allowance of zero for current accounts receivable or current contract assets that have been fully collected as of the date that the financial statements are available to be issued (or the date selected by the entity that is after the balance sheet date but before the financial statements are available to be issued). For any remaining uncollected receivables, the entity would apply the practical expedient to develop its estimate of expected credit losses based on the collection status of those assets as of such date.

How we see it

Entities applying the accounting policy election would only be allowed to consider cash collection activity after the balance sheet date. Other events occurring after the balance sheet date that could affect the collectibility of receivables, such as the bankruptcy or delinquency of a customer, would not affect the credit loss estimate as of the balance sheet date.

Entities would need to apply the practical expedient and accounting policy election consistently to all current accounts receivable and current contract assets arising from transactions accounted for under ASC 606.

Effective date, transition and disclosures

The Board will determine the effective date after it considers stakeholder feedback. Early adoption would be permitted.

Entities electing the practical expedient and accounting policy would apply them prospectively and would not be required to justify that the use of the practical expedient and accounting policy election are preferable in accordance with ASC 250, *Accounting Changes and Error Corrections*. Entities would be required to disclose their practical expedient and accounting policy elections.

Endnotes:

[1] Proposed Accounting Standards Update (ASU), *Measurement of Credit Losses for Accounts Receivable and Contract Assets for Private Companies and Certain Not-for-Profit Entities*

[2] The Master Glossary defines a private company as "[a]n entity other than a public business entity, a not-for-profit entity, or an employee benefit plan within the scope of Topics 960 through 965 on plan accounting."

[3] The Master Glossary defines an NFP as "[a]n entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity: (a) Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return, (b) Operating purposes other than to provide goods or services at a profit, and (c) Absence of ownership interests like those of business entities. Entities that clearly fall outside this definition include the following: (a) All investor-owned entities, and (b) Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans."

[4] Under the Master Glossary definition, "[f]inancial statements are considered available to be issued when they are complete in a form and format that complies with GAAP and all approvals necessary for issuance have been obtained, for example, from management, the board of directors, and/or significant shareholders. The process involved in creating and distributing the financial statements will vary depending on an entity's management and corporate governance structure as well as statutory and regulatory requirements."