Florida Institute of Certified Public Accountants

October 26, 2020

Technical Director
File Reference No. 2020-600
FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, *Franchisors—Revenue from Contracts with Customers (Subtopic 952-606)*

Dear Technical Director:

The Accounting Principles and Auditing Standards Committee (the Committee) of the Florida Institute of Certified Public Accountants (FICPA) respectfully submits its comments on the referenced proposal. The Committee is a technical committee of the FICPA and has reviewed and discussed the above referenced proposed ASU. The FICPA has more than 19,600 members, with its membership comprising primarily CPAs in public practice and industry. The Committee comprises 26 members, of whom 42% are from local or regional firms, 19% are from large multi-office firms, 19% are sole practitioners, 4% are in international firms, 8% are in education, and 8% are in industry. Regarding the practical expedient under consideration (PE), the Committee has the following comments to the Board's questions numbered below:

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.***

On balance, the Committee supports introducing such guidance. It is readily apparent that private company franchisors require swift relief, given the unique complications and burdens associated with their accounting for initial franchise fees (IFFs). The Committee applauds the Board's efforts in responding to persistent requests for clarifications on the relevant issues. However, the prolonged struggle of these franchisors in designing cost-effective implementations, along with their widespread adoption of distortive "self-help" measures (e.g., crude simplifications about uniformly recognizing IFFs over the license terms), suggest that a codified simplification—and not merely education—is advisable.

The cost and complexity to these entities of identifying performance obligations and determining standalone selling prices concern the Committee. In determining whether pre-opening services are distinct from promised franchise licenses, franchisors routinely encounter complications in applying the codification's criteria in paragraph 606-10-25-19. When a private company franchisor evaluates the "capability" criterion, for instance, it often considers whether a pre-opening service transfers a benefit to the franchisee directly and whether such benefit exists without regard to the franchisee's license use. These considerations, in turn, may require understanding the relationship between the franchisee's rights to intellectual property (typically symbolic) and a (concrete) list of pre-opening services.

For some services, the degree of brand-specificity and other indicators may be conspicuous and readily discernible from the franchise agreement. But for others, judgments may prove far more layered and nuanced. In some instances, the ability of a franchisee to benefit from a pre-opening service (without use of the license) may be shaped, indirectly, by laws and regulations. Judgments may be further complicated by the need to consider effects of implicit promises and, more generally, the franchisor's customary business practices.

When a private company franchisor later allocates the transaction price to identified performance obligations, its determinations of standalone selling prices often will entail a significant share that are not directly observable (unbundled, considered in isolation); will require extensive reliance on unobservable inputs in applying estimation methods; and as a corollary, will provide an unwelcome burden and undue cost to the franchisor.

And all of the above complexity to what avail? Aside from costs, the Committee believes that the aggregate effect of these determinations is a process vulnerable to material misjudgments and inconsistent assumptions, including those made among similarly situated franchisors. Consider that, as noted in BC12, "The primary users of nonpublic franchisor financial statements are regulators and *franchisees* (both current and prospective)." (Emphasis added.) Also, as mentioned in BC25, "nonpublic franchisors are more likely than public franchisors to be in a start-up or growth phase." Based on the Committee's auditing experience, these "start-up" franchisors often have only a handful of outlets open during this phase. Each outlet may, therefore, represent a substantial share of the revenue from IFFs, which may predominate over royalty fees and other fees in terms of relative contributions to overall revenue. In this high-stakes environment, material misjudgments and inconsistent assumptions among similarly situated franchisors, even in relation to the pre-opening of a *single outlet*, can threaten to gravely misinform or confuse prospective franchisees.

For these reasons, the Committee believes relief is warranted in the form of a practical expedient. It acknowledges the issues raised by the alternative views in the exposure draft. Ultimately, though, the Committee accepts that, even under the principles-based framework of Topic 606, accommodation for *some* industry-specific, incremental guidance is inevitable. When introduced, such guidance should ideally, consistent with the guiding principles of the FASB's Rules of Procedure, "fill a significant need." In this circumstance, the Committee believes such need is self-evident, and it is hopeful for a solution appropriately tailored to the unique challenges at issue.

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.***

Generally, the Committee supports the narrowly designed scope of the proposed amendments to franchisors that are not public business entities. In particular, the Committee finds the reasoning provided in BC25 through BC27 to be persuasive regarding the considerations raised therein. Additionally, the Committee believes that when this revenue recognition issue is considered under the Private Company Decision-Making Framework, *Differential Factor IV* (involving the difference in accounting resources between private and public companies) produces an especially harsh result. The Committee also reasons that, at this time, there is little-to-no cost-benefit justification that would support a broader scope.

And while the Committee finds the "slippery slope" themed warnings, provided in the alternative views, to be exaggerated, it urges caution before assuming the existence of "comparable arrangements" in other industries. The Committee believes that so long as the Board addresses industry-specific Topic 606 issues in a surgical and limited manner, as supported by industry-tailored reasoning, the integrity of the Topic 606 framework will not unravel. It should be emphasized, as well, that the critical factors underlying the Board's protracted review, which has spanned several years and progressed through multiple procedural agendas, have focused almost exclusively on the concerns of private company franchisors.

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.***

Generally, the Committee believes the proposed amendments would simplify the identification of performance obligations and would reduce the cost and complexity of applying Topic 606 to pre-opening services.

On the one hand, the list under proposed paragraph 952-606-25-2 effectively limits the extent of time-consuming and complex judgments otherwise required. (See the Committee's response to *Question 1*.) However, there were concerns within the Committee regarding issues raised in BC42, including "questions inevitably [arising] about the items included in the list, the ongoing maintenance of the list . . . and the applicability of the list to an entity's unique facts and circumstances." These concerns were well grounded and reasonable, and perhaps the Board should perform targeted outreach to understand whether representative participants of the "220 sectors within franchising" foresee such problems over the long term. However, it should be noted that the list derives largely from the (superseded) definition of "initial services" provided in Section 952-605-20. Incidentally, the list is also reasonably consistent with services described by the Federal Trade Commission in its (non-exhaustive) list under 16 C.F.R. § 436.5, in the context of Franchise Disclosure Document requirements. Committee members who had performed engagements for private company franchisors under the prior "substantial performance" standard by applying (superseded) paragraph 952-605-25-2, which relied in part on the definition of "initial services," observed that the definition had not been a significant source of uncertainty.

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.***

The Committee believes this type of guidance is generally operable and that it is critical to preventing distortions when "the structure of the payments may not reflect the economics of the transaction." (See BC20.) While providing slightly different operative *effects*, the proposed guidance would apply in the same circumstances in which the superseded guidance applied. Entities' experience with the prior guidance provides a reliable indication that they can cost-effectively identify the relevant circumstances. However, because the criterion can single-handedly cut off the PE's availability, the Board should consider whether assumptions or discretion in determining "continuing cost of services plus a reasonable profit" should be limited or clarified. Although not inherently vulnerable to abuse or error, the criterion may produce a more reliable and consistent effect if the Board provided *explicit* limitations on the discretion and application of forecasting assumptions, use of historical data, etc. (or provided a link to other guidance).

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

The Committee believes that the scope of the proposed amendments should be so limited. For further detail regarding the Committee's views on the scope of the proposal, see its response to *Question 2*.

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?***

The Committee did not form a meaningful consensus on this question. Some members urged restraint in the belief that further guidance was unnecessary and may threaten to complicate the PE, thereby undermining its purpose. Others offered thoughtful critiques and raised the possibility of an overlaying definition of "pre-opening services" for the proposed Subtopic. The reasoning was that, by placing the PE's list in the context of a broader category of pre-opening services, private company franchisors could more effectively make determinations regarding the PE's applicability. (See also the Committee's response to *Question 4* re: potential guidelines in determining "continuing cost of services plus a reasonable profit" under proposed paragraph 952-606-25-3.)

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.***

The Committee believes that the PE should include a disclosure requirement for entities electing to apply it. In particular, members aligned themselves with the Board's reasoning offered in BC32.

Neither members in public practice nor those working in industry identified any credible justification for omitting such a simple and low-cost requirement.

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.***

The Committee believes that the transition provisions and effective date in paragraph 606-10-65-1 are sensible as applied in these circumstances.

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.***

For these entities, such a requirement would prove overly burdensome, and the Committee encourages the Board to permit a modified retrospective transition. The Committee acknowledges the issues raised by the Board regarding comparability and the evaluation of trends. However, Committee members, particularly those from industry, voiced concerns about the significant burdens that a full retrospective requirement would entail. Another concern was related to possible momentary confusion, and the potential for oversights, among early-adopting franchisors in their first annual reporting periods beginning after December 15, 2019 to the extent they are required to produce three years of certain statements in tabular form. In these circumstances, the Committee believes that most early-adopters will understand the interaction of such requirements, but many will not. Additionally, the Committee believes that the limitations of a modified retrospective transition can be mitigated by meaningful disclosures.

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.***

The Committee agrees with the above-referenced effective date for entities that have already adopted Topic 606. In its view, a significant share of nonpublic franchisors that have transitioned to Topic 606, particularly among those that have overseen a small number of outlet openings, would eagerly welcome the opportunity to apply the PE for periods beginning before such date. Accordingly, the flexibility afforded by the option for early application, if ultimately codified, should provide relief for these entities and may additionally increase comparability among smaller franchisors for annual reporting periods beginning *before* December 15, 2020.

The Committee appreciates the opportunity to respond to the exposure draft. Members of the Committee are available to discuss any questions you may have regarding the responses in this letter.

Respectfully submitted,

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