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November 3, 2020

Ms. Hilary H. Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

File Reference No. 2020-600

Re: Proposed Accounting Standards Update, *Franchisors — Revenue From Contracts With Customers (Subtopic 952-606) — Practical Expedient*

Dear Ms. Salo:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Franchisors — Revenue From Contracts With Customers (Subtopic 952-606) — Practical Expedient*.

ASC 606 was developed to provide “a comprehensive revenue recognition model that applies to a wide range of transactions and industries” that would, among other things, improve “comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets.”¹ Amendments to ASC 606 that create an optional alternative accounting model for a specific type of reporting entity or industry compromise the benefits of this objective and therefore should be rare.

In considering the FASB's efforts to address the accounting and financial reporting concerns of private companies, we note that the Board's *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (the “*Decision Framework*”) provides relevant guidance. Specifically, paragraph 1.3 of the *Decision Framework* notes that a practical expedient may be appropriate if it “could satisfy the needs of users of private company financial statements while reducing the cost and complexity for preparers of those financial statements” and that the “term *practical expedient* means a more cost-effective way of achieving the same or a similar accounting or reporting objective.”

We do not believe that the proposed amendments represent a practical expedient because they would not achieve “the same or a similar accounting or reporting objective.” Instead, because some franchisors that have adopted ASC 606 have concluded that certain preopening services are not distinct, we believe that the proposed amendments would permit accounting treatment that is an alternative to the requirements in ASC 606. Nonetheless, if the Board obtains information from users of private-company franchisor

¹ See paragraph BC3 of ASU 2014-09, *Revenue From Contracts With Customers*.

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financial statements indicating that the financial reporting outcome would still “satisfy the needs of users of private company financial statements” under the *Decision Framework*, we would not object to the proposed accounting alternative for franchisors that are not public business entities.

We believe that the proposed amendments would reduce some of the cost and complexity of preparing a private-company franchisor’s financial statements because they would simplify the analysis and lessen the amount of judgment management would need to use when identifying performance obligations in a franchise agreement. However, we have concerns about the example in the proposed ASU. ASC 952-606-25-4 in the proposed ASU states that the “practical expedient in paragraph 952-606-25-2 applies only to identifying performance obligations” and that an “entity should refer to Topic 606 for guidance on the remaining aspects of recognizing revenue from contracts with customers, including allocating the transaction price and recognizing revenue.” However, we do not believe that it is clear that Example 1 in ASC 952-606-55-1 through 55-8 of the proposed ASU is consistent with the guidance in ASC 606-10-32-28 and 32-29. Specifically, it is not clear whether the transaction price is allocated to each performance obligation on a relative stand-alone selling price (SSP) basis. Accordingly, we question whether a residual approach was used in that example to allocate the transaction price to the franchise license, particularly since proposed ASC 952-606-55-4 states that “the entity regularly provides franchise renewals in exchange for 5 percent of customer sales **without a similar upfront fee**” (emphasis added). While proposed ASC 952-606-55-4 states that the initial franchise fee is “commensurate with [the entity’s] level of effort in providing the pre-opening services plus a customary nonrefundable fee associated with the intellectual property,” because renewals do not include a similar “customary nonrefundable fee,” it is not clear whether the transaction price should instead be allocated to the performance obligations on a relative SSP basis (because the 5 percent royalty is the SSP of the license and the initial franchise fee is priced at a premium) or whether some portion of the up-front fee is associated with a potential material right (because the SSP of the license is \$5,000 plus the 5 percent royalty but the \$5,000 is not paid upon renewal). We therefore recommend that the Board amend the example to either (1) clarify how the allocation objective in ASC 606-10-32-28 and 32-29 has been met or (2) remove the guidance on how the transaction price should be allocated to the identified performance obligations. Further, we believe that the analysis in Case A of Example 1 should be expanded to include an evaluation of all the requirements and indicators in ASC 606-10-25-19 through 25-21 (e.g., explanation of a lack of significant integration) rather than only stating that the services are not brand-specific or could be provided by a third party.

The appendix below contains our responses to the proposed ASU’s questions for respondents.

We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Sandie Kim at (415) 783-4848.

Yours truly,
Deloitte & Touche LLP

cc: Robert Uhl

Appendix
Deloitte & Touche LLP
Responses to Proposed ASU's Questions for Respondents

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 do not object to the proposed accounting alternative for franchisors that are not public business entities if the Board obtains information from users of private-company franchisor financial statements indicating that the financial reporting outcome would still “satisfy the needs of users of private company financial statements” under the *Decision Framework*. We defer to the views of financial statement users about whether the proposed amendments would affect the usefulness of information related to revenue recognition for preopening services that a private-company franchisor provides to a franchisee.

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.*

Yes, we believe that the amendments in the proposed ASU should be limited to franchisors that are not public business entities. We do not believe that it would be appropriate for entities in other industries with comparable arrangements that are not within the scope of the proposed ASU to analogize to the amendments because ASC 606 is intended to provide comprehensive guidance to all entities and industries. Paragraph BC2 of ASU 2014-09 states that one of the reasons the Board undertook the revenue project was because “U.S. GAAP comprised broad revenue recognition concepts and detailed guidance for particular industries or transactions, which often resulted in different accounting for economically similar transactions.” Thus, any deviations from the Board’s objective of achieving accounting consistency for economically similar transactions under ASC 606 should be as limited as possible. Extending the accounting alternative to other entities or industries would reduce the comparability of revenue recognition practices among entities and industries, particularly since the proposed accounting alternative would be optional. Further, since an entity may need to use significant judgment when identifying “comparable arrangements,” inconsistent application or inappropriate analogies could result.

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.*

We believe that the proposed amendments would reduce some of the cost and complexity of preparing financial statements by private-company franchisors because they would simplify the analysis and lessen the amount of judgment management would need to use when identifying performance obligations in a franchise agreement. However, we believe that determining the SSP of the identified performance obligations when there are preopening services that are included in the predefined list, but would not otherwise be considered distinct from the franchise license, could result in additional cost and complexity. For example, if the accounting alternative was not applied and the preopening services were not distinct from the franchise license, determining the SSP for those preopening services would not be required. In addition, we believe that the proposed guidance would add complexity to an entity’s assessment of which activities constitute “continuing services,” as described in our response to Question 4 below.

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 do not believe that the guidance in proposed ASC 952-606-25-3 is necessary because the proposed ASU's amendments are only intended to simplify the process of identifying performance obligations. That is, because private-company franchisors would still be required to apply the guidance on determining the SSP of, and on allocating the transaction price to, each performance obligation, we do not believe that "guardrails" are needed to prevent structuring or abuse of the accounting alternative's application. We agree with the FASB's rationale in paragraph BC18 of the proposed ASU, which states that "if an entity charges a large initial franchise fee but the services provided are minimal, then the standalone selling price should naturally provide a ceiling for how much revenue could be recognized." Therefore, we do not believe that the Board should reinstate the superseded guidance from ASC 952-605-25-4 to prevent abuse and ensure that the allocation objective is met.

However, if the Board decides to retain the proposed guidance in ASC 952-606-25-3, we believe that it would be helpful to clarify what the term "continuing services" includes. While franchisors that historically applied ASC 952-605 may understand the meaning of continuing services under legacy guidance, we recommend that the Board clarify (1) that continuing services are related only to post-opening services and (2) which activities an entity should consider when determining the cost of continuing services to be provided by the franchisor. In particular, because the post-opening services include a right to access the franchisor's intellectual property (IP), and there is at least an implied promise that the franchisor will perform activities to maintain that IP, it is not clear how an entity should consider activities related to one or more franchisees (e.g., activities that maintain the IP, broad-based advertising, supplier management) when applying the requirement in proposed ASC 952-606-25-3.

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

Yes, we believe that the scope of the proposed amendments should be limited to preopening services since the concerns raised by private-company franchisors were limited to such services.

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?*

Yes, we believe that additional guidance on other aspects of applying ASC 606 to preopening services is needed for the proposed amendments to be operable. As stated above, we do not believe that it is clear that Example 1 in ASC 952-606-55-1 through 55-8 of the proposed ASU is consistent with the guidance in ASC 606-10-32-28 and 32-29. Therefore, we recommend that the example be amended to either (1) clarify how the allocation objective in ASC 606-10-32-28 and 32-29 has been met or (2) remove the guidance on how the transaction price should be allocated to the identified performance obligations. Further, we believe the analysis in Case A of Example 1 should be expanded to include an evaluation of all the requirements and indicators in ASC 606-10-25-19 through 25-21 (e.g., explanation of a lack of significant integration) rather than only stating that the services are not brand-specific or could be provided by a third party.

In addition, proposed ASC 952-606-65-1(d) includes transition disclosure requirements for entities that have already adopted ASC 606. It is unclear whether such requirements would replace those in ASC 250. We therefore recommend that the Board clarify the application of the disclosure requirements in ASC

250, particularly those in ASC 250-10-50-1(b), 50-1(c), and 50-2. For example, it is not clear whether entities would be required to disclose a “description of the prior-period information that has been retrospectively adjusted, if any,” under ASC 250-10-50-1(b)(1).

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.*

Yes, we believe that entities that elect to apply the accounting alternative should be required to disclose that fact.

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.*

Yes, we believe that entities that have not yet adopted ASC 606 should be required to apply the transition provisions and effective date in ASC 606-10-65-1 to the proposed amendments.

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.*

Yes, we believe that entities that have already adopted ASC 606 should be required to apply the proposed amendments on a full retrospective basis, including an entity’s first reporting period under ASC 606.

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.*

Yes, we believe that the proposed amendments should be effective for annual reporting periods beginning after December 15, 2020, including interim reporting periods within that period, with early application permitted, subject to feedback from private-company franchisors indicating whether they would need additional time to adopt the proposed amendments.