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November 5, 2020

Via email to director@fasb.org

Ms. Hillary H. Salo, Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Practical expedient for franchisors under ASC 606 (File Reference No. 2020-600)

Dear Ms. Salo:

We are pleased to provide our comments on the Board's proposal to provide nonpublic franchisors with an exception from applying certain requirements of the revenue model under Topic 606. In general, we support the Board's efforts in providing this relief, mainly due to the unique regulatory environment surrounding the franchise industry, as described in our responses. Nevertheless, we believe that introducing additional industry-specific alternatives might nullify the notion of a single revenue model and would not be beneficial for users of the financial statements. Therefore, we do not support allowing the practical expedient to be applied either directly or by analogy in other industries.

With respect to the list of pre-opening services qualifying for the proposed exception, we recommend clarifying in the final ASU what actions would be considered as the 'preparation' of an operating manual. In this context, it will be important for the final amendments to clarify whether it refers merely to administrative activities or the intellectual property reflected in the manual. The rest of our detailed responses and suggestions to the Questions for Respondents are contained in the attached Appendix.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Angela Newell at (214) 689-5669 or Adam Brown at (214) 665-0673.

Very truly yours,

BDO USA, LLP

BDO USA, LLP

Appendix

Question 1— Do you support introducing guidance for franchisors that are not public business entities to account for pre-opening services provided to a franchisee? Please explain why or why not.

We generally support the proposed exception for nonpublic franchisors as it accommodates the industry's difficulties in accounting for pre-opening services provided by a franchisor to a franchisee. In addition, this relief is especially helpful for nonpublic franchisors in the start-up phase that have fewer resources for applying the general requirements in the standard and for which regulatory requirements are more onerous and relevant, as further discussed below in our response to Question 2. Nevertheless, we have several reservations and suggestions.

First, we believe the relief proposed by the Board should be characterized as an exception from applying the accounting requirements in Step 2 of the model to the pre-opening services listed in paragraph 952-606-25-2. In our view, the term 'practical expedient' is more suitable for an accounting alternative that eases the application of a general requirement but does not determine the ultimate conclusion about that notion for a specific case. For example, the practical expedient in paragraph 606-10-10-4 allows entities to apply the guidance on a portfolio basis for contracts with similar characteristics if certain criteria are met, which is expected to result in an outcome that is substantially the same as would be obtained by applying Topic 606 on an individual contract basis. Unlike this practical expedient, the proposed relief effectively excludes specified pre-opening services provided in a specific industry from the evaluation of Step 2, and thereby is more akin to a narrow-scope exception than a practical expedient. We further note that the proposed Update will result in some cases in a different outcome. Franchisors which apply the guidance in Topic 606 do not always conclude that the services which are considered distinct in the proposed Update are distinct when applying the guidance in ASC 606-10-25-19 through 25-22. In our experience, we have seen some franchisors conclude that few if any of the preopening services provided are distinct from the franchise right, while others have concluded that many if not all preopening services are distinct. This variety in outcomes is because franchisors operate a wide variety of types of businesses. For example, for some franchisors, training services are integral to operating the brand, and include training on how to perform proprietary functions, such as preparing brand-specific recipes. For others, the operating procedures are not proprietary, and thus training is geared more towards general business training that is considered distinct from the franchise right. Although granting a practical expedient versus an exception may have the same practical effect, we believe that it is important to be clear about the type of relief being granted, as it may be easier to avoid unintended expansion of the proposed guidance to other situations or industries if the Board acknowledges that the relief represents an exception that is to be narrowly applied.

In addition, when considering the inclusive list of pre-opening services, we suggest that the Board clarify the meaning of "preparation" of an operating manual in ASC 952-10-25-3(d). Specifically, it is unclear whether this term should be read to mean the actual creation of the intellectual property inherent in the manual, or merely the administrative actions of printing and then distributing the manual to the franchisee. We would not support the former, as the content of the operating manual is generally indistinguishable from the value of the license itself. We are not aware of cases in practice in which the provision of an operating manual has been identified as a distinct performance obligation because these operating manuals are usually considered as part of the franchise license and do not provide an additional separate benefit to the franchisee. These manuals usually provide general operating guidelines for operating the franchise. To illustrate, in the restaurant industry, such manuals will include recipes, opening and closing procedures, general housekeeping and restaurant operations

checklists. We have not had an experience in which providing that information has value outside of the franchise right. In addition, because that information is pre-existing, there is little to no cost associated with providing it to a new franchisee. Therefore, we recommend that the Board add a short discussion in the Basis for Conclusions to clarify what actions are considered as 'preparation' of the manual in order to prevent inconsistent and inappropriate application.

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.

We believe that the proposed exception should be limited to nonpublic franchisors, especially when taking into account the unique regulatory environment of the franchise industry. In particular, franchisors are required by regulators to meet a certain financial requirements set independently by each state. Often state regulators will require a franchisor that does not meet the financial requirements to deposit the initial franchise fees received in an escrow account, in which case it cannot access the funds until the required pre-opening services are provided and the franchise is open for business. This restriction adversely impacts the franchisor's ability to use these funds for operations and is particularly burdensome for nonpublic franchisors in the start-up phase, resulting in an increased risk of bankruptcy as these funds constitute a significant share of their assets. In addition, many of these smaller franchisors lack the resources to perform technical accounting assessments, which may result in a decision to improperly conclude that none of the upfront services are distinct from the franchise right. In that case, the initial upfront fee would be deferred and recognized over the franchise term, which generally ranges from five to twenty years. For franchisors in the start-up phase, this deferral may result in net losses and thus negative equity, making it more likely that state regulatory escrow requirements are triggered. Therefore, considering these unique circumstances and the narrow scope of the exception, we find this deviation from the general revenue model acceptable.

However, we do not support the application by analogy of the exception for comparable arrangements in other industries that are not subject to such regulatory requirements and are not affected by this issue to the same extent. Accordingly, we believe that the Board should retain the note in paragraph 952-606-15-3 in the final ASU, and provide additional information in the Basis for Conclusions which would further clarify that the exception is limited to entities that have applied ASC 952 in the past and it is not intended to change practice for other entities. Moreover, we share the same concerns expressed in BC45 and BC46 of the proposal that allowing entities from other industries to apply this exception by analogy is a 'slippery slope'. We are aware of existing technical issues in some industries that based on the wording of the final ASU might result in stakeholders requesting additional industry-specific relief. We would strongly oppose allowing the revenue guidance to gradually revert to industry-based guidance.

Question 3— Would the proposed amendments to simplify Step 2—identify the performance obligations—reduce the cost and complexity of applying Topic 606 to pre-opening services? Please explain why or why not.

We believe that the proposed exception will reduce the cost and complexity of applying step 2 of Topic 606 to pre-opening services. The comprehensive list of services specified in proposed paragraph 952-606-25-2 includes the most common services present in different franchise agreements and as such the application of the guidance to the initial franchise fees will be less time-consuming and less costly.

However, we believe that the proposed exception could have unintended consequences that result in an increase in cost and complexity, specifically as it relates to valuing certain components of the resulting performance obliation in step 4 of Topic 606. In particular, we note that if the Board does not accept our proposal to define "preparation and distribution of manuals" to include only the costs to reproduce and distribute the manuals, but instead defines it as including the costs to develop the intellectual property in the manual, then valuing that portion of the performance obligation would be very difficult. As noted above in our response to Question 1, we have not seen any franchisors in practice conclude that the operating manual is distinct from the franchise right, so we believe the industry does not have experience with valuing such manual on a stand-alone basis.

Question 4— In paragraph 952-606-25-3, the proposed amendments would reinstate superseded guidance from paragraph 952-605-25-4 as a required criterion for applying the practical expedient. Is this guidance operable? Please explain why or why not.

We believe that the guidance in paragraph 952-606-25-3 is operable, especially as it was previously applied by franchisors under legacy guidance. Moreover, the requirement to estimate future expected costs in a revenue contract is not unique to franchisors and is also present in the construction industry and in other long-term projects. Accordingly, franchisors can apply similar estimates for their future costs. We also agree that this guidance is an important anti-abuse provision, which is especially important given that the term "franchise fee" is not defined. Absent an explicit definition included in the final ASU, franchisors might be motivated to structure the composition of the payments, front-load amounts related to the franchise license and attribute them to the pre-opening services. For example, some franchise agreements require the payment of area development fees for the franchisee's right to develop and operate a store in a specified area. Broad interpretation of "initial franchise fees" might incorporate such fees, even though the period over which the service is provided might be for the entire franchise term such as when the franchisee is granted exclusivity in that area throughout the license term. Therefore, we believe it is important to include the language in proposed paragraph 952-606-25-3.

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

Yes. The Board's proposed exception is intended to reduce cost and complexity associated with identifying and evaluating performance obligations for certain services performed by the franchisor prior to the opening of the business, and specifically whether those services are distinct from the franchise right. We believe that the need for an accounting relief is diminished for services that are provided after opening of the franchise as the application of Step 2 for these services would generally be more straightforward. If a service is performed as of inception of the franchise agreement and continues to be performed after opening of the business (for example, area development rights), it will likely not be distinct from the franchise license. On the other hand, when the fee is paid for a service or right that is only provided after the franchise is open (e.g. renewal right), it may serve as an indication that it is distinct from the franchise license.

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?

We do not believe that additional guidance about other aspects of applying Topic 606 is necessary. While we understand that the industry would appreciate additional guidance related to determining the standalone selling price of the performance obligation bundle, we believe such guidance would be

difficult to provide as it would likely not faithfully represent the economics of all franchisors given the variety of businesses represented by the franchise model, as discussed above in our response to Question 1.

Question 7— Should entities that elect to apply the practical expedient be required to disclose that fact? Do the proposed amendments provide decision-useful information for users of financial statements? If not, please explain why.

We expect that many nonpublic franchisors will elect to apply the proposed exception to their franchise agreements and that users of financial statements of franchisors will be aware of this common practice. Regardless, we believe that entities applying the exception should be required to disclose their accounting election, consistent with the disclosure requirement in paragraph 606-10-50-22 for application of practical expedients.

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.

We believe entities should apply the transition provisions and effective date in paragraph 606-10-65-1 to the proposed amendments.

Question 9— Should entities that have already adopted Topic 606 be required to apply the proposed amendments on a full retrospective basis, including an entity's first reporting period under Topic 606? If not, please explain why.

Yes. If an entity that has already adopted Topic 606 elects to apply the proposed practical expedient, we think it is important that it applies that practical expedient as of the date that it initially adopted Topic 606. Although the initial services are typically provided over a relatively short period of time, the term of the franchise license is generally five to twenty years. Therefore, any change in what promises are considered distinct from the franchise right can have a significant change in the timing of revenue recognition.

Question 10— For entities that have already adopted Topic 606, should the proposed amendments be effective for annual reporting periods beginning after December 15, 2020, including interim reporting periods within that period, with early application permitted? If not, please explain why.

Yes. However, we would not oppose providing additional time in light of the resource constraints mentioned above and other potential application issues that may arise. Therefore, we would not object to application of the proposed amendments for interim periods beginning after December 15, 2021.