

Board Meeting Handout
Reference Rate Reform: Refining the Scope of Topic 848
December 9, 2020

Meeting Purpose

1. The December 9, 2020, meeting is a decision-making meeting. The purposes of this handout are to (a) provide a summary of comments received on the proposed Accounting Standards Update, *Reference Rate Reform (Topic 848): Scope Refinement*, which was issued on October 29, 2020, with the comment period ending on November 13, 2020, and (b) serve as a basis for the Board's discussion and redeliberations on the proposed Update.

Questions for the Board

Scope Refinement

- 1) Does the Board want to affirm its decision to refine the scope of Topic 848 amended for the following to improve the clarity and operability of the guidance:
 - a) Clarify that contract modification relief may be applied to contracts that reference the London Interbank Offered Rate (LIBOR) or another reference rate that is expected to be discontinued as a result of reference rate reform and that are affected by the discounting transition?
 - b) Simplify the hedge accounting relief by removing the prescriptive guidance as proposed in paragraph 848-30-25-9A on the addition of one or more basis swaps?

Additional Issues Identified

- 2) Does the Board want to provide additional optional relief to allow receive-variable-rate, pay-variable-rate cross-currency interest rate swaps that are affected by reference rate reform to continue to qualify as eligible hedging instruments in net investment hedges?

Transition and Effective Date

- 3) Does the Board want to affirm its decision that the optional relief guidance should be effective immediately with retrospective application available as of the date of application of the amendments in Accounting Standards Update No. 2020-04, *Reference Rate Reform*

(Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting?

Cost-Benefit Analysis and Permission to Ballot

- 4) Does the Board think that the expected benefits of the changes would justify the expected costs of the changes? If not, is there additional information that the Board needs to make that determination?

- 5) Does the Board give the staff permission to draft a final Update for vote by written ballot?

Comment Letter Demographics

2. The 11 respondents to the proposed Update are summarized below by type as follows:

Respondent Type	
Professional Associations	2
State Society of CPAs	1
Auditors	5
Preparers	2
Consultant	1
Total:	11

Summary of Comments Received

General

3. All respondents expressed broad agreement with the proposed scope refinement. Respondents noted that the amendments in the proposed Update would address diversity in practice by mitigating the costs and complexity of accounting for contract modifications and the effect on associated hedging relationships resulting from the discounting transition. Most respondents expressed agreement that the proposed amendments are operable, however, some provided additional suggestions to further improve the clarity and operability of the guidance.

Scope (and Consequential Application of the Contracts Modification Guidance)

4. One respondent noted that the proposed amendments could preclude contracts that reference LIBOR or another reference rate expected to be discontinued from electing contract modification relief for the discounting transition due to scope language in paragraph 848-20-15-2 that requires all modifications to be contemporaneous with the modification to replace, or have the potential to replace, a reference rate with another interest rate index. In response, the respondent requested that the Board clarify that the contract modification relief can be applied to contracts that reference LIBOR or another rate expected to be discontinued separately from when an entity elects the contract modification relief for changing the reference rate of the contract to a new reference rate.

Basis Swaps

5. Stakeholders indicated that the prescriptive guidance in paragraph 848-30-25-9A in the proposed Update would be of limited usefulness and may introduce complexity. One respondent requested that the Board provide additional guidance to address that complexity.

Other Feedback

6. Some respondents noted that they did not view the discounting transition as a change in critical terms that would require reassessment of previous conclusions that a financial instrument is a derivative or the dedesignation of a hedging relationship (that is, in the view of those respondents, the proposed amendments were not necessary). Those respondents were still supportive of the Board's proposed amendments because the respondents acknowledged (a) the potential for diversity in practice under current GAAP and (b) that having clear guidance would ensure consistency and comparability in financial reporting.
7. However, those respondents pointed out that subjecting the discounting transition relief to the sunset provisions in Topic 848 may create the need to seek an extension of this guidance for the population of bilateral contracts that undergo the discounting transition after the sunset date. Those respondents requested that the Board consider either eliminating the sunset date associated with the relief related to the discounting transition or addressing the issue through amending accounting guidance within Topic 815, Derivatives and Hedging. In addition, if similar changes to interest rates used for discounting, margining, or contract price alignment that are unrelated to reference rate reform occur in the future, the accounting guidance would not directly address the issue and would effectively reintroduce diversity in practice.

Additional Issues Identified

Net Investment Hedges

8. A few respondents highlighted that in instances in which an entity is using a receive-variable-rate, pay-variable-rate cross-currency interest rate swap as a hedging instrument the existing guidance in Topic 848 may not be sufficient to avoid dedesignation. Those respondents have requested that the Board consider additional relief to allow for those instruments to continue to qualify as hedging instruments during the transition period.

Transition and Effective Date

9. The proposed amendments would be effective immediately and allow an entity to elect to apply those amendments on a full retrospective basis as of any date from the beginning of the interim period that includes or is subsequent to March 12, 2020, or on a prospective basis to new modifications from any date within the interim period that includes or is subsequent to the date of the issuance of a final Update, up to the date that financial statements are available to be issued.
10. All respondents expressed broad agreement with the proposed transition method.

Board Meeting Handout
Revenue Recognition—Practical Expedient for Private Company Franchisors
December 9, 2020

Meeting Purpose

1. The December 9, 2020 Board meeting is a decision-making meeting. The purpose of this meeting is for the Board to discuss feedback received on the proposed Accounting Standards Update, *Franchisors—Revenue from Contracts with Customers (Subtopic 952-606): Practical Expedient for Private Company Franchisors*, and to begin its redeliberations on this project.

Questions for the Board

Issue 1: Project Direction

1. Which path does the Board select for the project direction (Path 1: move forward with a simplified Step 2 approach or Path 2: shift focus to educational efforts rather than standard setting)?

If the Board selects Path 2 in Question 1, then none of the remaining questions are applicable.

Issue 2: Guidance for Simplification of Step 2

Issue 2 is only applicable if the Board selects Path 1 in Issue 1

2. Which alternative does the Board select for simplified Step 2 guidance (Alternative 1: account for pre-opening services as distinct or Alternative 2: account for pre-opening services as not distinct)?

2(a). Would the Board like to characterize the selected alternative as a practical expedient or as a private company accounting alternative? If the Board selects an accounting alternative, does the Board consider the amendments to be (i) in accordance with the guidance in the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (PCDMF) or (ii) an exception to the guidance in the PCDMF?

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Questions 3–5 are only applicable if the Board selects Alternative 1 in Issue 2

3. Which option does the Board select regarding the screen criterion about whether the continuing fee will cover the cost of the continuing services (Option 1: remove the screen criterion from the amendments in the final Update, Option 2: affirm the screen criterion as drafted in the proposed Update, or Option 3: affirm the screen criterion, but update the drafting to use Topic 606 terminology)?

4. Which option does the Board select regarding the determination of whether the services on the list should be accounted for as a single performance obligation or analyzed under Step 2 of Topic 606 (Option 1: single performance obligation [affirm as drafted in the proposed update]). Option 2: apply Step 2 of Topic 606 to the pre-opening services, or Option 3: accounting policy election)?

5. Does the Board want to affirm its decision to provide a predefined list of services to be accounted for as distinct? Would the Board like to affirm the list that was included in the proposed Update?

Question 6 is only applicable if the Board selects Alternative 2 in Issue 2

6. Does the Board want to affirm its decision to include the simplified Step 2 guidance within Topic 952, Franchisors, or include the guidance in Topic 606?

Questions 7–11 are applicable only if the Board selects Path 1 in Issue 1 and regardless of whether the Board selects Alternative 1 or Alternative 2 in Issue 2

7. Does the Board want to retain the examples in Case A and Case B or should (a) the example be limited to the application of the amendments (note that Case A illustrates application of Topic 606 as issued and Case B illustrates application of the amendments) or (b) the examples be removed entirely from the final guidance?

Issue 3: Scope, Disclosures, and Transition

8. Does the Board want to affirm its previous decisions on scope, disclosures, transition method, and transition disclosures? If the Board selects Option 3 in Question 4, would the Board like to add a disclosure for the accounting policy election?

Issue 4: Effective Date

9. Does the Board want to affirm its previous decisions about effective date or does the Board want to amend the effective date to be consistent with the effective date approach for private company accounting alternatives?

Costs and Benefits

10. Would the expected benefits of the changes justify the expected costs of the changes? If not, is there additional information that the Board needs to make that determination?

11. Does the Board give the staff permission to draft a final Update for vote by written ballot?

Project Background

2. The Board decided to undertake this project to address issues raised by stakeholders regarding the level of effort required for nonpublic franchisors to determine whether pre-opening services (that is, services performed in advance of opening a new franchise location) are distinct under Topic 606, Revenue from Contracts with Customers. Stakeholders asserted that nonpublic franchisors were spending significant time and money analyzing whether pre-opening services are distinct from the franchise license and also to determine the standalone selling price of any separate performance obligations. The Board also became concerned that some nonpublic franchisors appeared to presume that the initial franchise fee would always be recognized over the franchise license term rather than applying the guidance in Topic 606 to identify performance obligations. The Board observed that the guidance does not include such a presumption.
3. The objective of the amendments in the proposed Update was to introduce a practical expedient to reduce the cost and complexity of applying the Step 2 guidance—identify performance obligations—in Topic 606 to pre-opening services. The practical expedient would allow nonpublic franchisors to account for pre-opening services as a single performance obligation if they are consistent with those included in a predefined list in the guidance. The questions in the proposed Update focused on the following five main areas: practical expedient, scope, operability, disclosure, and transition and effective date. The comment letter feedback is provided by area, and the corresponding proposed Update questions are included within each section.

Comment Letter Feedback

4. The comment period for this proposed Update ended on November 5, 2020. Twenty-one letters were received on this proposed Update. Most respondents addressed every question, although some focused only on specific questions and areas, while others answered all questions and provided detailed comments for each area. The following table provides information on the composition of the comment letter respondents by respondent type:

Type of Respondent	Number of Respondents
Preparer	1
Practitioners	10
Trade Association	1
State CPA Societies	6
Consultants	2
Individual	1
Total Respondents	21

5. Overall, the comment letter feedback was mixed about whether to provide a practical expedient, as proposed. Approximately half of the respondents agreed with the amendments in the proposed Update and indicated that they would reduce the cost and complexity of applying Topic 606. Those respondents who agreed with the simplified Step 2 approach generally commented that the proposed amendments were operable but provided some suggestions for clarifying or improving certain aspects of the guidance.
6. The other half of respondents disagreed with the amendments in the proposed Update because they cited that the simplified Step 2 approach would introduce industry-specific guidance to a principles-based standard. Most of those respondents stated that the proposed amendments represent an accounting exception and not a practical expedient (many of those respondents agreed with the Alternative Views described in the proposed Update). Some of those respondents noted that the threshold for a private company accounting alternative under the Private Company Decision-Making Framework (PCDMF) would not be met.
7. While there were mixed views whether to move forward with the proposal, almost all respondents agreed that if the Board chooses to do so, the scope should be limited and generally agreed with the proposed disclosure and transition and effective date.

Area 1: Practical Expedient

Background

8. The amendments in the proposed Update are intended to simplify Step 2 of the revenue recognition model, which requires that entities determine whether goods or services transferred to a customer are separate performance obligations. The Board received feedback that this part of the model is difficult and costly for franchisors to apply. The proposed amendments would allow nonpublic franchisors to account for pre-opening services as distinct if they are consistent with those included in a predefined list in the guidance. That list was developed by leveraging the superseded definition of *initial services* in the Master Glossary of Topic 952, Franchisors, with some modifications.

Summary of Comments

9. As noted earlier in the handout, the comment letter feedback was mixed, with approximately half of respondents disagreeing with the proposal and the other half agreeing. Those respondents who disagreed generally expressed concern about introducing industry-specific guidance to a principles-based standard and noted that the amendments in the proposed Update seem to be an accounting exception, rather than a practical expedient. That is, their concern was about broader implications to revenue recognition and setting precedents for exceptions rather than focusing solely on the specific franchise issue. Some respondents commented that the proposed amendments would significantly reduce costs and asserted that the proposed practical expedient would aid the franchise industry in implementing Topic 606.

Questions 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.

10. All 21 respondents commented on this question. Eight of those respondents agreed with introducing the guidance in the proposed Update for franchisors that are not public business entities. Generally, those respondents commented on the cost and complexity of applying Topic 606 to initial franchise fees. A state CPA society and a trade association noted that despite the Board's previous efforts to clarify the guidance through educational efforts, franchisors have continued to struggle with applying the guidance and, in some cases, have resorted to recognizing the initial franchise fee over the franchise license term rather than performing an analysis under Topic 606. Those respondents stated that, in many cases, significant judgment is required to determine whether pre-opening services are distinct from the franchise license, which can lead to differences in reporting outcomes among franchisors.

They noted that this makes it harder for prospective franchisees to compare franchisor financial statements. The trade association commented that franchisors typically conclude that some pre-opening services are distinct under Topic 606, but that they incur excessive costs to perform that analysis. The state CPA society stated that even though Topic 606 is a principles-based standard, the need for relief in this area warrants introducing industry-specific guidance.

11. A practitioner stated that, in most cases, Topic 606 requires that franchisors recognize the initial franchise fee over the franchise license agreement, which is typically 7–10 years. That practitioner stated that the initial franchise fee is generally charged to cover a franchisor's costs of providing pre-opening services and that the royalty is structured to cover the franchisor's ongoing costs. Therefore, the practitioner stated that revenues and expenses are not matched when the initial franchise fee is deferred. Instead, it suggested that franchisors be permitted to recognize both the costs and related revenue in the period incurred or when the franchise location is opened. The practitioner further stated that deferring the initial franchise fee could result in a negative equity position that may prompt regulatory consequences. Additionally, that practitioner commented that some franchisors are structured such that a separate entity owns the intellectual property and provides other ancillary services, which creates an additional difficulty for franchisors in accounting for those transactions.
12. Two respondents conditionally agreed with introducing the guidance in the proposed Update. A state CPA society agreed with introducing the proposed guidance but expressed concern that many industries may request relief if guidance is provided for public entities, and, therefore, they stated that exceptions to Topic 606 should be made only for nonpublic entities, as proposed. A practitioner agreed with introducing the proposed guidance, particularly because of the regulatory effects on certain nonpublic franchisors. However, that practitioner stated that the guidance appears to be an exception, rather than a practical expedient, because it excludes certain services from the Step 2 evaluation and may result in a different accounting outcome than the Topic 606 guidance, as written. That practitioner commented that it is important for the Board to be clear about the nature of the amendments in the proposed Update because it may be easier to avoid further expansion if the Board clarifies that the guidance is a narrow-scope exception.
13. Two practitioners conditionally disagreed with introducing the proposed guidance. One of those practitioners stated that it opposes the amendments in the proposed Update because they would introduce industry-specific guidance to a principles-based standard. Additionally, both practitioners commented that the proposed amendments do not seem to align with the definition of *practical expedient* in the PCDMF and, instead, seem to be an accounting

alternative. However, they stated that if the Board receives feedback from users that the proposed amendments would provide decision-useful information and, therefore, would be acceptable as a private company accounting alternative in accordance with the PCDMF, then they would not oppose them.

14. Nine respondents disagreed with the guidance in the proposed Update. All nine of those respondents stated that introducing guidance for nonpublic franchisors would be counter to the objectives of Topic 606, which included eliminating industry-specific guidance and driving more comparable revenue recognition across entities and industries. Several of those respondents commented that there are similar arrangements in other industries; therefore, it does not make sense to limit the amendments in the proposed Update only to franchisors. Many of those respondents were concerned that finalizing the proposed guidance might set a precedent for making industry-specific exceptions for revenue guidance. A state CPA society commented that it opposes variances from a prescribed standard for a specific industry, and that this proposal would permit a variance from the measurement requirements of Topic 606 for a specific industry.
15. Of the respondents who disagreed with introducing the proposed guidance, eight commented that the guidance appears to be an accounting exception rather than a practical expedient. Those respondents generally stated that applying the amendments in the proposed Update would result in a different accounting outcome than applying the guidance in Topic 606. Four respondents noted that most public franchisors have concluded that pre-opening services are not a separate performance obligation, and, therefore, referring to the proposed amendments as a practical expedient could call those conclusions into question. One of those respondents, a preparer, further commented that the example included in the proposed guidance (Case A, in which the franchisor concludes that the pre-opening services are distinct in applying Topic 606) may be unrealistic and, therefore, could create confusion. A practitioner stated that the Board should limit accounting exceptions to situations in which undue complexity is present or the Topic 606 model has resulted in an accounting outcome that does not represent the underlying economics. That practitioner stated that, in this case, the threshold for providing an exception has not been met.
16. Another practitioner commented that a practical expedient typically would be available to all entities and not limited to only nonpublic entities in a certain industry. That respondent also commented that the amendments in the proposed Update could decrease comparability and make it more difficult for financial statement users to perform analyses. Additionally, that respondent acknowledged the potential regulatory consequences of deferring initial franchise fees but stated that this is an issue that would be better addressed by the regulators, and not through standard setting.

17. One practitioner noted that the amendments in the proposed Update would diverge from IFRS Standards because, in its experience, many nonpublic entities apply the general IFRS Standards and not IFRS for small- and medium-sized entities. A consultant observed that the Board stated in the proposed Update that limiting the proposed amendments to nonpublic franchisors would largely preserve convergence with IFRS Standards. However, that respondent commented that if the proposed amendments were a practical expedient, then convergence with IFRS Standards would be maintained.
18. Two practitioners opposed introducing the proposed guidance because they noted that the amendments in the proposed Update would not achieve the objective of reducing cost and complexity. A practitioner and a preparer suggested that, as an alternative, the Board could allow entities to recognize the entire initial franchise fee over the franchise license term. The practitioner noted that this alternative would function more like an expedient because it would produce accounting results more similar to those produced by applying Topic 606 as written (based on the accounting for initial franchise fees by public franchisors). As another alternative, that practitioner stated that the Board could require nonpublic franchisors to disclose the transaction price allocated to the remaining performance obligations (this disclosure is currently optional for nonpublic entities). The practitioner stated that this disclosure in combination with the information provided in the statement cash flows would allow users to determine how much cash a franchisor has collected from initial franchise fees.

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.

19. Nineteen respondents commented on this question. Eight of those respondents agreed that the amendments in the proposed Update would reduce the cost and complexity of applying Topic 606 to pre-opening services. A practitioner stated that the amount of benefit provided will vary by franchisor and that most of the cost of applying Step 2 is a one-time implementation cost. Therefore, those entities that have not yet adopted Topic 606 are likely to benefit the most from the proposed amendments. Two state societies commented that the ability to combine all of the pre-opening services into a single performance obligation will reduce the cost and complexity associated with identifying performance obligations and allocating the transaction price.
20. One practitioner commented that the expedient would significantly reduce cost and complexity, but that further relief would be provided if the expedient were expanded to include other costs, such as commissions. That practitioner noted that this would allow for better matching of revenues and expenses. The practitioner also stated that, economically,

franchisors and franchisees view the pre-opening services as a single performance obligation.

21. Another practitioner recommended that the Board consider addressing the reason for not including advertising assistance provided to franchisees (for example, advertising associated with the grand opening of a new franchisee location) in the list of pre-opening services. It noted that advertising assistance is currently included in the Master Glossary definition of *initial services*, but it is excluded from the proposed list of pre-opening services that would qualify for the practical expedient. An industry trade association commented that the list of pre-opening services in paragraph 952-606-25-2 may not necessarily include all of the services that a franchisor may provide before a franchise location opening. That trade association suggested that the list of pre-opening services be defined as an example of the types of costs that would be considered pre-opening, such that the list would not be finite.
22. Five respondents conditionally agreed that the amendments in the proposed Update would reduce cost and complexity. A state CPA society stated that the proposed amendments would reduce cost and complexity, but acknowledged the issues raised in paragraph BC42 of the proposed Update regarding potential questions about the services on the list. That state CPA society noted that those concerns are reasonable and that the Board should consider performing targeted outreach to determine whether franchisors from various sectors foresee any issues with the list. However, the state CPA society also commented that the list is relatively consistent with the Federal Trade Commission's (FTC) list in Section 16 C.F.R. §436.5 of the FTC Rule, which specifies the types of services ("obligations") that a franchisor should disclose in its Franchise Disclosure Document.
23. Three practitioners commented that although the amendments in the proposed Update would reduce some cost and complexity, there would still be cost and complexity associated with performing a standalone selling price analysis. Two of those practitioners noted that this issue would be especially prevalent for services that would not have been considered distinct under the Topic 606 guidance as written, but that would be included in the bundle of pre-opening services under the practical expedient. For example, one practitioner commented that the Board should clarify what is meant by preparation of an operating manual. That is, whether "preparation" refers to the development of the intellectual property included in the manual, or rather, the administrative service of distributing the manual. That practitioner stated that there would be additional cost associated with determining the standalone selling price of an operating manual if preparation includes the development of the intellectual property.

24. Two respondents conditionally disagreed that the amendments in the proposed Update would reduce cost and complexity. A state CPA society stated that although the proposed amendments may reduce some cost and complexity, the cost associated with applying Topic 606 to initial franchise fees is a one-time implementation cost. Therefore, the state CPA society stated that the cost reduction would not be enough to warrant adding the proposed guidance to the Codification. A practitioner noted that when the pre-opening services provided by a franchisor are included in the list in paragraph 952-606-25-2 and are completed before the franchise location opening, the proposed amendments would likely reduce cost and complexity. However, that practitioner stated that many (or most) franchise arrangements are not so simple, and, therefore, the proposed amendments may increase cost and complexity in a majority of situations when assessing whether the services are consistent with the list. That respondent gave some examples, including franchise arrangements in which a franchisor provides certain services both before and after a franchise location opening and franchise arrangements that include renewal rights. The respondent also questioned whether franchisors would experience difficulty in applying the guidance in paragraph 952-606-25-3 (see the detailed feedback on the guidance in paragraph 952-606-25-3 under Question 4 below).
25. Four respondents disagreed that the amendments in the proposed Update would reduce cost and complexity. Two of those respondents, both practitioners, stated that the cost reduction associated with applying Step 2 of the revenue recognition model may be outweighed by increased cost and complexity in applying Step 4 (allocation) and Step 5 (recognize revenue) to the combined bundle of pre-opening services. The practitioners noted that to determine the standalone selling price of the combined performance obligation, a franchisor would still have to individually determine the standalone selling price of each pre-opening service. One of those practitioners referenced Revenue Recognition Transition Resource Group Paper 41, which discussed the complexity of determining a measure of progress for revenue recognition when goods or services are bundled into a single performance obligation. That practitioner commented that the cost of applying Step 2 is generally a one-time cost, while the costs of applying Step 4 and Step 5 are ongoing.
26. That practitioner also noted that Example 1, Case A seems to provide conflicting descriptions about the allocation of the consideration between the pre-opening services and the license. That is, the example states that an entity regularly charges a nonrefundable fee for intellectual property, but also states that the entity does not charge a fee for license renewals. The practitioner commented that in order to allocate the transaction price in practice, the entity would first have to determine the standalone selling price of the license and any renewal rights. It stated that often that determination is made at the contract level.

27. Another practitioner commented that although the expedient allows a franchisor to account for pre-opening services as a combined performance obligation, the franchisor must still evaluate each service and its eligibility for the expedient individually. That respondent noted that if a franchisor provides a service that is not specifically listed in paragraph 952-606-25-2, then it would have to perform an analysis of whether that service is a separate performance obligation (that is, it would have to perform Step 2 of the revenue recognition model). Additionally, the respondent stated that franchisors may try to analogize to the services on the list or may try to interpret the list broadly.
28. Two consultants commented that any ongoing cost reduction likely would be insignificant unless a franchisor's agreements were significantly modified. However, one of those consultants noted that a franchisor may incur ongoing costs to evaluate the criterion in paragraph 952-606-25-3 (see the detailed feedback on the guidance in paragraph 952-606-25-3 below). Additionally, both of those respondents stated that the costs to users of evaluating financial statements that are prepared using the practical expedient would be ongoing and may outweigh the benefit of any relief provided to franchisors.

Area 2: Scope

Background

29. The amendments in the proposed Update were limited to those franchisors that are not public business entities. Paragraph 952-606-15-3 in the proposed Update would explicitly prohibit analogy by entities in other industries (that is, entities that are not within the scope of Topic 952). Additionally, the scope of the proposed amendments was limited to pre-opening services because the Board did not receive feedback that there was undue cost and complexity associated with applying Topic 606 to other fees that franchisors charge, such as area franchise fees or renewal fees.

Summary of Comments

30. Most respondents agreed with the scope of the amendments in the proposed Update. That is, that the proposed amendments should be limited to nonpublic franchisors and pre-opening services, and that entities in other industries should not be permitted to analogize to them. Five respondents supported expanding the scope to include entities in other industries.

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.

31. Nineteen respondents commented on this question. Fourteen of those respondents supported limiting the scope of the amendments in the proposed Update to franchisors that are not public business entities. Eleven of the respondents who supported limiting the scope of the proposed amendments to nonpublic franchisors also commented that it would be inappropriate for entities with comparable arrangements to analogize to the proposed amendments. Five respondents expressed support for explicitly prohibiting analogy in the Codification. One of those five respondents commented that unless the Board has performed a comprehensive evaluation of similar arrangements in other industries, analogy should not be permitted. Another of those five respondents suggested that the Board provide additional commentary in the basis for conclusions on the scope of the proposed Update, including that the scope of the proposed amendments is intended to be applied only by those nonpublic entities that have applied Topic 952 in the past.
32. Two of the respondents noted that the amendments in the proposed Update are specifically designed to address franchise arrangements and resolve an issue that is specific to franchisors. Several practitioners noted that one of the objectives of Topic 606 was to eliminate industry-specific guidance, and that expanding the scope of the proposed amendments or allowing application by analogy would be counter to that objective. One of those practitioners also commented that applying the proposed amendments by analogy would require significant judgment, which could result in inappropriate analogies or inconsistent application. One state CPA society noted that it opposes the proposed amendments for franchisors and, therefore, it also opposes the proposed amendments for other industries.
33. A state CPA society and a practitioner acknowledged certain Board members' concerns described in the Alternative Views about further requests for relief from entities in other industries and stated that any other requests should be considered separately by the Board through its normal standard-setting process (that is, rather than through a broadening of the scope of this project). Another practitioner cautioned the Board against allowing Topic 606 to revert to industry-specific guidance. A state CPA society stated that if the Board makes amendments to Topic 606 in a limited manner, then the integrity of the guidance will be maintained. That state CPA society agreed with the Board's reasoning for limiting the scope of the amendments in the proposed Update to nonpublic franchisors as outlined in paragraphs BC25–BC27. That respondent stated that there does not seem to be a cost-benefit argument for expanding the scope of the proposed amendments and noted that the

Board's involvement with and response to this issue over the past several years has been limited to nonpublic franchisors.

34. Two practitioners commented that expanding the scope of the expedient would increase diversity, result in accounting outcomes that are inconsistent with the principles in Topic 606 and potentially disrupt the application of the guidance by public entities and entities in other industries. One of those practitioners expressed concern that the statements in the proposed Update that the proposed amendments would provide "financial reporting results that are more consistent with the intent of Topic 606" may be misinterpreted by entities in other industries to mean that upfront activities in similar arrangements are separate performance obligations. Therefore, it suggested clarifying or removing those statements from the basis for conclusions. That practitioner also supported limiting the proposed amendments to nonpublic entities because nonpublic entities that have not yet adopted Topic 606 are the most likely to benefit from the cost reduction provided by the proposed amendments.
35. One practitioner referred to the regulatory environment in the franchise industry as a reason for why it is appropriate to limit the scope of the amendments in the proposed Update to nonpublic franchisors. That practitioner commented that many small nonpublic franchisors lack the accounting resources to perform a thorough analysis of their franchise arrangements under Topic 606 and, therefore, may inappropriately conclude that no pre-opening services are distinct from the franchise license. That conclusion would result in recognizing initial franchise fee revenue over the franchise license term, which could result in a franchisor reporting deferred revenue or negative equity. In certain states, this could lead to regulatory action, which may include a requirement that initial franchise fees be held in an escrow account until all pre-opening services have been completed. Because start-up nonpublic franchisors may have limited assets, this requirement could be detrimental to their business and could result in bankruptcy. Therefore, the respondent commented that those unique circumstances justify limiting the scope of the proposed amendments to nonpublic franchisors.
36. Five respondents disagreed with limiting the scope of the amendments in the proposed Update to nonpublic franchisors. A few of those respondents noted that there are comparable fact patterns in other industries that create similar difficulties in determining whether pre-opening services are separate performance obligations. Some of those respondents suggested that the Board expand the scope of the proposed amendments to provide relief for a greater population of entities. A state CPA society suggested that the Board modify Step 2 for all entities rather than making the proposed amendments.

37. A consultant who disagreed with limiting the scope of the amendments in the proposed Update to nonpublic franchisors stated that it is neither appropriate to create industry-specific exceptions to Topic 606 nor create private company accounting alternatives for recognizing revenue. Additionally, that respondent stated that it was surprised that the Board would limit the applicability of a practical expedient to only nonpublic franchisors, especially if the accounting result of applying that expedient would be more consistent with the intent of Topic 606. Furthermore, the respondent commented that there does not seem to be an aspect of franchise arrangements that is unique to nonpublic franchisors and that the accounting outcome of deferring some or all of the initial franchise fee over the franchise license term is not an issue that is unique to nonpublic franchisors. The respondent noted that revenue would seem to be a line item for which users of financial statements would want comparability. Therefore, that respondent stated that there does not seem to be a conceptual reason to limit the scope of the proposed amendments to nonpublic franchisors.

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

38. Eighteen respondents commented on this question. Sixteen of those respondents supported limiting the scope of the amendments in the proposed Update to pre-opening services. Generally, those respondents commented that limiting the scope to pre-opening services is appropriate because feedback received from franchisors has indicated that the cost and complexity of applying Topic 606 to franchise agreements is related to pre-opening services. Therefore, limiting the scope to pre-opening services would address the issues that were raised. Some respondents stated that there do not seem to be other significant issues in practice regarding revenue recognition for franchise licenses.
39. A practitioner commented that the need for relief is less significant for services that are performed after a new franchise location is opened because applying Topic 606 to those services is less complex. For example, if services are performed before the opening of a new franchise location and continue to be performed after the location opens, those services would likely not be distinct from the franchise license. Conversely, if services are performed only after the opening of a franchise location, those services may be distinct from the franchise license.
40. One practitioner commented that because the amendments in the proposed Update seem to be an exception, and not a practical expedient, the scope of those proposed amendments should be limited to pre-opening services. That respondent also noted that the guidance should clarify whether an entity must apply the proposed amendments to all pre-opening services or whether the entity can choose to apply the proposed amendments to some pre-opening services and not others.

41. One practitioner disagreed with limiting the amendments in the proposed Update to pre-opening services and suggested that other pre-opening costs, such as commissions, should be included within the scope of the proposed amendments. That respondent commented that initial franchise fees are typically a small portion of the overall revenue related to a franchise agreement and that other revenue streams, such as royalties, marketing fees, and fees for other ancillary services, are substantially larger than the initial franchise fee. A consultant expressed confusion about why pre-opening services have caused concern only for nonpublic franchisors and not for public entities or entities in other industries. That respondent commented that there does not seem to be anything unique about applying the Topic 606 guidance on performance obligations to pre-opening services.

Area 3: Operability

Background

42. Paragraph 952-606-25-3 in the proposed Update would reinstate superseded guidance from Topic 952 as a required criterion for applying the practical expedient. That guidance stipulates that if the continuing fees charged by a franchisor are not sufficient to cover the franchisor's continuing costs plus a reasonable profit, then it would be precluded from applying the practical expedient.
43. The amendments in the proposed Update would provide an expedient for applying Step 2, but would not provide guidance about how to apply the other aspects of the revenue recognition model. Instead, paragraph 952-606-25-4 states that an entity should refer to the guidance in Topic 606 on the other aspects of revenue recognition.

Summary of Comments

44. Most respondents commented that the amendments in the proposed Update would be operable; however, many respondents offered suggestions for additions or clarifications that would make the guidance easier to apply. Some respondents stated that the proposed amendments in paragraph 952-606-25-3 are unnecessary. Other respondents suggested that the Board revise Example 1 and provide further guidance about how to determine a measure of progress for recognizing revenue for the combined bundle of pre-opening services.

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.

45. Seventeen respondents commented on this question. Twelve of those respondents stated that the guidance in paragraph 952-606-25-3 would be operable. Generally, they noted that franchisors were applying this guidance under Topic 952, so reinstating it should not be an issue. One state CPA society commented that continuing fees may include ongoing license fees, royalties, and revenue from the sale of equipment or other products to a franchisee. That respondent stated that the criterion would not introduce additional cost and complexity because those fees are typically a significant revenue stream and, therefore, monitoring and assessing the profitability of those services/fees is expected. A practitioner commented that the requirement in paragraph 952-606-25-3 to assess expected costs is not unique to franchisors. For example, assessing expected costs is required in the construction industry and for other long-term projects. That respondent also stated that the criterion is important to prevent abuse of the practical expedient, because franchisors may attempt to broadly interpret the definition of *initial franchise fees* such that they are able to frontload revenue.
46. Four of those respondents agreed that the guidance in paragraph 952-606-25-3 would be operable but noted other reservations. A state CPA society commented that because the criterion could determine a franchisor's eligibility for applying the practical expedient, the Board should consider clarifying or limiting the discretion allowed in applying that criterion. That state CPA society noted that doing so would increase consistency in the application of the guidance.
47. A practitioner expressed concern that franchisors may be able to structure agreements such that just enough of the continuing franchise fees will cover the cost of continuing services, in a manner that would allow them to pass the screen in paragraph 952-606-25-3 and recognize revenue upfront that otherwise would have been recognized over time. That respondent questioned why superseded paragraph 952-605-25-2¹ was not included in the proposed Update, because that guidance could provide a basis for how a franchisor should think about the timing of revenue recognition for the combined bundle of pre-opening services. If similar guidance is not added to the amendments in the proposed Update, that respondent commented that there may be differences in how franchisors determine the timing of revenue recognition under the practical expedient. A practitioner stated that although this guidance is

¹ **952-605-25-2** Substantial performance for the franchisor means that all of the following conditions have been met:

- a. The franchisor has no remaining obligation or intent—by agreement, trade practice, or law—to refund any cash received or forgive any unpaid notes or receivables.
- b. Substantially all of the initial services of the franchisor required by the franchise agreement have been performed.
- c. No other material conditions or obligations related to the determination of substantial performance exist.

operable, reinstating it would be inappropriate because it may result in payment terms determining the identification of performance obligations. That respondent commented that if the guidance from paragraph 952-605-25-4 were to be reinstated, it should be allowed as an exception to applying Step 3 and Step 4 of the revenue recognition model, which would further reduce cost and complexity.

48. Two practitioners conditionally disagreed with the operability of the proposed guidance in paragraph 952-606-25-3. Both practitioners commented that the criterion is unnecessary because applying the standalone selling price guidance should prevent structuring. One of those practitioners stated that the proposed guidance is operable, but that it may increase costs because determining the cost of providing access to a symbolic license may be complex. That respondent stated that if the proposed guidance is retained in a final Update, then the language should be updated to align with the terminology in Topic 606. The other practitioner suggested that the Board clarify what continuing services include and how a franchisor should evaluate the costs associated with those services, particularly the costs of providing a symbolic license that are related to one or more franchisees.
49. Three practitioners disagreed that the proposed guidance in paragraph 952-606-25-3 would be operable. One of those practitioners stated that the combination of the proposed guidance in paragraph 952-606-25-3 and Example 1, Case A, may suggest that a residual allocation approach is appropriate for determining the standalone selling price. At present, using a residual approach to determine the standalone selling price is allowed only in limited circumstances as outlined in paragraph 606-10-32-34(c). That practitioner noted that this approach would simplify the allocation guidance, but that the Board should clarify whether that is its intent. That respondent also commented that additional guidance regarding franchise fees and future services may be necessary because some franchisors may conclude that future services only include discrete services provided to a specific franchisee and not the continuing service of providing the franchise license. Additionally, if future services include the franchise license, the ongoing costs related to that service may be difficult to allocate to a specific franchise arrangement and may require a franchisor to forecast future franchise sales or openings. Furthermore, if scale is required for a franchisor to cover its continuing costs (that is, if a franchisor needs to sell and open a certain number of franchise locations to make a profit), then this criterion may preclude smaller start-up franchisors from applying the practical expedient.
50. Another practitioner stated that the criterion in paragraph 952-606-25-3 addresses a hypothetical situation because a franchisee would likely not pay more than market value for the pre-opening services it receives. Additionally, that respondent noted that franchisors are focused on the ongoing royalty stream and, therefore, are incentivized to charge a

reasonable upfront fee to promote franchise growth. The third practitioner noted that the concept of a symbolic license did not exist under the superseded guidance and, therefore, franchisors may struggle to determine whether continuing fees will cover the costs of continuing services because those services would include a symbolic license. To address this, that respondent suggested adding language to Example 1, Case B about how the criterion would be applied.

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?

51. Eighteen respondents commented on this question. Eight of those respondents commented that additional guidance about other aspects of applying Topic 606 is not needed for the amendments in the proposed Update to be operable. One practitioner commented that although the franchise industry would appreciate additional guidance on how to determine the standalone selling price of the bundled pre-opening services performance obligation, it would be difficult to develop guidance in this area that could apply to all franchise arrangements.
52. A state CPA society noted that its members were unable to come to a consensus on whether additional guidance would be necessary. That state CPA society commented that some of its members noted that additional guidance is unnecessary and that adding more guidance could complicate the expedient, which would be counter to the objective of the amendments in the proposed Update. Conversely, other members suggested providing an overlaying definition of *pre-opening services* that would assist nonpublic franchisors in making decisions about the applicability of the expedient.
53. Two practitioners stated that additional guidance is unnecessary for the amendments in the proposed Update to be operable but suggested certain modifications. Both practitioners stated that the Board should add additional discussion to Example 1, Case A, regarding how the entity determined that the pre-opening services are distinct. They also noted that in the example, it appears that a residual approach was used to determine the standalone selling price. One of those practitioners suggested making the standalone selling price of the pre-opening services equal to the initial franchise fee to address this issue. The other practitioner commented that there already is an example of applying Topic 606 to franchise licenses in the guidance (Example 57 in Topic 606), so it would be preferable to remove Example 1, Case A from the proposed amendments. That existing example describes a franchise arrangement in which equipment and a franchise license are identified as distinct performance obligations.

54. That practitioner also commented on the proposed requirement to account for the pre-opening services as a single performance obligation. Because accounting for the pre-opening services as a single performance obligation could be complex in some circumstances, it suggested that the Board provide an option for entities to account for the services as a single performance obligation or separate performance obligations.
55. Six respondents commented that additional guidance about other aspects of applying Topic 606 would be necessary for the amendments in the proposed Update to be operable. Three of those respondents, all practitioners, stated that additional guidance on how to determine the appropriate measure of progress for recognizing revenue for the bundle of pre-opening services would be necessary to promote consistent application of the guidance. One of those respondents noted that services are generally transferred over time, but that it may be difficult to determine a single measure of progress for a combined bundle of pre-opening services. Additionally, that respondent noted that under the superseded guidance in Topic 952, revenue for pre-opening services was generally recognized at a point in time when the franchise location was opened, and that some entities may determine that it is also appropriate to recognize revenue for the combined bundle of pre-opening services at a point in time. That respondent commented that this method of revenue recognition would suggest that the pre-opening services do not provide benefit for the franchisee until the franchise location is opened, which may contradict with the conclusion that the pre-opening services are distinct from the franchise license. Another of those respondents questioned whether an entity should recognize revenue when or as the last service provided is transferred to the customer, as the predominant service is transferred to the customer, or when the services have been substantially performed as defined in superseded paragraph 952-605-25-2.
56. Two practitioners stated that Example 1, Case A does not provide a sufficient explanation of how the standalone selling price was determined, including whether the residual value method was used. Additionally, one of those respondents suggested that the language in Example 1, Case A be expanded to include a discussion of all of the factors in paragraphs 606-10-25-19 through 25-21 regarding how to determine whether a good or service is distinct. (Those comments are similar to the comments made by two practitioners that stated that additional guidance is unnecessary for the amendments in the proposed Update to be operable.)
57. One of those respondents also expressed concern that the amendments in the proposed Update could lead to inappropriate accounting outcomes or structuring opportunities. For example, that respondent noted that the proposed amendments do not require that an entity evaluate whether training is generic or proprietary to determine whether it is a separate

performance obligation. Therefore, that respondent questioned how the accounting outcome of applying the proposed amendments would be “closer to the intent of Topic 606.”

58. Another of those respondents suggested that the Board provide additional guidance about the assessment of continuing fees and continuing services that would be required by the proposed amendments in paragraph 952-606-25-3. For example, that respondent questioned whether renewals would factor into an entity’s assessment of continuing fees and continuing services, and over what period the reasonable profit should be considered. That respondent suggested that the Board provide further guidance on renewal rights generally because applying that area of the guidance may be costly and complex.
59. That respondent also questioned how a franchisor should account for services that occur both before and after a franchise location opening. For example, that respondent explained that a franchisor may provide training services or bookkeeping services both before and after a franchise location is opened. The respondent suggested that the Board clarify whether those services would be within the scope of the practical expedient and noted that it could do so by providing a glossary definition of *pre-opening services*.

Area 4: Disclosure

Background

60. Topic 606 currently includes a disclosure requirement about using practical expedients (including the practical expedient about the existence of a significant financing component in paragraph 606-10-32-18 and the practical expedient about the incremental costs of obtaining a contract in paragraph 340-40-25-4). The amendments in the proposed Update include a similar disclosure requirement for entities about using the proposed practical expedient.

Summary of Comments

61. Almost all respondents supported requiring disclosure about using the practical expedient. Not all respondents commented on whether the amendments in the proposed Update provide decision-useful information for users of financial statements, but, among those that did, views were mixed.

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.

62. Eighteen respondents commented on this question. Seventeen of those respondents supported requiring disclosure about using the practical expedient. Three practitioners and a state CPA society commented that applying the practical expedient could result in different accounting outcomes than applying the Topic 606 guidance as written, and, therefore, disclosure about the use of the expedient should be required. A state CPA society agreed with the Board's reasoning in paragraph BC32 of the proposed Update and noted that both its practitioner and preparer members were unable to justify the omission of this low-cost requirement. One practitioner suggested two additional disclosures, including the amount of pre-opening services revenue recognized during the period and the average length of a franchise agreement entered into during the period. That respondent noted that those two disclosures in combination would provide enough information for users to reverse the effects of applying the practical expedient to create comparability with public franchisor financial results. A consultant commented that the amendments in the proposed Update seem to be an accounting alternative and that GAAP requires that an entity disclose the election of accounting principles.
63. One respondent, an industry trade association, disagreed with requiring disclosure about using the practical expedient. That respondent stated that franchisors are already required to provide extensive disclosures under Topic 606 that provide users with sufficient information. That respondent further commented that if the Board were to require disclosure, it should be simple and straightforward.
64. Not all respondents commented on whether the amendments in the proposed Update would provide decision-useful information for users of financial statements. Three practitioners stated that they would defer to feedback from users on whether the proposed amendments would provide decision-useful information. However, one of those practitioners commented that the disclosure would be more useful for financial statement users if Example 1, Case A was replaced with an example in which an entity concludes that the pre-opening services are not distinct from the franchise license. That respondent stated that this conclusion is more typical in practice, and, thus, a distinction between that scenario and a scenario in which the practical expedient is applied would more clearly illustrate the potential accounting differences that may arise from applying the expedient. A consultant commented that the proposed amendments could result in accelerated revenue recognition, which could negatively affect comparability among franchisors; therefore, the proposed amendments could make it more difficult for users to obtain decision-useful information from the financial statements. That respondent commented that it is important for the Board to obtain input from financial statement users before finalizing the proposed amendments.

65. Two practitioners commented that the amendments in the proposed Update would provide decision-useful information for users of financial statements. One of those practitioners noted that some franchisor financial statements may show a net loss or negative equity under the guidance in Topic 606, which could be misleading to potential franchisees that are trying to evaluate the financial health of the franchise. A state CPA society noted that if franchisors were required to disclose that they applied the practical expedient, then users would be able to obtain decision-useful information from the financial statements.

Area 5: Transition and Effective Date

Background

66. The amendments in the proposed Update would have different transition and effective date provisions depending on whether an entity previously adopted Topic 606. Those entities that have not yet adopted Topic 606 (that is, those that availed themselves of the effective date deferral in Accounting Standards Update No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*), would be required to apply the transition method and effective date provisions in paragraph 606-10-65-1, which provides an option of full or modified retrospective transition, and an effective date of annual reporting periods beginning after December 15, 2019, and interim reporting periods within annual reporting periods beginning after December 15, 2020. For those entities that previously adopted Topic 606, the amendments in the proposed Update would require a full retrospective transition to an entity's first period reporting under Topic 606 and an effective date of annual reporting periods beginning after December 15, 2020, including interim reporting periods within that period, with early application permitted.

Summary of Comments

67. Most respondents agreed with the transition and effective date provisions in the proposed Update. Some respondents expressed concern about the timing of the issuance of a final Update and the cost of applying the amendments in the proposed Update on a full retrospective basis for those entities that have already adopted Topic 606. Other respondents did not comment on this topic and, instead, deferred to financial statement preparers' input on the operability of the proposed transition and effective date provisions.

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.

68. Seventeen respondents commented on this question. Fourteen of those respondents agreed that entities that have not yet adopted Topic 606 should apply the transition provisions and effective date in paragraph 606-10-65-1 to the amendments in the proposed Update. A state CPA society commented that maintaining the same effective date for the entire standard would prevent confusion for preparers and users. A practitioner noted that requiring those entities that have not yet adopted Topic 606 to apply the transition provisions and effective date in paragraph 606-10-65-1 would maintain consistency among franchisors. That respondent also noted that, in most cases, applying the practical expedient will not result in significant differences in revenue recognition as compared with applying the superseded guidance in Topic 605, Revenue Recognition.
69. One practitioner expressed conditional agreement with the proposed transition method and effective date for those entities that have not yet adopted Topic 606. That respondent noted that some nonpublic franchisors have debt agreements that require them to submit audited financial statements no later than 120 days after the balance sheet date. That is, no later than April 30 for a calendar-year entity. Therefore, the practitioner stated that depending on the issuance date of a final Update, entities may struggle to adopt the amendments on time.
70. Two respondents disagreed with the proposed transition method and effective date. A state CPA society commented that more time would be needed to adopt the amendments in the proposed Update because it is near year-end for many entities. That state CPA society recommended a one-year deferral of the proposed effective date but noted that early application should be permitted.

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.

71. Seventeen respondents commented on this question. Thirteen of those respondents supported requiring a full retrospective transition for those entities that have already adopted Topic 606. Those respondents generally commented that the expedient could change the pattern of revenue recognition, such that a full retrospective transition would be necessary to preserve consistency and comparability between periods. For example, one practitioner noted that although pre-opening services are generally completed over a short period of time, initial franchise fee revenue related to services that were not determined to be distinct from the franchise license under an entity's initial adoption of Topic 606 may be deferred and recognized over a period of 5–20 years, depending on the franchise license term. Therefore,

the amendments in the proposed Update could significantly change the pattern of an entity's revenue recognition.

72. One practitioner that agreed with the proposed transition method questioned whether the transition disclosure requirements in paragraph 952-606-65-1(d) would replace the disclosure requirements in Topic 250, Accounting Changes and Error Corrections. That respondent suggested that the Board clarify the disclosure requirements in paragraphs 250-10-50-1(b) through 50-1(c) and 250-10-50-2.
73. Two respondents conditionally supported requiring a full retrospective transition but commented that, alternatively, a modified retrospective transition may provide useful information for financial statement users if entities were required to provide related disclosures. For example, a trade association noted that for those entities that have already concluded under Topic 606 that most or all of the initial franchise fee is related to a separate performance obligation to provide pre-opening services to a franchisee, a modified retrospective transition with disclosure may be sufficient. The other respondent, a practitioner, stated that if entities were required to provide disclosure about the pro forma effect of applying the practical expedient, then financial statement users may still receive useful information if an entity adopted the amendments in the proposed Update on a modified retrospective basis.
74. Two respondents, a practitioner and a state CPA society, disagreed with the proposed transition method for those entities that have already adopted Topic 606. The practitioner stated that an option of full retrospective or prospective transition would align with the objective of the project, which is to reduce the cost and complexity of applying Topic 606 to initial franchise fees. The state CPA society noted that a full retrospective transition may be burdensome for preparers and, therefore, suggested that the Board allow a modified retrospective transition. That respondent noted that meaningful disclosures could mitigate the effect of allowing a modified retrospective transition. That respondent also noted that most entities would understand the interaction between early adoption and the requirement to provide three years of tabular financial statements, but that some may not.

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.

75. Seventeen respondents commented on this question. Thirteen of those respondents agreed with the proposed effective date for those entities that have already adopted Topic 606. A few of those respondents noted that allowing early application would provide flexibility. One state CPA society commented that a significant portion of the smaller nonpublic franchisors

that have already adopted Topic 606 would likely prefer to apply the expedient for periods beginning before December 15, 2020, thus making early application preferable. One practitioner agreed with the proposed effective date but noted that it would not be opposed to a later effective date because of the resource constraints that entities are facing and the potential for application issues. Another practitioner noted that it agrees with the proposed effective date, subject to feedback received from financial statement preparers. A third practitioner stated that it would defer to financial statement preparers' input on the effective date.

76. One practitioner conditionally supported the proposed effective date but noted that depending on the timing of the issuance of a final Update, entities may struggle to adopt the amendments in the proposed Update on time. Another practitioner conditionally disagreed with the proposed effective date. That respondent agreed that the proposed amendments should be effective for annual reporting periods beginning after December 15, 2020, but preferred that they not be effective for interim periods until after December 15, 2021. One state CPA society disagreed with the proposed effective date. That state CPA society noted that it is near year-end for many entities; therefore, a one-year deferral of the proposed effective date would be appropriate.

Redeliberation Issues

77. On the basis of the comment letter feedback, the Board will decide on the project's direction and other redeliberation issues. There are four issues that the Board will consider. Depending on the Board's decision on Issue 1, the remaining issues may or may not be relevant.

Issue 1: Project Direction

78. In Issue 1, the Board will discuss the overall direction of the project. The Board will discuss the following paths.
 - (a) Path 1: Move forward with a simplified Step 2 approach—Selecting Path 1 would mean providing simplified guidance; however, the specific guidance (that is, whether to affirm the approach in the proposed amendments or pursue a different approach) is the subject of Issue 2.
 - (b) Path 2: Shift focus to educational efforts rather than standard setting—If the Board selects Path 2, then the project would be removed from the Board's technical agenda and the remaining issues and questions are not applicable. Under this approach, the Board will provide feedback on the educational plan.

Issue 2: Guidance for Simplification of Step 2

79. If the Board selects Path 1 (move forward with a simplified Step 2 approach in Issue 1), then the Board will select an alternative for simplifying Step 2. The staff has identified the following two alternatives:
- (a) *Alternative 1: Account for pre-opening services as distinct*—This alternative was exposed for comment in the proposed Update. This alternative would allow a franchisor to account for pre-opening services as a separate performance obligation if they are consistent with those included in a predefined list in the guidance.
 - (b) *Alternative 2: Account for pre-opening services as not distinct*—This alternative would allow a franchisor to account for pre-opening services and the franchise license as a combined performance obligation. This would effectively result in the franchisor recognizing revenue from the initial franchise fee over the franchise license term. This approach was described in the basis for conclusions and Alternative Views in the proposed Update.
80. After the Board has selected an alternative, the Board will consider whether that alternative should be characterized in the guidance as a practical expedient or as a private company accounting alternative. If the Board determines that the selected alternative represents a private company accounting alternative, and not a practical expedient, then the Board will discuss the PCDMF.
81. If the Board selects Alternative 1, then the Board will need to answer Questions 3–5. Question 3 relates to the screen criterion included in paragraph 952-606-25-3 in the proposed Update, which is as follows:
- 952-606-25-3** Sometimes, large initial franchise fees are required but continuing franchise fees are small in relation to future services. If it is probable that the continuing fee will not cover the cost of the continuing services to be provided by the franchisor and a reasonable profit on those continuing services, then the franchisor is precluded from applying the practical expedient in paragraph 952-606-25-2.
82. The Board will need to determine which of the following options to select:
- (a) *Option 1:* Remove the screen criterion from the amendments in the final Update.
 - (b) *Option 2:* Affirm the screen criterion as drafted in the proposed Update.
 - (c) *Option 3:* Affirm the screen criterion but update the drafting to use the Topic 606 terminology.

83. Question 4 relates to the identification of pre-opening services as a single performance obligation. In initial deliberations, the Board decided that any pre-opening services included on the list in the guidance should be accounted for as a single bundled performance obligation. On the basis of the feedback received through comment letters, the Board will select one of the following options:
- (a) *Option 1: Single performance obligation (affirm as drafted in the proposed Update)*—This alternative would affirm the Board’s prior decision to require that any pre-opening services be accounted for as a single bundled performance obligation.
 - (b) *Option 2: Apply Step 2 of Topic 606 to the pre-opening services*—This alternative would require a franchisor to perform a Step 2 analysis for any pre-opening services that are included on the list to determine whether they are separate performance obligations. This alternative would still allow a franchisor to account for any pre-opening services included on the list as distinct from the franchise license, but would not allow a franchisor to assume that any pre-opening services should be bundled together as a single performance obligation.
 - (c) *Option 3: Accounting policy election*—This alternative would allow a franchisor to elect to treat the pre-opening services as a single performance obligation or to perform a Step 2 analysis to determine whether the services constitute separate performance obligations.
84. Question 5 relates to the list of pre-opening services included in paragraph 952-606-25-2 of the proposed Update. That list is as follows:
- (a) Assistance in the selection of a site
 - (b) Assistance in obtaining facilities and preparing the facilities for their intended use, including related financing, architectural, and engineering services, and lease negotiation
 - (c) Training of the franchisee’s personnel or the franchisee
 - (d) Preparation and distribution of manuals and similar material concerning operations, administration, and record keeping
 - (e) Bookkeeping, information technology, and advisory services, including setting up the franchisee’s records and advising the franchisee about income, real estate, and other taxes or about local regulations affecting the franchisee’s business
 - (f) Inspection, testing, and other quality control programs.

85. The Board will consider whether to affirm its decision to provide a predefined list of services that can be accounted for as distinct and whether to affirm the list that was included in the proposed Update.
86. Question 6 is applicable only if the Board selects Alternative 2. If the Board selects Alternative 2, it will decide whether to include the simplified Step 2 guidance (account for pre-opening services as not distinct) in Topic 952 or Topic 606.
87. Question 7 is applicable regardless of whether the Board selects Alternative 1 or Alternative 2. This question relates to the illustrative example included in paragraphs 962-606-55-1 through 55-8. The illustrative example in the proposed Update includes two cases. Case A illustrates the application of Topic 606 without application of the proposed practical expedient and Case B illustrates the application of Topic 606 using the proposed practical expedient. The Board will discuss whether to retain the illustrative examples, remove the illustrative examples, or to remove Case A of the example but retain Case B.

Issue 3: Scope, Disclosures, and Transition

88. The Board will discuss whether to affirm the proposed amendments on scope, disclosures, transition method, and transition disclosures, as follows:
 - (a) Scope: The guidance is applicable to a franchisor that is a nonpublic business entity for accounting for pre-opening services in a franchise agreement.
 - (b) Disclosure: If an entity elects to use the practical expedient, the entity would disclose that fact.
 - (c) Transition:
 - (i) An entity that has not yet adopted Topic 606 would apply the amendments when it first adopts Topic 606 and would apply the same transition requirements for the pending content that links to paragraph 606-10-65-1 (that is, an option of modified retrospective or full retrospective transition).
 - (ii) An entity that has adopted Topic 606 would apply the amendments by means of a cumulative-effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the pending content that links to paragraph 606-10-65-1 was applied (full retrospective transition).
 - (d) Transition Disclosures:
 - (i) The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle
 - (ii) The method of applying the change

- (iii) The effect of the adoption on any line item in the statement of financial position as of the beginning of the first period for which the amendments are applied
- (iv) The cumulative effect of the change on retained earnings or other components of equity in the statement of financial position as of the beginning of the first period for which the amendments are applied.

89. If the Board selects Option 3 in Question 4 (accounting policy election for whether pre-opening services are a single bundled performance obligation), the Board will decide whether it wants to add a disclosure for that accounting policy election.

Issue 4: Effective Date

90. The proposed Update includes the following effective date:
- (a) If an entity has not yet adopted Topic 606, the effective date in paragraph 606-10-65-1 would be required. That effective date would be for annual reporting periods beginning after December 15, 2019, and interim reporting periods within annual reporting periods beginning after December 15, 2020.
 - (b) If an entity has already adopted Topic 606, the amendments in the proposed Update would be effective in interim and annual periods beginning after December 15, 2020. Early application would be permitted.
91. The Board will discuss whether to affirm its proposed effective date, or, if the Board decides that the amendments represent a private company accounting alternative, it may decide to amend the effective date so that it is consistent with the effective date approach for other private company accounting alternatives. That approach would be as follows:
- (a) Entities that have not yet adopted Topic 606 would apply the guidance as of its initial adoption (apply guidance in 606-10-65-1).
 - (b) For entities that previously adopted Topic 606, the effective date that was included in the proposed Update would not be needed. Rather, these entities may apply the guidance for adopting private company alternatives (an unconditional one-time election to allow entities to adopt the proposed alternative without assessing preferability).

Board Meeting Handout
Conceptual Framework—Presentation
December 9, 2020

Meeting Purpose

1. The Board will discuss the Conceptual Framework–Presentation project across two meetings. The purpose of those meetings is for the Board to decide on issues related to redeliberations of the proposed FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation*.
2. The issues that the Board will consider are as follows:
 1. Distinguishing between revenues and expenses and gains and losses (meeting date: November 11, 2020).
 2. Aggregation factors (meeting date: November 11, 2020).
 3. Other comprehensive income (OCI) (meeting date: November 11, 2020).
 4. Full set of financial statements (meeting date: November 11, 2020).
 - (a) Use of the term *full set of financial statements* (meeting date: December 9, 2020).
 5. Netting (meeting date: December 9, 2020).
 6. Subtotals (meeting date: December 9, 2020).
 7. Cost-benefit constraints (meeting date: December 9, 2020).

Issue 4(a): Use of the Term *Full Set of Financial Statements*

3. The questions for the Board on this issue are as follows:

Questions for the Board

1. Does the Board want to continue to use the term *full set of financial statements* to describe a set of financial statements that excludes related notes?
2. If not, what term would the Board like to use instead of *full set of financial statements*?

4. At the November 11, 2020 Board meeting, the Board discussed using the term *full set of financial statements* to describe a set of financial statements that would provide the

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

information currently laid out in paragraph PR19 of proposed Chapter 7. Paragraph PR19, which is derived from paragraph 13 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, states the following:

PR19. To address those purposes, resource providers need a variety of types of information, including information about:

- a. Assets, liabilities, and equity at the beginning and end of the period
- b. Revenues, expenses, gains, and losses during the period
- c. Cash flows during the period
- d. Investments by and distributions to owners.

5. Some Board members expressed concern that using the term *full set of financial statements* to describe a set of financial statements with the content in paragraph PR19 without related notes could be confusing because the term *full set of financial statements* may currently be used as shorthand by certain stakeholders to refer to financial statements and the notes to financial statements. To mitigate that potential confusion, the Board asked the staff to consider other possible terms to describe what the staff had called a full set of financial statements.

Issue 5: Netting

6. The questions for the Board on this issue are as follows:

Questions for the Board

1. Do Board members agree with the staff recommendation to only address netting narrowly in Chapter 7 to clarify that it is not the aggregation of individual items into line items?
2. Do Board members agree with the staff recommendation to not provide a conceptual basis for netting? If not, how would the Board like for netting to be addressed?

7. A few respondents to proposed Chapter 7 commented on the issue of netting financial statement line items. In particular, one respondent suggested that the Board clarify that the concepts in proposed Chapter 7 are not for the purpose of developing standards for netting items in financial statements. The respondent noted that doing so may help prevent the unintended application of the Conceptual Framework to netting items in financial statements.
8. One respondent commented that the Board should develop concepts related to the presentation of exchanges of assets with counterparties. The respondent pointed out that in practice, certain exchanges are presented in two separate line items (for example, the asset

received is presented separately from the asset transferred). In other transactions, the exchange is presented net in one line item that consists of the difference between the initial measurement of the asset received and the carrying value of the asset transferred. The respondent suggested that this inconsistency should prompt the Board to examine the concepts on when exchanges of consideration should be presented with each transfer in a separate line item and when they should be netted.

9. There are a few instances of netting in current practice that the staff examined, including:
 - (a) When there is a *right of setoff*
 - (b) Accounting for pensions
 - (c) In-substance defeasance transactions.
10. A potential alternative to not attempting to develop a conceptual basis for netting could be as follows:

Netting in the statement of comprehensive income or statement is only appropriate when the net presentation of items furthers the objective of financial reporting. To do so, net presentation in a particular line item would need to provide more useful information than gross or separate presentation of that line item.

Issue 6: Subtotals

11. The questions for the Board on this issue are as follows:

Questions for the Board
<ol style="list-style-type: none">1. Does the Board agree with the staff's recommendation that operating income should be addressed at the standards level?2. Are there other considerations/concepts necessary to address for totals/subtotals?3. Are there certain factors of those listed in paragraph PR37 of proposed Chapter 7 that would help determine subtotals?

12. Proposed Chapter 7 explains that an important part of preparing financial statements is simplifying, condensing, and aggregating data into meaningful items, subtotals, and totals, stating the following in paragraph PR32:

PR32. Nearly all reporting entities would find it excessively difficult and expensive to provide full information

about every detail of their activities during an accounting period. Even if that were feasible, the resulting masses of data would be very difficult for resource providers to understand and use. Consequently, preparing financial statements for all but the simplest and smallest entities requires simplifying, condensing, and aggregating data into meaningful line items, subtotals, and totals.

13. Previous standard-setting attempts have addressed the topic of developing income statement categories for operating activities and nonoperating activities. However, past staff and Board efforts to develop a principles-based definition or description of operating activities have proven unsuccessful.
14. One comment letter respondent observed that proposed Chapter 7 only includes considerations for determining line items (paragraph PR37), not subtotals and totals. Another respondent suggested providing objective guidance about presenting subtotals in financial statements, specifically the statement of comprehensive income.

Issue 7: Cost-Benefit Constraint

15. The question for the Board on this issue is as follows:

Question for the Board
1. Should a cost-benefit constraint be addressed in the context of presentation?

16. A few respondents suggested that the Board should more thoroughly address the factors of complexity and cost/benefit. One of those respondents said that the concepts in proposed Chapter 7, if made final and utilized by the Board, could result in pervasive, costly changes in the design of financial statements. That respondent commented that there is an inconsistency in the discussion of cost as a standards-level or a concepts-level consideration. On the one hand, paragraph PR14 of the proposed Chapter says that cost constraints are a standards-level consideration. Other Concepts Statements, however, discuss cost constraints at the concepts level.
17. Chapter 3, *Qualitative Characteristics of Useful Financial Information*, of Concepts Statement 8 addresses cost constraints. Specifically, paragraphs QC35–QC39 of Chapter 3 address the cost constraint on useful financial reporting. However, proposed Chapter 7 does not explicitly reference Chapter 3.

Permission to Ballot

18. Assuming the Board decides on all issues discussed in the memos included in this packet, the staff will ask the Board for permission to proceed to draft the final Chapter 7 for vote by written ballot.