FRANdata
Franchise Business Intelligence

May 5, 2020

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

Dear Chairman Golden:

On behalf of FRANdata, the leading franchise research and advisory company, I write on behalf of the nation's franchising community, which prior to the COVID-19 pandemic, was comprised of over 733,000 establishments that employed nearly 8 million individuals and contributed $674.4 billion of economic output to the U.S. economy. I am writing particularly with regard to Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* and the actions taken by the Financial Accounting Standards Board (FASB) to grant relief to the franchising sector at its meeting held on Wednesday, April 8, 2020. Thank you for your understanding and appreciation of our concerns, as well as your leadership, during this critical time.

We conducted a research study to understand the costs franchisors incur to support their franchisees before the business opens for operation. Our study focused on emerging franchisors with less than 100 franchised units. We obtained confidential data from them that showed costs providing non brand-specific services necessary for the franchisee to open for business averaged 73% of the initial franchise fee revenues. These costs ranged from 40% to 81% of the initial franchise fee.

The costs that all franchisors incur in providing advice and services necessary for the franchisee to begin operations can be broadly characterized into 3 buckets – franchisee prospect acquisition costs, training costs, and pre-opening support costs. Our analysis found that emerging brands are most impacted by the FASB revenue recognition rule change. They must disproportionately rely on this form of revenue until their systems have expanded and matured sufficiently to generate recurring revenue (usually in the form of royalties). Because of this, our analysis showed that an estimated 930 brands face a serious risk of bankruptcy or closure within the first three years of the rule going into effect.

In conducting this study, our interviews included emerging franchisors who had gone through the arduous and costly ASC 606 accounting exercise to identify the costs they incur to support a new franchisee before they open for business. They spoke candidly and passionately about the impact this has had on their business. They simply said they don't have the financial resources to provide the accounting details in support of the robust training, onboarding and support programs to set their franchisees up for success. Further, the financial presentation impact it has on prospective franchisees and lenders will likely discourage them from providing the very comprehensive business training programs and pre-opening support that their franchisees need.

Franchisors use initial fees to defray the costs they incur in the process of assisting franchisees through the initial stages until franchisees achieve full operational status. Delaying full recognition of these

funds for up to 10 or even 20 years forces franchisors to add significant accounting costs to minimize the negative consequences of presentation issues and, as a result, quite possibly state regulatory impound actions. This domino effect will put tremendous cash flow pressure on young companies trying to establish their brands, a dramatic outcome for a fundamental component of the franchise business model that has performed very well for the better part of a century. Accordingly, we urge you to adopt an expedient that allows private franchisors to immediately recognize the maximum portion of the initial franchise fee under the rule, without inordinately burdensome analysis required.

Thank you for your leadership during this unprecedented time and for your consideration of these technical clarifications.

Sincerely,

Darrell Johnson
CEO
FRANdata