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WEBINAR SERIES

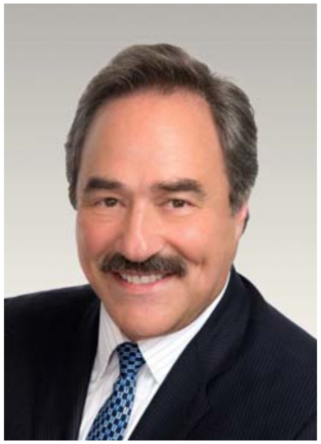
FASB

FASB approves “Practical Expedient” for Revenue Recognition (ASC 606)

Speakers

Shelly Sun
CEO and Founder
BrightStar Care

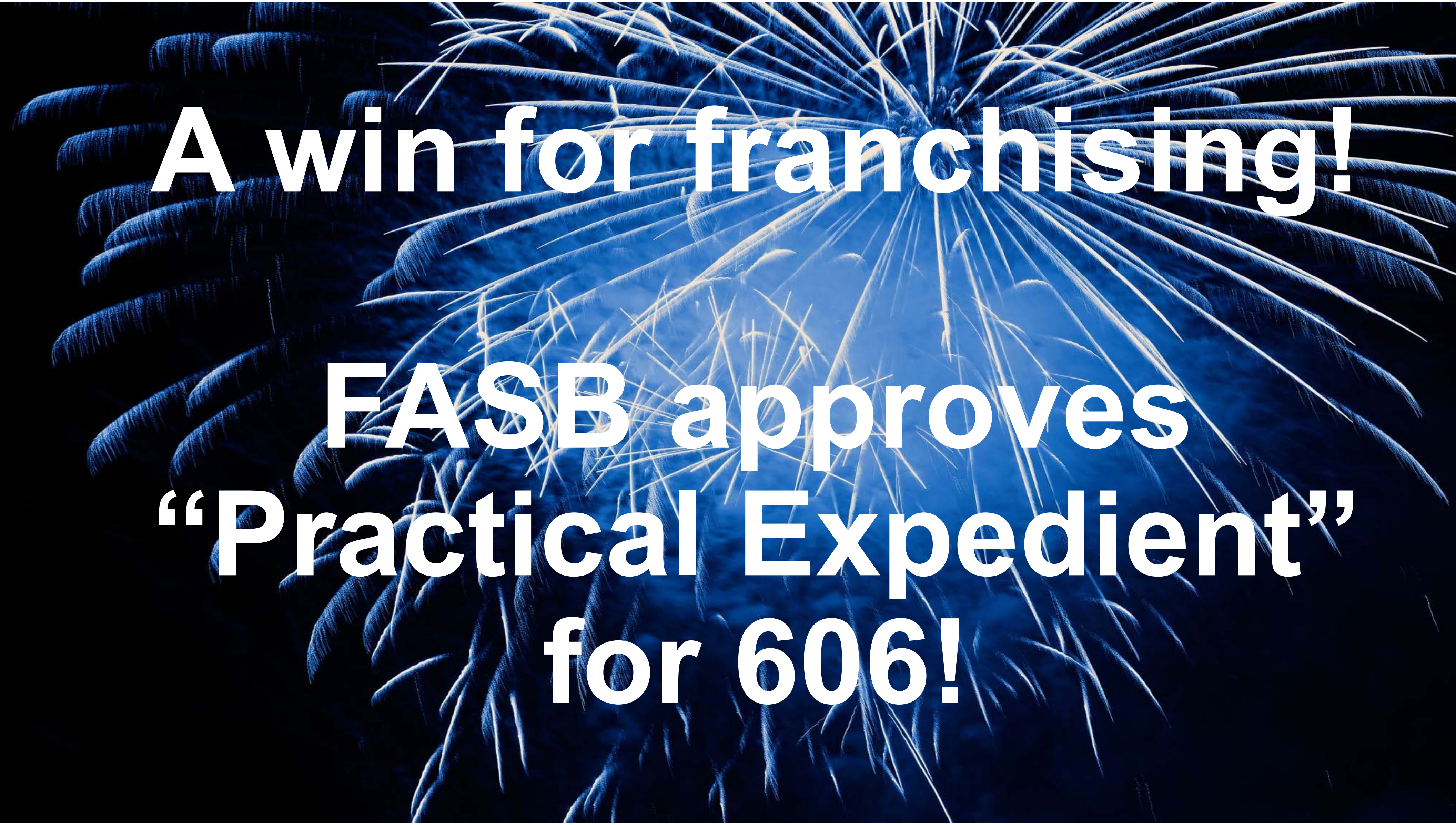
Lee Plave
Partner
Plave Koch PLC



Aaron Chaitovsky, CPA
Partner, Co-Practice Leader
Citrin Cooperman

KEY TAKEAWAYS

- IFA FASB Task Force
- Historical Journey
- FASB Expedient for Private Company Franchisors
- Working with Your Auditors


A win for franchising!
FASB approves
“Practical Expedient”
for 606!

IFA FASB Task Force: How Did We Get Here?

- IFA Member Engagement: 80+ Brands
- IFA Task Force Request for FASB Guidance
- Bipartisan Congressional Oversight
- Joint Communications with FASB Chairman and FASB Staff
- January 29th and February 26th Meetings with SBA and Congress
- May 20th FASB call committing to research on implementation issues
- July 28th FASB vote to publish expedient recommendation for comments
- December 9th FASB approved expedient

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October 24, 2018

Dear Members of the United States Senate and House of Representatives:

The undersigned franchise brands and members of the International Franchise Association (IFA) write to request swift Congressional action encouraging the Financial Accounting Standards Board (FASB) to issue accurate examples that clarify the revenue recognition schedule of initial franchise fees under their new ASC 606 rules.

Starting on January 1, 2019, brands operating under a franchise model will have to comply with new accounting standards for the recognition of revenue in licensing contracts. Because a trademark license is a core component of a franchise agreement, these new standards will be applied to the recognition of initial franchise fees, which are the fees a franchisor collects at the outset of the franchise relationship to cover initial costs, such as site selection, training in brand standards, and other immediately recognizable services.

Historically, franchise brands have been allowed to immediately recognize the initial franchise fees, which average $36,000, when all material services or conditions relating to the sale have been substantially performed or satisfied. This rule was created decades ago to provide prospective franchisees with confirmation the franchisor is financially stable and not surviving off its initial franchise fees.

As the FASB moves towards international standards and away from the issuance of industry-specific accounting standards, franchise brands are facing significant uncertainty as to how the new revenue recognition standards will apply to initial franchise fees. This is because the only franchise-related example the FASB published as a guideline within the new rules contained a grossly inaccurate example of a $1 million franchise fee without recognition of any multiple performance obligations, such as site selection and training in brand standards.

IFA strongly believes these services should be recognized upon substantial performance by the franchisor. FASB acknowledged the uncertainty facing franchises during their November 29, 2017, board meeting, yet this uncertainty remains due to the lack of written guidance from FASB for accounting firms to follow. Without accurate examples as a guideline, an audit of franchisor brands will produce reduced assets and greater liabilities, resulting in a lower perceived valuation on balance sheets. This inaccurate portrayal of financial stability will have a particularly devastating impact on small and growing franchise brands, which will likely have to escrow initial franchise fees collected in certain states.

It is imperative to have certainty regarding the standards that ASC 606 will impose on the franchise business model. We request that Congress ask FASB to swiftly issue accurate franchise-related examples that clarify the recognition schedule of initial franchise fees under their new ASC 606 rules before the new rules take into effect in January 2019.

Thank you,

A&W Restaurants
Abrakadoodle
Alliance Franchise Brands
Archadeck Outdoor Living
Bach to Rock
Ballard Brands, LLC
BrightStar Care
Buffalo Wings & Rings, LLC
Buzz Franchise Brands

California Closets
CertaPro Painters
Chicken in a Barrel BBQ
Church's Chicken
Closet & Storage Concepts
College Pro
Conserva Irrigation
Decor&You
Discovery Point Franchising, Inc.

Donut King
Duck Donuts
East Coast Wings & Grill
EatGatherLove
Fas-Tec Franchise Systems, LLC
Fast-Fix Jewelry and Watch Repairs
FASTSIGNS International
Five Star Painting
Floor Coverings International
Franchise Services Inc.
Glass Doctor, A Neighborly Company
Gloria Jean's Coffees
Goldfish Swim School Franchising, LLC
Great Clips
Hand and Stone Franchise Corp.
Handyman Connection
Home Clean Heroes
Home Helpers
HTeaO FC, LLLP
Hwy 55
It's A Grind Coffee
Just Between Friends
Kiddie Academy
Lapels Dry Cleaning
Lightbridge Academy
Moms on the Run
Moran Family of Brands
Mosquito Squad
Mr. Appliance

Mr. Electric
Mr. Rooter
MRI Network
Mrs. Winner's Chicken & Biscuits
Nothing Bundt Cakes
Our Town America
Outdoor Lighting Perspectives
Paul Davis Restoration
Pillar to Post
Pinot's Pallette
PIP Printing
Pool Scouts
Pure Barre
PuroClean
Real Property Management
Renew Crew
Rita's Franchise Company
Signal Graphics
Sir Speedy Inc.
Sirius Day Spa Franchising LLC
Sola Salon Studios
Spring Touch Lawn & Pest Control
TeamLogic IT
The Joint
US Lawns
V's Barbershop
Window Genie
Wings Etc. Inc.
Ziebart International Corporation

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Congressional Oversight

- Bipartisan Interest in Congressional Oversight
- House Financial Services Committee Oversight FASB/PCAOB Hearing (January 15, 2020)
- House Small Business Committee Letter to FASB (2018) and PCAOB (Forthcoming)

STEVE CHABOT, OHIO
CHAIRMAN

NYDIA M. VELAZQUEZ, NEW YORK
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515–6315

July 27, 2018

Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Dear Chairman Golden:

As the organization that develops accounting and reporting standards for organizations in the United States, the Financial Accounting Standards Board's (FASB) actions directly impact millions of small businesses. Pursuant to Rules X and XI of the United States House of Representatives, the Committee on Small Business is conducting oversight of FASB and requesting information regarding Accounting Standards Codification 606, *Revenue from Contracts with Customers* (ASC 606).[1]

Within ASC 606, FASB has determined new standards that may impact revenue recognition for franchisors, and specifically a franchisor's initial franchise fee. ASC 606 changes the long settled process, whereby franchisors recognized the payment initially at the commencing of a business. Unintended consequences could impact the franchise industry, which is instrumental to the United States economy.

In light of our concerns that FASB's actions may produce uncertainty for small businesses and with the ASC 606 compliance date approaching, the Committee requests that FASB provide a staff briefing on this issue. Please contact Robert Yavor with Chairman Chabot at (202) 225-5821 and Justin Pelletier with Ranking Member Velázquez at (202) 225-4038 by August 3, 2018 to schedule this briefing. Thank you for your attention to this matter.

Sincerely,

Steve Chabot
Chairman

Nydia M. Velázquez
Ranking Member

[1] CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Revenue from Contracts with Customers, No. 2014-09 (Fin. Accounting Standards Bd. 2014).

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Why IFA Fought So Hard?

- ***FranData Estimate:*** Without relief, **930 brands** at risk of bankruptcy or closure in 3 years; **104,098** physical locations at risk of closure; and **1.1m** jobs lost
- Experience was, that after speaking with their auditors, <u>most</u> franchisors' financial statements deferred entire initial franchise fee over entire term (e.g., $40k fee went from $40,000 revenue in year 1 to $4,000/year for 10-year term)
- Emerging franchisors lacked resources to create documentation needed to justify recognizing any portion of initial fees up-front (e.g., when training complete).
- Got a temporary reprieve/delay May 20th – but most companies had already implemented.
- Determined to engage for a solution before year-end 2020

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Published for Comment…Now Approved!!

No. 2020-23
23 September 2020

To the Point

FASB – proposed guidance

FASB proposes practical expedient for nonpublic franchisors to account for initial franchise fees

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Overview

The proposal addresses concerns raised by private company franchisors about the cost and complexity of applying ASC 606 to initial franchise fees.

What you need to know

- The FASB proposed a practical expedient that would allow a franchisor that is not a PBE to account for pre-opening services provided to a franchisee as a single performance obligation if they are included in the list of pre-opening services in the proposed guidance.
- The proposed practical expedient would simplify the evaluation of whether each of these pre-opening services is a separate performance obligation.
- Franchisors may only elect to apply the practical expedient if it is probable that continuing franchise fees will cover the continuing cost of services plus a reasonable profit.
- The expedient could be used by franchisors that have not yet adopted ASC 606 and by franchisors that are not PBEs but have already adopted ASC 606.
- Comments are due by 5 November 2020.

Overview

The Financial Accounting Standards Board (FASB or Board) proposed[1] providing a practical expedient that would allow a franchisor that is not a public business entity (PBE) to account for pre-opening services provided to a franchisee as a single separate performance obligation if they are consistent with those included in the list of pre-opening services in the proposed guidance. Franchisors may only elect to apply the practical expedient if it is probable that continuing franchise fees will cover the continuing cost of services plus a reasonable profit.

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Background

BEFORE (605): franchisors must recognize revenue upon substantial completion of "all material services or conditions relating to the sale" (e.g., typically when the franchise location opened).

INITIAL ADOPTION OF 606:

- Five-step process for analyzing how much to recognize and when to recognize initial fees
- Required consider degree of subjectivity
- Initial FASB example of $1.0 million was an example without practical parallel – so people applying that reasoning for how to implement 606 reached varied conclusions, no one standard, and many that were impractical
- IFA Task Force set out to work with FASB Chair, Vice Chair, and its professional and technical staff to address concerns

Key considerations

The proposed amendments would apply only to private company franchisors, even if they adopted the earlier understandings re 606.

The proposed practical expedient simplifies the guidance on identifying performance obligations for franchisors that perform pre-opening services. Rather than having to evaluating each promise to perform a pre-opening service to determine whether it is distinct from the promise to provide a franchise license, the **practical expedient would allow a franchisor to account for the pre-opening services as a single performance obligation, such as:**

- **Site selection assistance**
- **Facilities assistance** (e.g., architectural and engineering services, lease negotiations, etc.)
- **Training the franchisee or its personnel**
- **Preparation and distribution of manuals and similar guidance re operations, admin., and records**
- Bookkeeping, I.T., and advisory services, including **setting up the franchisee's records** and advising the franchisee about income, real estate, and other taxes and/or local regulations affecting the franchisee's business
- Inspection, testing, and other quality control services

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Transition and effective date

Entities that have not yet adopted ASC 606 would apply the transition provisions and effective date in ASC 606-10-65-1.

That guidance allows modified retrospective transition or full retrospective transition, and the effective date is annual reporting periods beginning after 15 December 2019 and interim reporting periods within annual reporting periods beginning after 15 December 2020.

For private company franchisors that have already adopted ASC 606, the amendments would be effective in annual periods beginning after 15 December 2020 and interim periods therein. **Full retrospective application would be required to preserve comparability between reporting periods. Early application would be permitted.**

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Preparation Needed

- **Begin discussions now with your auditors**
- **Document costs and/or market value approach on training, site selection, pre-opening support services, etc.**

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Questions?

Thank you for attending!