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November 4, 2020

Ms. Hillary Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2020-600

Re: Proposed Accounting Standards Update, Franchisors – Revenue from Contracts with Customers (Topic 952-605) *Practical Expedient*

Dear Ms. Salo:

Connor Group, Inc. is pleased to provide our comments on the FASB's Proposed Accounting Standards Update, Franchisors – Revenue from Contracts with Customers (Topic 952-605) *Practical Expedient* (Proposal). Connor Group was founded in 2005 and is a technical accounting advisory firm built of Big 4 alumni and industry executives. We currently have over 300 accounting professionals and over 1000 clients and specialize in helping our clients solve complex technical accounting issues under both U.S. GAAP and IFRS. Our clients represent industries such as technology, software, internet, cloud services, life sciences and manufacturing, amongst others. Many of our clients are emerging growth public entities, companies aspiring to become public in the near future, or high-growth private companies.

While we appreciate the effort to simplify revenue recognition for private companies, we object to the issuance of the Proposal in its current form. We agree with the various reasons expressed by the dissenting Board members in paragraphs BC39 through BC46. In particular, we believe the Proposal is more an exception than a "practical expedient" in how Topic 606 is applied.

This is because we believe the proposed "practical expedient" would significantly change the application of Topic 606 for companies in the franchisor industry. As we understand based on our experiences and review of the accounting firms' publications, the AICPA Revenue Recognition Audit & Accounting Guide, and the filings of publicly-held franchisor companies, most entities conclude when applying Topic 606 that the "pre-opening services" as defined in the proposed paragraph 952-606-25-2 are not distinct from the franchise license promised by the franchisor (or alternatively may be characterized as internal activities that do not transfer goods or services to the franchisee).



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In those rare instances when the pre-opening services are distinct, we also do not find the proposed treatment to combine the various promises comprising the pre-opening services into a single performance obligation to be useful. We believe entities would be able to reach this conclusion even in the absence of a practical expedient. Further, even if the individual pre-opening services are not combined and are each treated as a separate performance obligation, this will likely have a minimal effect on recognition of revenue.

The accounting profession achieved a major milestone under the Board's leadership when the FASB, in close coordination and near-convergence with the International Accounting Standards Board, was able to issue what is now known as Topic 606. This allowed practicing accountants to get rid of thousands of pages of industry-specific guidance originating from different decades and with different prevailing concepts in mind. Instead, a single uniform principle-based standard was introduced that, while in some respects technically not always easy to apply, substantially improved the quality of revenues reported by companies in their financial statements.

We see no reason why a narrowly defined industry should be entitled to a preferential treatment by virtue of a custom-crafted "practical expedient". We draw the Board's attention to the fact that the franchisor industry is not the only one that has encountered challenges in transitioning to Topic 606. If industry-specific guidance were to exist for this industry, there should be no substantive reason it should not exist for other industries in similar circumstances.

For example, there is a perception in the software industry that the model requiring upfront recognition of most term software licenses is inconsistent with the economics of the underlying business. We appreciate the challenges the Board and the staff had in developing a principle-based model that enables meaningful recognition of revenue for any types of intellectual property licenses. However, the current model does result in substantial costs on both the software companies that sell term licenses and the users of their financial statements. The cost is driven by entities trying to retain ratable revenue recognition either through development of the associated accounting positions, or implementation of business changes along the lines of a proverbial tail wagging a dog. Many of these entities feel challenged to explain their financial performance to investors and other users. For the users, the cost is incurred in understanding the performance results, as they may become engaged in developing their own alternative performance measures to "neutralize" the effect of upfront recognition of the term licenses.

The adoption of the proposed "practical expedient" for the franchisor industry is likely to be noticed in other industries, which eventually could lead to a repeat of the pre-Topic 606 situation, with industry-specific guidance permeating the revenue recognition landscape.



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We are also not convinced that the proposed “practical expedient” results in a reasonable cost-benefit ratio to justify a significant departure from the recognition principles of Topic 606.

The Board itself acknowledged in paragraph BC12 that the proposal will likely result in additional costs to the users of the financial statements. As related to the preparers, we do not expect any savings will be significant. Usually franchisors have the ability to structure their franchise transactions in the same or substantially the same manner, utilizing a master agreement framework. This means once performance obligations have been analyzed under Topic 606 for one transaction, the same analysis can be applied for any number of additional similarly structured transactions. While it is true the adoption of Topic 606 is not always straightforward, effectively, the proposed “practical expedient” will merely reduce the franchisor’s cost of preparing a single technical accounting memorandum.

We are also concerned about the statements in paragraph BC10 of the Proposal that the proposed “practical expedient” would allow to achieve “financial reporting results that are more consistent with the intent of Topic 606 for those entities that are nonpublic business entities”. This raises a broader question as to whether Topic 606 as it exists is consistent with its “intent” in various specific areas, as well as whether the “intent” of Topic 606 was to result in different accounting conclusions for public and nonpublic business entities.

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We would be pleased to respond to any questions the Board might have regarding our comments.

Sincerely,

Connor Group, Inc.

Accounting Standards and Professional Practice Group