

FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2021-02
January 2021

Franchisors—Revenue from Contracts with Customers (Subtopic 952-606)

Practical Expedient

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

On May 28, 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. During the implementation of Update 2014-09, private company stakeholders in the franchise industry raised concerns about the cost and complexity of applying Topic 606 to determine the amount and timing of revenue recognition for initial franchise fees, especially for franchisors that are start-ups or that have a small number of franchise units. The initial franchise fee typically is paid in a lump sum to a franchisor in exchange for establishing a franchise relationship, along with the provision of varying levels of pre-opening services. Before the adoption of Topic 606, under the industry-specific guidance in Topic 952, Franchisors, the initial franchise fee typically was recognized when the franchise location opened. Under the guidance in Topic 606, the franchisor is required to determine whether the pre-opening activities contain any separate performance obligations and to analyze the standalone selling prices for those performance obligations to determine the timing and amount of revenue recognition.

The Board decided to undertake this project to address the issues raised by stakeholders who expressed concerns about the level of effort required to account for pre-opening services by private company franchisors. The Board also became concerned that some entities that are not public business entities presumed that the pre-opening services would not be distinct from the franchise license and that the initial franchise fee would always be recognized over the license term rather than applying the Topic 606 model to identify performance obligations. The amendments in this Update are intended to reduce the cost and complexity of applying Topic 606 to pre-opening services for franchisors that are not public business entities by providing a practical expedient for applying Topic 606 to pre-opening services. Additionally, the Board expects that for nonpublic business entities, applying the practical expedient directionally will result in accounting outcomes generally consistent with the intent of Topic 606 for those entities and will counter biases that appear to have emerged in practice.

Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to entities that are not public business entities that are within the scope of Topic 952. The guidance in that Topic applies to all entities that meet the definition of *franchisor*, that is, the party who grants business rights (the franchise) to the party (the franchisee) who will operate the franchised business.

The timing of an entity's adoption of Topic 606 (that is, whether the entity previously adopted Topic 606 or whether it will apply the deferred effective date) does not affect the applicability of the guidance.

What Are the Main Provisions?

The amendments in this Update introduce a new practical expedient that simplifies the application of the guidance about identifying performance obligations. The practical expedient permits franchisors that are not public business entities to account for pre-opening services provided to a franchisee as distinct from the franchise license if the services are consistent with those included in a predefined list within the guidance.

Additionally, the Board decided to provide an accounting policy election to recognize the pre-opening services as a single performance obligation.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Under the current guidance in Topic 606, franchisors are required to analyze pre-opening activities in their franchise agreements to identify whether those activities represent promised goods or services and, if so, whether they are performance obligations. If the activities represent promised goods or services and if the goods or services and the franchise license are determined to be distinct from each other and, therefore, are separate performance obligations, entities are then required to analyze each performance obligation to determine the standalone selling prices, allocation of the transaction price, and timing of revenue recognition.

In applying the practical expedient, pre-opening services that are consistent with those included in a predefined list within the guidance may be accounted for as distinct from the franchise license.

Feedback from private company stakeholders indicated that significant cost and complexity are associated with identifying and evaluating performance obligations related to pre-opening services under a franchise agreement. In addition, they noted that some nonpublic business entities presumed that the pre-opening services would not be distinct from the franchise license and that the initial franchise fee would always be recognized over the license term rather than applying the Topic 606 model to identify performance obligations. Accordingly, the Board expects that applying the practical expedient may achieve accounting results that are generally more consistent with the intent of Topic 606 for those entities. Additionally, the practical expedient simplifies the guidance on identifying performance obligations for franchisors that perform pre-opening services by

allowing a franchisor to account for pre-opening services as distinct if they are consistent with those included in a predefined list of pre-opening services. The practical expedient does not amend other aspects of Topic 606, for example, the guidance on allocating the transaction price and determining standalone selling prices.

When Will the Amendments Be Effective and What Are the Transition Requirements?

If an entity has not yet adopted Topic 606, the existing transition provisions and effective date in paragraph 606-10-65-1 are required. That guidance allows for an option of modified retrospective transition or full 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.

If an entity has already adopted Topic 606, the amendments in this Update are effective in interim and annual periods beginning after December 15, 2020. Early application is permitted. For those entities, this guidance should be applied retrospectively to the date Topic 606 was adopted.

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–5. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Addition of Subtopic 952-606

2. Add Subtopic 952-606, Franchisors—Revenue from Contracts with Customers, with a link to transition paragraph 952-606-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Franchisors—Revenue from Contracts with Customers

Overview and Background

General

952-606-05-1 This Subtopic addresses a practical expedient for revenue recognition for a **franchisor** that is not a **public business entity**.

Scope and Scope Exceptions

General

952-606-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 952-10-15.

952-606-15-2 A **public business entity** shall not apply the guidance in this Subtopic. Entities that are not within the scope of this Subtopic shall not apply the guidance in this Subtopic directly or by analogy.

Glossary

Contract

Note: The following definition is Pending Content; see Transition Guidance in 606-10-65-1

An agreement between two or more parties that creates enforceable rights and obligations.

Customer

Note: The following definition is Pending Content; see Transition Guidance in 606-10-65-1

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Franchise Agreement

A written business agreement that meets the following principal criteria:

- a. The relation between the franchisor and franchisee is contractual, and an agreement, confirming the rights and responsibilities of each party, is in force for a specified period.
- b. The continuing relation has as its purpose the distribution of a product or service, or an entire business concept, within a particular market area.
- c. Both the franchisor and the franchisee contribute resources for establishing and maintaining the franchise. The franchisor's contribution may be a trademark, a company reputation, products, procedures, manpower, equipment, or a process. The franchisee usually contributes operating capital as well as the managerial and operational resources required for opening and continuing the franchised outlet.
- d. The franchise agreement outlines and describes the specific marketing practices to be followed, specifies the contribution of each party to the operation of the business, and sets forth certain operating procedures that both parties agree to comply with.
- e. The establishment of the franchised outlet creates a business entity that will, in most cases, require and support the full-time business activity of the franchisee. (There are numerous other contractual distribution arrangements in which a local businessperson becomes the authorized distributor or representative for the sale of a particular good or service, along with many others, but such a sale usually represents only a portion of the person's total business.)
- f. Both the franchisee and the franchisor have a common public identity. This identity is achieved most often through the use of common trade names or trademarks and is frequently reinforced through advertising

programs designed to promote the recognition and acceptance of the common identity within the franchisee's market area.

The payment of an initial franchise fee or a continuing royalty fee is not a necessary criterion for an agreement to be considered a franchise agreement.

Franchisor

The party who grants business rights (the franchise) to the party (the franchisee) who will operate the franchised business.

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

- a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
- b. Operating purposes other than to provide goods or services at a profit
- c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

- a. All investor-owned entities
- b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Performance Obligation

Note: The following definition is Pending Content; see Transition Guidance in 606-10-65-1

A promise in a **contract** with a **customer** to transfer to the customer either:

- a. A good or service (or a bundle of goods or services) that is distinct
- b. A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Public Business Entity

A public business entity is a business entity meeting any one of the criteria below. Neither a **not-for-profit entity** nor an employee benefit plan is a business entity.

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other

entities whose financial statements or financial information are required to be or are included in a filing).

- b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- d. It has issued, or is a conduit bond obligor for, **securities** that are traded, listed, or quoted on an exchange or an over-the-counter market.
- e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including notes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Security

A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

- a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
- b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
- c. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Recognition

General

952-606-25-1 Revenue shall be recognized in accordance with Topic 606, Revenue from Contracts with Customers.

952-606-25-2 As a practical expedient, when applying the guidance in Topic 606, a **franchisor** that enters into a **franchise agreement** may account for the following pre-opening services as distinct from the franchise license:

- 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 regulations affecting the franchisee's business
- f. Inspection, testing, and other quality control programs.

952-606-25-3 A franchisor that elects the practical expedient in paragraph 952-606-25-2 shall apply the guidance in paragraphs 606-10-25-19 through 25-22 to determine whether the pre-opening services are distinct from one another unless it makes an accounting policy election to account for the pre-opening services as a single **performance obligation**.

952-606-25-4 The practical expedient in paragraph 952-606-25-2 applies only to identifying performance obligations. An entity shall apply this guidance consistently to contracts with similar characteristics and in similar circumstances. An entity should see Topic 606 for guidance on the remaining aspects of recognizing revenue from contracts with customers, including allocating the transaction price and recognizing revenue. If an entity elects not to apply the practical expedient or if the services performed are not consistent with the list in paragraph 952-606-25-2, the entity shall apply the guidance in Topic 606 on identifying performance obligations.

Disclosure

General

952-606-50-1 If an entity elects to use the practical expedient in paragraph 952-606-25-2, the entity shall disclose that fact.

952-606-50-2 An entity that makes the accounting policy election to recognize pre-opening services as a single performance obligation as described in paragraph 952-606-25-3 shall disclose that fact.

Implementation Guidance and Illustrations

General

> Illustrations

> > Example 1—Identifying Performance Obligations

952-606-55-1 An entity enters into a **contract** with a **customer** and promises to grant a franchise license to open a restaurant location. The franchise license term is 10 years. In addition to the license, the entity also promises to provide two services related to the opening of the franchise location—site selection and training. The entity receives a fixed fee of \$25,000, as well as a sales-based royalty of 5 percent of the customer's sales for the term of the license. The fixed consideration of \$25,000 is payable on or before the opening of the restaurant location.

952-606-55-2 The entity first assesses whether it is eligible for the practical expedient for identifying **performance obligations** in paragraph 952-606-25-2. The entity determines that it is eligible because it is not a **public business entity**, it is a **franchisor** that is within the scope of Topic 952, and it has entered into a franchise agreement with a customer.

952-606-55-3 In applying the practical expedient, the entity compares its pre-opening services (training and site selection) to the list of services in paragraph 952-606-25-2 instead of applying the guidance in paragraph 606-10-25-19. The entity determines that those services may be accounted for as distinct from the franchise license because they are consistent with the list of services in paragraph 952-606-25-2. The entity makes an accounting policy election to account for all pre-opening services that are consistent with the list in paragraph 952-606-25-2 as a single performance obligation. Therefore, the entity determines that it has two performance obligations—a franchise license and pre-opening services.

952-606-55-4 The entity then applies the guidance in paragraphs 606-10-32-28 through 32-45 to allocate the transaction price to the performance obligations and the guidance in paragraphs 606-10-25-23 through 25-37 and 606-10-55-65 through 55-65B to determine when and how to recognize revenue for satisfaction of the performance obligations.

952-606-55-5 The entity discloses its use of the practical expedient and its accounting policy election to treat the pre-opening services as a single performance obligation in accordance with the disclosure requirements in paragraphs 952-606-50-1 through 50-2.

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2021-02, *Franchisors—Revenue from Contracts with Customers (Subtopic 952-606): Practical Expedient*

952-606-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2021-02, *Franchisors—Revenue from Contracts with Customers (Subtopic 952-606): Practical Expedient*:

- a. An entity that has not yet adopted the pending content that links to paragraph 606-10-65-1 shall apply the pending content that links to this paragraph when it first applies the pending content that links to paragraph 606-10-65-1 and shall apply the same transition requirements for the pending content that links to paragraph 606-10-65-1.
- b. An entity that has adopted the pending content that links to paragraph 606-10-65-1 shall apply the pending content that links to this paragraph for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. Early application is permitted.
- c. An entity that adopts the pending content that links to this paragraph in accordance with (b) shall apply the pending content that links to this paragraph retrospectively to each prior period 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.
- d. An entity that adopts the pending content that links to this paragraph in accordance with (b) shall disclose the following in the period that the entity adopts the pending content that links to this paragraph:
 1. The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle
 2. The method of applying the change
 3. 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 pending content that links to this paragraph is applied
 4. 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 pending content that links to this paragraph is applied.

Amendments to Topic 606

3. Add paragraph 606-10-25-18C, with a link to transition paragraph 952-606-65-1, as follows:

Revenue from Contracts with Customers—Overall

Recognition

> Identifying Performance Obligations

> > Promises in Contracts with Customers

606-10-25-18C See Subtopic 952-606, Franchisors—Revenue from Contracts with Customers, for additional guidance and a practical expedient for entities within the scope of that guidance that are not public business entities.

Amendments to Status Sections

4. Add paragraph 952-606-00-1 as follows:

952-606-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract	Added	2021-02	01/28/2021
Customer (1 st def.)	Added	2021-02	01/28/2021
Franchise Agreement	Added	2021-02	01/28/2021
Franchisor	Added	2021-02	01/28/2021
Not-for-Profit Entity	Added	2021-02	01/28/2021
Performance Obligation	Added	2021-02	01/28/2021
Public Business Entity	Added	2021-02	01/28/2021
Security (2 nd def.)	Added	2021-02	01/28/2021
952-606-05-1	Added	2021-02	01/28/2021
952-606-15-1	Added	2021-02	01/28/2021
952-606-15-2	Added	2021-02	01/28/2021

Paragraph	Action	Accounting Standards Update	Date
952-606-25-1 through 25-4	Added	2021-02	01/28/2021
952-606-50-1	Added	2021-02	01/28/2021
952-606-50-2	Added	2021-02	01/28/2021
952-606-55-1 through 55-5	Added	2021-02	01/28/2021
952-606-65-1	Added	2021-02	01/28/2021

5. Amend paragraph 606-10-00-1, by adding the following item to the table, as follows:

606-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
606-10-25-18C	Added	2021-02	01/28/2021

The amendments in this Update were adopted by the affirmative vote of four members of the Financial Accounting Standards Board. Ms. Botosan and Messrs. Buesser and Schroeder dissented.

Ms. Botosan and Messrs. Buesser and Schroeder dissent from the issuance of this Accounting Standards Update because they believe that applying a one-size-fits-all approach violates the core principle of Topic 606 in paragraph 606-10-10-2, which states that “an entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services” provided by the entity. They believe that the amendments in this Update will not improve GAAP and that the expected benefits do not justify the costs.

The amendments in this Update will allow franchisors that are not public business entities to account for certain pre-opening services that are consistent with a codified list as distinct from the franchise license, regardless of the nature of those services within the context of the arrangement. Adding that guidance to a principles-based standard will override Topic 606’s inherent application of judgment in determining the accounting for revenue. They believe that judgment is critical to best reflect the economics of an entity’s unique revenue contracts with its customers that evolve over time.

Ms. Botosan and Messrs. Buesser and Schroeder observe that a major achievement of Topic 606 was that it eliminated a vast body of industry-specific revenue recognition guidance that suffered from internal inconsistencies. In their view, the amendments in this Update simply reintroduce industry-specific guidance. Compounding their concern is that adding industry-specific guidance for franchisors that are not public business entities may open the door to additional requests from others for their own unique guidance. Those Board members believe that, like this request, the purpose of those requests would likely not be to achieve a more faithful representation of performance, but rather to achieve a more preferred revenue recognition outcome. They also are concerned that limiting the scope of the Update to only franchisors that are not public business entities could prove difficult because entities in other industries may have similar revenue contracts with similar economics. In other words, there is nothing unique about initial franchise fees compared with initial fees charged in a variety of other industries. Therefore, they believe that the amendments will open the door to requests from entities in other industries that can reasonably argue that they face similar economic circumstances.

Ms. Botosan and Messrs. Buesser and Schroeder also question the efficacy of the amendments in this Update. If cost reduction is the primary concern, a less costly alternative would be to allow private company franchisors to account for certain pre-opening services as *not* distinct. They believe that this approach would be far less costly than the amendments that allow private company franchisors to account for certain pre-opening services as distinct. Their preferred approach would eliminate not only the costly and complex judgments required to identify the distinct performance obligations in the contract (Step 2) but also the costly and complex judgments required to allocate the transaction price to the distinct performance obligations based on relative standalone selling price (Step 4). They believe that because standalone selling prices for the listed pre-opening services are often unobservable, the amendments will shift the cost and complexity from Step 2 to Step 4. Also, they anticipate that as a result of the amendments, the judgments applied in Step 4 will become even more critical and consequently subject to greater monitoring by auditors and greater scrutiny from financial statement users.

In addition, Ms. Botosan and Messrs. Buesser and Schroeder are concerned that introducing a defined list of pre-opening services will increase cost and complexity. They believe that higher costs are a likely consequence because questions inevitably will arise about the items included in the list, the ongoing maintenance of the list (as the nature of arrangements evolve over time), and the applicability of the list to an entity's unique facts and circumstances. As one outreach participant noted, there are approximately 220 sectors within franchising. Therefore, Ms. Botosan and Messrs. Buesser and Schroeder believe that the Board cannot develop and maintain a list applicable to all franchisors that will result in the same or similar outcome to one resulting from the application of the five-step model in Topic 606.

Ms. Botosan and Messrs. Buesser and Schroeder also believe that their preferred approach of allowing private company franchisors to account for certain pre-opening services as *not* distinct would result in revenue recognition outcomes that are more comparable to those of most public company franchisors. According to several comment letter respondents and the FASB staff's analysis of regulatory filings, many public company franchisors recognize revenue from initial franchise fees in compliance with Topic 606 over the life of the arrangement because pre-opening services either are administrative activities that do not represent a distinct promise to the customer or are highly interrelated with, and not distinct from, the franchise license. While the nature of the pre-opening services performed by private company franchisors may differ from those of public company franchisors in some cases, Ms. Botosan and Messrs. Buesser and Schroeder are unaware of persuasive evidence of systematic differences between public and private company franchise agreements that would overturn, only for private company franchisors, many public company franchisors' conclusions from applying Topic 606 to pre-opening services. Consequently, they believe that allowing private company franchisors to account for certain pre-opening services as not distinct would offer a more faithful representation of those franchise arrangements that they believe are more typical, that is, arrangements that do not convey distinct pre-opening services to franchisees.

Finally, rather than introducing a practical expedient, Ms. Botosan and Messrs. Buesser and Schroeder believe that the amendments in this Update represent an accounting alternative to the Topic 606 model. More than 60 percent of comment letter respondents to the proposed Accounting Standards Update agreed with their view. According to the Private Company Decision-Making Framework (PCDMF), "No alternatives within U.S. GAAP should be considered *unless input from users indicates that a difference or change is appropriate*" (paragraph 1.9, emphasis added). Ms. Botosan and Messrs. Buesser and Schroeder believe that the Board deviated from the PCDMF's principles by failing to obtain adequate input from users regarding the appropriateness of an optional difference in revenue recognition by private company franchisors. Ms. Botosan and Messrs. Buesser and Schroeder note that during the nine months that this project was active, the Board sought no input from franchisees or their advisors and obtained input from only *one* user of private company franchisor financial statements (a regulator of franchisors). They believe that this minimal input from clearly affected user stakeholders falls well short of achieving "a comprehensive and independent process that encourages broad participation [and] objectively considers *all* stakeholder views" (page 2 of the FASB's *Rules of Procedure*, amended and restated through February 26, 2013, emphasis added).

Ms. Botosan and Messrs. Buesser and Schroeder believe that if user input had been obtained from more than one user (a regulator), the Board could have learned whether franchisees and other users would support a practical expedient or accounting alternative for the recognition of revenue by private company franchisors. Although none of the comment letter respondents were users of

private company franchisor financial statements, more than 75 percent of comment letter respondents addressed the effect of the proposed amendments on the perceived decision usefulness of the information. They indicated that the Board should have sought input from users before finalizing the amendments or expressed concern that the amendments will lessen users' abilities to obtain decision-useful information.

In summary, Ms. Botosan and Messrs. Buesser and Schroeder conclude that the expected benefits do not justify the expected costs of the amendments in this Update. They believe that the amendments will impose greater cost on the collective financial reporting system by reintroducing industry-specific revenue recognition rules into the principles-based guidance designed to apply to all industries, which is guidance that has largely converged with IFRS 15, *Revenue from Contracts with Customers*. They are concerned that such costs will likely grow if other industries similarly urge the Board to address their specific concerns. They also believe that the amendments will not significantly reduce cost and complexity for preparers but will shift much of the mostly one-time implementation cost from Step 2 to Step 4 of the revenue recognition model. They also believe that any cost savings experienced by preparers will be more than offset by a permanent and ongoing cost increase for financial statement users who will receive less comparable and, in some cases, less relevant information about an entity's revenue.

Members of the Financial Accounting Standards Board:

Richard R. Jones, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Susan M. Cospers
Marsha L. Hunt
R. Harold Schroeder

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The Board decided to undertake this project to address issues raised by stakeholders in accounting for pre-opening services by private company franchisors.

Background Information

BC3. On May 28, 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. During the implementation of Update 2014-09, private company stakeholders in the franchise industry raised concerns about the cost and complexity of applying Topic 606 to determine the amount and timing of revenue recognition for initial franchise fees, especially for franchisors that are start-ups or that have a small number of franchise units. The initial franchise fee is a fee paid to a franchisor in exchange for establishing a franchise relationship, along with the provision of varying levels of pre-opening services. Before the adoption of Topic 606, under the industry-specific guidance in Topic 952, Franchisors, the initial franchise fee typically was recognized when the franchise location opened. Under the current guidance in Topic 606, franchisors are required to analyze pre-opening activities in their franchise agreements to identify whether the goods and services provided are distinct from the franchise license and, therefore, are performance obligations. If the goods or services are determined to be performance obligations, entities are then required to analyze each performance obligation to determine the standalone selling prices, allocation of the consideration, and timing of revenue recognition. Nonpublic franchisors expressed concern about the cost and complexity of applying the Topic 606 guidance to pre-opening services and that without a practical expedient accounting results may generally be inconsistent with the intent of Topic 606 for those entities because of an incorrect view that those pre-opening services always would not be distinct from the franchise license and the initial franchise fee therefore would always be recognized over the license term rather than applying the Topic 606 model to identify performance obligations.

BC4. The Board discussed this issue at a public Board meeting in November 2017, in which the Board explained that Topic 606 does not include presumptions about the number of performance obligations in an arrangement. The Board also shared its views that when assessing the standard, an entity should consider the facts and circumstances of its specific arrangements and not overgeneralize. The handout for the Board meeting and a recording of the Board meeting were posted to the FASB's revenue implementation website. In November 2018, the FASB staff drafted an educational paper, including an example of the application of Topic 606 to pre-opening services, and produced a short educational video, which also were posted to the revenue implementation website.

BC5. In early 2020, nonpublic stakeholders in the franchise industry again raised concerns about Topic 606 adoption. At the time, nonpublic franchisors had begun the audits of their 2019 annual financial statements, and they observed that it was costly and complex to complete the evaluation required to account for pre-opening services as distinct from the franchise license, despite analyses performed by some franchisors that were intended to support their view that a portion of pre-opening services is distinct from the franchise license. The Board also became concerned that some entities that are not public business entities presumed that the pre-opening services would not be distinct from the franchise license and that the initial franchise fee would always be recognized over the license term rather than applying the Topic 606 model to identify performance obligations. Accordingly, the Board decided to add a research project to its agenda to evaluate how to reduce the costs and complexity related to applying Topic 606 to pre-opening services and how to improve the application of the guidance to achieve accounting results more consistent with the objective of Topic 606. In July 2020, the Board decided to move the project from its research agenda to its technical agenda and to pursue a private company practical expedient.

BC6. The guidance in Update 2014-09 was effective for calendar-year-end public business entities on January 1, 2018. For all other entities with calendar year-ends, the guidance was set to be effective as of January 1, 2019, for annual reporting periods (and interim reporting periods in 2020). At the April 8, 2020 Board meeting, the Board decided to delay the effective date of Topic 606 for all nonpublic entities that had not yet issued financial statements, including franchisors that are not public business entities, to provide the Board with time to identify a cost-effective solution for the pre-opening services issue. The effective date deferral was finalized in June 2020 when the Board issued Accounting Standards Update No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*, which deferred the effective date for nonpublic entities to annual reporting periods beginning after December 15, 2019, for entities that had not issued financial statements (or made financial statements available for issuance) as of June 3, 2020 (the date the Update was issued). The Board observes that some franchisors had adopted the guidance in Topic 606 before the deferral of the effective date. The timing of an entity's adoption of Topic 606 (that is, whether the entity previously adopted Topic 606 or

whether it will be applying the deferred effective date) does not affect the applicability of the amendments in this Update.

Benefits and Costs

BC7. The FASB's *Rules of Procedure* states:

The mission of the FASB is to establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports.

BC8. In fulfilling that mission, the Board follows certain precepts, including issuing standards only when the expected benefits of the resulting information justify the expected costs. The Board strives to determine that a standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. The Board's assessment of the costs and the benefits of applying new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC9. Paragraph OB2 of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting, Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 3, Qualitative Characteristics of Useful Financial Information*, states the following:

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit. [Footnote reference omitted.]

BC10. Because the amendments in this Update introduce a practical expedient for applying Topic 606 to pre-opening services, the Board believes that the amendments will provide the benefit of reducing the cost and complexity of applying Topic 606 for franchisors and their auditors as well as providing financial reporting results that are generally more consistent with the Topic 606 revenue model for those entities that are nonpublic business entities. The practical expedient allows nonpublic franchisors to apply a simplified Step 2, Identify the Performance Obligations in the Contract, of the five-step revenue recognition

model, which should eliminate some of the judgment required in applying Topic 606.

BC11. The Board has been working for several years with nonpublic stakeholders in the franchising industry on the issue of the cost and complexity of revenue recognition for pre-opening services. In response to the issue, the FASB communicated with industry stakeholder groups, discussed the topic at a public Board meeting, and published educational materials on the subject. Despite the FASB's educational efforts to clarify the purpose of the guidance in Topic 606 and to reduce the cost and complexity associated with applying the guidance to pre-opening services, the issue has not been resolved. Furthermore, the issue seems to be pervasive among nonpublic franchisors. Therefore, the Board concluded that it is appropriate to resolve the issue through standard setting and that a limited-scope solution that results in narrow-scope changes to GAAP is appropriate to address the issue.

BC12. The Board acknowledges that there may be a cost for financial statement users in analyzing the financial statements affected by amendments in this Update. The primary users of nonpublic franchisor financial statements are regulators and franchisees (both current and prospective). Because of the importance of the financial statement information to regulators, extensive research was performed about franchising regulations at both the federal level and the state level, including outreach with a state regulator. The Board understands that regulators are concerned about inconsistent application of Topic 606. Given the challenges franchisors that are not public business entities have had in applying the provisions of Topic 606, the Board expects that the practical expedient should improve the consistency in the application of Topic 606, resulting in cost reduction for financial statement users. However, because application of the practical expedient is optional, financial statement users may incur some ongoing costs to assess the financial statements of both franchisors that choose to apply the practical expedient and franchisors that do not. Additionally, because the practical expedient is not applicable to public business entities, there may be an ongoing cost of comparing financial statements between public business entities and nonpublic entities. Overall, the Board concluded that the benefits of reducing the cost and complexity from applying the amendments in this Update exceed the potential costs for financial statement users.

BC13. On September 21, 2020, the Board issued proposed Accounting Standards Update, *Franchisors—Revenue from Contracts with Customers (Subtopic 952-606): Practical Expedient*. The Board received 21 comment letters on the proposed Update. 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 the proposed amendments would reduce the cost and complexity of applying Topic 606. Those respondents also noted that the proposed amendments were

generally operable. The other half of the respondents disagreed with the proposed amendments because they noted that the proposed amendments would introduce industry-specific guidance to a principles-based standard or that they would represent, in their view, an accounting exception and not a practical expedient. No financial statement users provided feedback through the comment letter process. In addition, the Board did not receive any feedback that would indicate that financial statement users would have concerns about the amendments in this Update, and it did not receive user input noting concerns about franchisor accounting related to initial fees prior to the adoption of Topic 606. The Board also solicited feedback from the Private Company Council and Small Business Advisory Committee about the amendments in this Update. Members of those groups that shared feedback generally supported the amendments and did not raise concerns about introducing a private company practical expedient. Many of the concerns raised by comment letter respondents that disagreed with the proposal had previously been considered by the Board during initial deliberations and did not change the Board's conclusions that the benefits of the amendments justify the costs. However, most of the comment letter respondents that disagreed with the practical expedient agreed with limiting the scope of the amendments to franchisors that are not public business entities.

Basis for Conclusions

Practical Expedient

BC14. Nonpublic stakeholder feedback indicated that significant cost and complexity for nonpublic franchisors were associated with identifying performance obligations related to pre-opening services under a franchise agreement. In response to that feedback, the Board decided to introduce a practical expedient to allow nonpublic franchisors to account for pre-opening services provided to a franchisee as distinct from the franchise license if the services are consistent with those included in a predefined list within the guidance. Additionally, the Board expects that, for nonpublic business entities, applying the practical expedient directionally will result in accounting outcomes generally consistent with the intent of Topic 606 for those entities and will counter biases that appear to have emerged in practice.

BC15. The Board concluded that the amendments in this Update represent a practical expedient to the application of the guidance in Topic 606 rather than an exception or an accounting alternative. An exception or accounting alternative allows an entity to forgo applying certain accounting guidance or allows different guidance to be applied, leading to a different accounting outcome. An example of an existing accounting exception in Topic 606 is the sales-based or usage-based royalty exception to the general revenue recognition principles in paragraph 606-10-55-65.

BC16. As defined in the Private Company Decision-Making Framework, a practical expedient is a more cost-effective way of achieving the same or a similar accounting or reporting objective. Nonpublic franchisors may use the practical expedient to simplify the determination of whether the promise of pre-opening services is distinct from the intellectual property performance obligation in a franchise agreement. Those entities will then need to apply the existing allocation model in Topic 606 to allocate the consideration in the contract among the license, pre-opening services, and any other goods or services in the arrangement (for example, equipment). Identifying performance obligations and allocating consideration in the contract are two objectives of Topic 606. Therefore, the Board concluded that the guidance should simplify the achievement of those objectives.

BC17. The Board observes that the revenue recognition outcome of applying Topic 606 without the practical expedient may differ in some cases from the outcome of applying Topic 606 with the practical expedient. Some comment letter respondents suggested that because the practical expedient will not always result in the same outcome as applying the Step 2 guidance in Topic 606, the guidance represents an exception rather than a practical expedient. However, the Board concluded that the practical expedient has the same objectives as Topic 606. The Board observes that, given the nature of the pre-opening services in a typical franchise arrangement, identifying performance obligations will involve significant judgments. The Board understands that in some cases accountants that exercise reasonable judgment in similar or even the same fact patterns may come to different conclusions. The Board views the practical expedient in this Update as simplifying the judgments needed to apply Step 2 guidance for franchisors. The Board understands that in many cases application of the practical expedient may provide a result closer to the intent of Topic 606 but acknowledges that in some cases the practical expedient may allow for identification of some pre-opening services as distinct that otherwise might have been deemed not to be distinct without use of the practical expedient. While the application of the practical expedient may not always result in exactly the same outcome as applying the Step 2 guidance in Topic 606, the Board observes that this can be the case with other practical expedients as well (for example, transition practical expedients in Topic 606 may result in differences in the timing of revenue recognition). Additionally, introducing this practical expedient is not meant to imply that when applying the guidance in Topic 606 (absent the practical expedient) the Board would expect entities to always conclude that pre-opening services are distinct from the franchise license or to conclude that it is appropriate to default to a conclusion that pre-opening services are not distinct. Rather, entities not applying the practical expedient should apply the Topic 606 guidance on identifying performance obligations. The Board observed that, as with the other practical expedients in Topic 606, an entity should apply the practical expedient consistently to similar contracts in similar circumstances.

BC18. The practical expedient simplifies the guidance on identifying performance obligations for franchisors that perform pre-opening services. Rather than evaluating each promise to perform a pre-opening service to determine whether it is both capable of being distinct from the franchise license promise and distinct in the context of the contract, the practical expedient allows a franchisor to account for pre-opening services as distinct from the franchise license if they are consistent with those services included in a predefined list of pre-opening services. That list of services in the practical expedient was developed by leveraging the definition of *initial services* that currently exists in the Glossary of Topic 952 (which was superseded by Topic 606). That definition has been updated to reflect stakeholders' feedback and the Board's views about which services should be included. One service was entirely removed from the previous list—*assistance in advertising, either for the individual franchisee or as part of a general program*. The Board observed that the description of *advertising services* may cover a wide array of services, some of which may be distinct and others that may not be distinct. Therefore, if a franchisor has provided advertising services, it should apply the Topic 606 guidance to assess whether the advertising services are distinct rather than apply the practical expedient. Accordingly, the list of pre-opening services is for purposes of applying the practical expedient and is not meant to imply that services not included on that list cannot be distinct from a franchise license. Rather, if an entity provides pre-opening services that are not consistent with the services on the list, the entity should apply the Topic 606 guidance on identifying performance obligations to determine whether the services are distinct. Additionally, as required by paragraph 952-606-25-4, the practical expedient should be applied consistently. That does not mean that the practical expedient, if elected, must be applied to all of the initial services listed. Rather, if an entity chooses to apply the practical expedient to certain services but not others, the entity should do so consistently.

BC19. The amendments in the proposed Update would have required that an entity identify the bundle of pre-opening services as one separate performance obligation. This was because the Board had believed that (a) determining the standalone selling price for the bundle would have been easier than determining the standalone selling price for each individual service and (b) the combined unit of account would have eliminated the need to determine whether the pre-opening services were distinct from each other (not only distinct from the franchise license). However, comment letter respondents noted that it may be operationally challenging to determine the standalone selling price of the pre-opening services as a bundle and that franchisors would need to determine the price of each service independently to use in the allocation analysis. Additionally, comment letter respondents noted concern that accounting for the services as a single performance obligation could complicate the judgments for when revenue should be recognized under Step 5 of Topic 606. The Board considered that while the accounting for some scenarios may be simplified by the single unit of account, others may be complicated by this requirement. Accordingly, the Board decided not to require a single unit of account and, instead, provided for an accounting

policy election to recognize the pre-opening services as a single performance obligation.

BC20. The amendments in this Update simplify the process of identifying performance obligations but do not amend the guidance on allocating the transaction price and determining standalone selling prices as well as recognizing revenue. The Board concluded that retaining this guidance is important to maintain a close link to the existing Topic 606 guidance. Counter to some of the feedback received from comment letter respondents, in the Board's view the guidance in this Update represents a practical expedient to applying the guidance on identifying performance obligations in Topic 606 and that introducing a private company practical expedient is consistent with the Private Company Decision-Making Framework. In the Board's view, retaining the requirement to apply the allocation guidance in Topic 606 ensures that the revenue recognized correlates to the services provided and will aid in preventing abuse. For example, if an entity charges a large initial franchise fee but the services provided are minimal, then the standalone selling price should naturally provide a ceiling for how much revenue could be recognized. In the proposed Update, the Board suggested that an entity should be required to assess the ongoing fees and the relationship of those fees to ongoing services to determine whether it is eligible to apply the practical expedient. The Board decided that such a requirement was not needed in the final Update because the evaluation of standalone selling prices should be sufficient to prevent abuses. After allocating the transaction price, an entity should apply the guidance in Topic 606 to determine when to recognize revenue. Under that guidance, an entity should evaluate whether revenue should be recognized over time (paragraph 606-10-25-27) or at a point in time (paragraph 606-10-25-30).

Alternative Approaches Considered but Dismissed by the Board

BC21. The Board considered three alternative approaches that would have significantly amended Topic 606 as compared with the amendments in this Update. These approaches are discussed in detail below. All of those approaches would have introduced industry-specific guidance for franchisors that are not public business entities. The Board ultimately dismissed those approaches because it concluded that the benefits would not justify the costs.

BC22. The first alternative that the Board considered would have allowed a franchisor to presume that an initial franchise fee can be recognized, in its entirety, when an entity has transferred control of the goods or services to which the consideration that has been received relates, unless certain conditions are met. Those conditions are that (a) the sales-based or usage-based royalty does not reflect the standalone selling price of the franchise license, (b) the initial franchise fee relates to multiple franchise units, or (c) the costs incurred by the franchisor in opening the franchise location are significantly less than the initial franchise fee. If any of those conditions are met, an entity would be precluded from applying the practical expedient. That alternative leveraged the existing practical expedient in

paragraph 606-10-55-18, which allows an entity to recognize revenue if the consideration received corresponds directly to the value to the customer of the entity's performance to date. The Board ultimately rejected this alternative because it disregards the requirement in Topic 606 to identify performance obligations and to allocate the transaction price based on the standalone selling prices of those performance obligations.

BC23. The second alternative that the Board considered would have allowed an entity to account for yet-to-be-determined pre-opening services as not distinct from the franchise license. This approach would have generally resulted in the deferral of the initial franchise fee, which would be recognized as revenue ratably over the license term. That approach would have eliminated the need to evaluate and document whether each pre-opening service is distinct, as well as the need to estimate the standalone selling price for the services, both of which seem to be a point of difficulty for nonpublic franchisors. However, the Board rejected this approach because it would have exacerbated stakeholders' concerns about the accounting treatment of pre-opening services and reinforced biases that appear to have emerged in practice that are inconsistent with the objectives of Topic 606. Because this approach would have deferred the timing of revenue recognition for pre-opening services that might have been deemed to be distinct had the Topic 606 model been applied, Board members were concerned that this approach would deviate from the intent of Topic 606. Board members also were concerned that such an approach would further separate the timing of the recognition of revenue from the timing of provision of the service. Furthermore, such an approach, in addition to reinforcing a presumption that does not exist in the guidance that it is appropriate to default to a conclusion that pre-opening services are not distinct, would further distance the accounting from the economics and the timing of satisfaction of performance obligations.

BC24. The third alternative considered would have allowed a predetermined percentage of the initial franchise fee to be recognized upon completion of the pre-opening services. The Board had concerns about drawing an arbitrary threshold and that such an approach would require ongoing maintenance of the guidance (for example, periodically reevaluating the threshold). The Board rejected this alternative because it is inconsistent with the objectives of Topic 606.

Scope

Entities That Are Not Public Business Entities

BC25. Nonpublic franchisors voiced concerns about the cost and complexity of applying Topic 606 to pre-opening services. On the basis of outreach with stakeholders, the Board understands that initial franchise fees related to pre-opening services are typically a more significant portion of revenue for nonpublic franchisors than for public franchisors, generally because nonpublic franchisors

are more likely than public franchisors to be in a start-up or growth phase. Additionally, the Board understands that nonpublic franchisors are experiencing more difficulty in applying the guidance on identifying performance obligations as compared with public franchisors.

BC26. The Board observes that public business entities have previously adopted Topic 606 and is unaware of questions being raised recently about the application of Topic 606 by public franchisors. Furthermore, limiting the amendments to entities that are not public business entities substantially retains convergence between GAAP and International Financial Reporting Standards (IFRS Standards), as described further in paragraphs BC34–BC36. For those reasons, the Board decided to limit the applicability of the practical expedient to entities that are not public business entities.

BC27. The Board observes that a private company practical expedient is allowable under the Private Company Decision-Making Framework, which states that if the guidance provides relevant information, the Board should consider whether using one or more practical expedients could satisfy the needs of the users of private company financial statements while reducing the cost for preparers of those financial statements.

BC28. The Private Company Decision-Making Framework provides that effective dates for private companies should be deferred as compared with the effective dates for public companies because private companies require additional time to effectively and efficiently implement new guidance and because many private companies and/or their public accountants acquire valuable knowledge and become efficient from observing the earlier implementation experiences of public companies. The Board observes that a longer implementation period has provided private companies with the time necessary to identify the issues in applying Topic 606 to pre-opening services and has provided insights into how to become efficient in adopting the guidance through the introduction of a new practical expedient.

Entities That Are Franchisors

BC29. In undertaking this project, the Board decided to limit the applicability of the guidance to entities that are franchisors. The Master Glossary defines *franchisor* as “the party who grants business rights (the franchise) to the party (the franchisee) who will operate the franchised business.”

BC30. Because the intent of the amendments in this Update is to limit the use of the practical expedient to entities that are franchisors, the Board decided to create a new Subtopic, Subtopic 952-606, Franchisors—Revenue from Contracts with Customers, to reduce the costs of applying the guidance by clarifying the scope for stakeholders. The Board determined that the Topic 606 application issue and the need for a practical expedient are unique to franchisors. While the Board

acknowledged that other industries may provide upfront services or collect upfront fees, the Board decided not to expand the scope of the amendments to other entities. Therefore, the amendments specify that the guidance should not be applied directly or by analogy by entities that are not within the scope of Subtopic 952-606.

Types of Services

BC31. The amendments in this Update apply to pre-opening services. During outreach, stakeholders highlighted that there are other fees that a franchisor collects that may be similar to an initial franchise fee that a franchisor collects in exchange for performing pre-opening services, such as area franchise fees, renewal fees, and transfer fees. The Board decided to limit the scope of the amendments to pre-opening services in franchise agreements because the stakeholders' concerns relate to recognition of revenue for those services. Additionally, the Board has not received feedback indicating a need for clarification or a practical expedient relating to other fees or services. Also, pre-opening services are well defined and share a certain level of commonality among franchisors and transactions that other types of fees may lack. For example, area arrangement fees are typically unique and may have complex structuring, and the accounting for a renewal depends on applying the contract modification framework and, therefore, the applicability of a practical expedient may depend on the structure of the renewal.

Disclosure

BC32. Paragraph 606-10-50-22 of Topic 606 currently includes a disclosure requirement about the use of practical expedients. The Board concluded that this disclosure will be important to the users of franchisor financial statements (a) because of the potential effect on comparability between those franchisors that apply the practical expedient and those that do not and (b) to ensure that the financial statements provide transparency for the primary users of franchisor financial statements, franchise regulators, and prospective franchisees about a practical expedient being applied. Accordingly, the Board included this disclosure requirement in Subtopic 952-606.

BC33. Because the Board decided that a franchisor that elects the practical expedient in paragraph 952-606-25-2 may make an accounting policy election to recognize the pre-opening services as a single performance obligation, the Board included a disclosure about that election.

International Financial Reporting Standards

BC34. On May 28, 2014, the FASB and the International Accounting Standards Board (IASB) jointly issued converged guidance on the recognition of revenue from contracts with customers. The guidance on revenue recognition for intellectual property (IP) has substantially converged, although there are some differences because GAAP includes evaluation of symbolic IP and functional IP to determine whether a license may be recognized over time or at a point in time, which does not exist in IFRS Standards. Despite those differences, the Board expects that franchise licenses would be recognized over time under both GAAP and IFRS Standards. Additionally, the guidance about identifying performance obligations and allocating the transaction price (and standalone selling price guidance) has converged. Because the amendments in this Update cannot be applied by public business entities, the Board concluded there is no effect on the convergence of Topic 606 and IFRS 15, *Revenue from Contracts with Customers*, for public business entities.

BC35. While IFRS 15 and Topic 606 have substantially converged, there is a significant difference between GAAP and IFRS Standards when it comes to the guidance for nonpublic entities. Under GAAP, both nonpublic entities and public business entities follow the same guidance. Private companies may elect to apply private company accounting alternatives, but largely they follow the same GAAP as public companies. Accordingly, the revenue guidance under GAAP for public and private companies is the same (except for some disclosure differences).

BC36. The IFRS Standards differ from GAAP because under IFRS Standards nonpublic entities may use the IFRS Standards for small and medium-sized entities (SMEs), although many nonpublic franchisors may choose to apply IFRS 15. The revenue section of the IFRS Standards for SMEs has not yet been updated to apply IFRS 15 principles. Accordingly, while the revenue guidance for public business entities has largely converged, revenue guidance for nonpublic entities that apply IFRS Standards for SMEs has not converged between GAAP and IFRS Standards.

Effective Date and Transition

BC37. The Board is providing the following two sets of transition guidance for entities that have not yet adopted Topic 606 and entities that have previously adopted Topic 606:

- a. If an entity has not yet adopted Topic 606, the existing transition provisions and effective date in paragraph 606-10-65-1 are required. That guidance allows for an option of modified retrospective transition or full 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.

- b. If an entity has already adopted Topic 606, the amendments are effective in interim and annual periods beginning after December 15, 2020. Early application is permitted. The effective date will provide sufficient time for entities and their auditors to analyze the effect of the amendments on their application of Topic 606. For those entities, those amendments should be applied retrospectively to the date Topic 606 was adopted. The Board decided that a full retrospective approach is necessary to preserve comparability between periods and data about historical revenue trends.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*[®] in this Accounting Standards Update do not require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy).