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October 27, 2020

Technical Director  
File Reference No. 2020-600  
Financial Accounting Standards Board  
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Sent via email to: [director@fasb.org](mailto:director@fasb.org), File Reference No. 2020-600

Dear Technical Director:

CliftonLarsonAllen LLP (CLA) appreciates the opportunity to comment on the Financial Accounting Standards Board's (the FASB's or the Board's) proposed Accounting Standards Update (ASU), *Franchisors—Revenue from Contracts with Customers (Subtopic 952-606)*. We appreciate the Board's efforts to create a standard with the objective to provide a practical expedient that would simplify the application of the existing guidance related to identifying performance obligations for initial franchise fees. We recognize that the proposed ASU was influenced by the feedback from private company stakeholders. While we agree that actions must be taken to simplify the existing guidance related to identifying performance obligations for initial franchise fees, we do not believe the proposed ASU will simplify the identification of performance obligations. We recommend the proposed ASU be modified to address the concerns that we have outlined in our responses below.

CLA has extensive experience providing professional services to franchisors. We provide assurance services to franchisors, both large and small. We also provide tax compliance, accounting, and consulting services to franchisors.

Our responses to the questions on which you are seeking comments follow.

***Question 1: Do you support introducing guidance for franchisors that are not public business entities to account for pre-opening services provided to a franchisee? Please explain why or why not.***

We support introducing guidance for franchisors that are not public business entities to account for pre-opening services. Current guidance under FASB *Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers (Topic 606)*, in most cases, requires a franchisor to recognize the revenue related to initial franchise fees over the term of the franchise agreement, which is typically 7 – 10 years. For many franchisors, these fees represent reimbursements for costs incurred to “onboard” the franchisee. Once onboarded, ongoing costs are subsequently covered by the separate royalty fee charged over the life of the franchise agreement. Recognizing the initial fees over the term of the franchise agreement causes an unintended mismatch of revenue and expenses.

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Also, the ability of the franchisee to use the franchisor's tradename and trademarks, or intellectual property, is often cited as support for recognizing the initial franchise fee beyond the on-boarding period. As a practical matter, usage of the intellectual property has very little future economic substance and franchisors view the initial franchise fee as reimbursement for the franchisor's costs to onboard the franchisee. In cases where a franchisor is growing significantly, recognizing the initial franchise fee over the term of the agreement creates a significant liability in the form of deferred revenue. Most states regulate franchisors and call for minimum equity requirements and other financial metrics. For franchisors experiencing significant growth, this adds potential undue capital call requirements and financial pressure when in reality the cash position of these companies is very strong.

Under Topic 606, onboarding costs are currently deferred and recognized over the same period as the franchise agreements. Permitting franchisors to recognize these costs and related revenue in the period incurred or upon opening by the franchisee greatly simplifies the administrative burden placed on the accounting departments of franchisors. In addition, the means to match future performance obligations and expenses is attained by charging on-going royalty fees.

Some franchisors are structured as a separate entity with additional related entities separately owning the intellectual property and providing personnel, support, and concepts. Under existing guidance, this creates additional burden for franchisors to track and charge related-party services and record transactions via inter-company accounts related to these activities. This then requires consideration of the franchising entity's ability to repay the related-party services which adds additional costs in connection with assurance services.

***Question 2: Should the scope of the amendments in this proposed Update be limited to franchisors that are not public business entities? Alternatively, would it be appropriate for entities in other industries with comparable arrangements that are not within the scope of the proposed Update to analogize to the amendments? Please explain why.***

We support avoiding "industry specific" limitations in favor of guidance that is applicable to non-public business entities that have similar burdens and fact patterns. There are other cases where a right to use intellectual property or some other type of initial fee, such as memberships or initiation fees, are currently deferred and recognized over the estimated life of a member. A broad exception could be made in cases where the use of intellectual property or initial membership or initiation fees are perfunctory in relation to other performance obligations in the contract.

***Question 3: Would the proposed amendments to simplify Step 2—identify the performance obligations—reduce the cost and complexity of applying Topic 606 to pre-opening services? Please explain why or why not.***

It would substantially simplify and reduce costs and reduce the burden on franchisors' accounting departments by simplifying the identification of performance obligations as opposed to capturing costs and deferring these over the term of the franchise agreements. From a practical and economic standpoint, pre-opening services are one performance obligation and are seen as such by both parties (franchisor and franchisee) to the franchise agreement.

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We believe that by taking this proposed amendment one step further to include other costs related to initial franchise fees, such as commissions, etc., and allowing franchisors to have the ability to recognize the related revenue and costs upon the completion of their performance obligations related to the initial franchise fee would also reduce costs to franchisors as well as allow for the proper matching of revenue and expenses related to performance obligations. As mentioned above, the charging of on-going royalties to a franchisee is meant to attain the proper matching of performance obligations as well as the proper matching of expenses.

***Question 4: In paragraph 952-606-25-3, the proposed amendments would reinstate superseded guidance from paragraph 952-605-25-4 as a required criterion for applying the practical expedient. Is this guidance operable? Please explain why or why not.***

We believe that in general this paragraph addresses a hypothetical situation that is not based on economic substance. A franchisee would be reluctant to pay more than market value for the costs of on-boarding in the form of a front loaded initial franchise fee, and franchisors have nothing to gain from reducing future royalties in exchange for a larger upfront fee. In most cases, franchisors are focused on the recurring revenue opportunities afforded by royalties. Franchisors are incentivized to onboard franchisees at a reasonable cost in order to protect and generate this future revenue stream and to promote franchise growth. Franchisors could amend new franchise agreements to lower the initial franchise fees and increase royalty rates. Requiring a franchisor to apply the reinstated guidance in paragraph 952-605-25-4 adds complexity with no additional value and likely would lead to improper matching of expenses and revenue.

***Question 5: Should the scope of the proposed amendments be limited to pre-opening services? If not, please explain why.***

We believe the proposed amendments should address pre-opening services and the attachment of the use of symbolic intellectual property to the initial franchise fee. In addition, the scope should also include any other potential up-front costs in connection with the sale of the franchise, such as commissions on the initial franchise fee. Initial franchise fees are a small portion of the overall total revenue related to a franchise agreement. Other potential revenue streams include royalties, marketing fees, and other ancillary services, such as IT, accounting, call center, and so on, which are substantially larger than the initial franchise fee over the term of the franchise agreement.

***Question 6: Is additional guidance about other aspects of applying Topic 606 to pre-opening services needed for the proposed amendments to be operable? If so, what specific guidance is needed?***

We do not believe additional guidance would be needed on other aspects of Topic 606 other than what is included above.

***Question 7: Should entities that elect to apply the practical expedient be required to disclose that fact? Do the proposed amendments provide decision-useful information for users of financial statements? If not, please explain why.***

We believe that entities that elect to apply the practical expedient should be required to disclose the fact because there will be a difference in accounting treatment compared to what is seen in publicly traded franchisors.

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Also, we believe that the proposed amendment does provide decision-useful information for users of financial statements. Franchisor audited financial statements are included within their franchise disclosure document which is provided to potential franchisees. With the existing guidance, some franchisors show net losses and negative equity, which may mislead a potential franchisee in regards to the financial stability of the franchisor.

***Question 8: Should entities that have not yet adopted Topic 606 be required to apply the transition provisions and effective date in paragraph 606-10-65-1 to the proposed amendments? If not, please explain why.***

We believe that entities that have not yet adopted Topic 606 should be required to apply the transition provisions and effective date in paragraph 606-10-65-1 to the proposed amendment. In order to maintain consistent financial reporting among franchisors, they should all be reporting consistently. In most cases the application will not change the entities that have not yet adopted Topic 606 related to revenue recognition under FASB ASC 605, *Revenue Recognition* (Topic 605.)

***Question 9: Should entities that have already adopted Topic 606 be required to apply the proposed amendments on a full retrospective basis, including an entity's first reporting period under Topic 606? If not, please explain why.***

We believe that entities that have already adopted Topic 606 should be required to apply the proposed amendments on a full retrospective basis. Again, this would maintain consistency in financial reporting among franchisors.

***Question 10: For entities that have already adopted Topic 606, should the proposed amendments be effective for annual reporting periods beginning after December 15, 2020, including interim reporting periods within that period, with early application permitted? If not, please explain why.***

We believe that the proposed amendments should be effective for both annual and interim reporting periods beginning after December 15, 2020. For entities that have already adopted Topic 606, we believe that early adoption should be permitted with a full retrospective transition basis. This will allow more flexibility and drive consistent financial reporting among franchisors.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions you may have.

Sincerely,



CliftonLarsonAllen LLP