

Letter of Comment No: 93  
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## Stacey Sutay

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**From:** Kirwan, Dan [DKirwan@themaids.net]  
**Sent:** Monday, December 01, 2003 7:33 PM  
**To:** Director - FASB  
**Subject:** FIN 46 - File Reference 1082-300 Consolidation of Variable Interest Entities

TA & I Director  
Financial Accounting Standards Board  
Norwalk, CT 06856-5116

RE: File Reference #1082-300  
December 1, 2003

On January 17, 2003, the Financial Accounting Standards Board (the FASB or Board) issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46 or the Interpretation), which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights. This initial interpretation is misguided as it relates to franchised organizations and I ask that you strongly consider the solutions which are proposed in this letter.

As a certified public accountant and certified management accountant, I can appreciate FASB's issue to properly address related entity issues. I am also confident that with further deliberation you will also recognize that franchise organizations should not be covered by your current Interpretation #46.

I represent The Maids International as its Executive Vice President of Operations. We are the second largest franchised maid organization in the country with system-wide revenues approaching \$100 million and over 130 franchisees. Our auditors, Deloitte & Touche have already concurred with us that implementing FIN 46 would be nearly impossible due to our lack of equity and control in the franchisor-franchisee relationship. Its implementation would add significant cost and absolutely no benefit to the reader of the financial statement. Listed below are other relevant issues which we believe you should take into consideration prior to finalizing the implementation of the Statement:

### **Franchise agreements should not fall under FIN 46**

- Franchise contracts are entered into on an arms' length basis and without any equity rights in the business. The franchisor does protect, for business longevity and success, the trademark, name and quality of the food.
- The franchisor receives a royalty from the franchisee but has no ownership interest in any franchisee assets, and the franchisee bears full risk of loss with regard to his assets.
- The franchisee has the ability to make decisions regarding the operations of his business including: the appropriate structure for the business, amount and timing of owner's compensation; lease versus buy determinations for franchise assets including land and buildings, pricing, forecasting, training, local advertising, hiring, staffing, compensation and firing as well as promotional opportunities for franchise employees; accounting methods; and deposit frequency and levels of cash on hand maintained. These "participating" rights show that the franchisee has a significant amount of control over its legal entity.
- Furthermore, this shows that the franchisor is effectively "leasing" its primary asset, its brand, to the franchisee for a specified period of time as stipulated in the franchise agreement. It then follows that the typical franchise entity should not be consolidated as long as the amount of equity at risk was considered sufficient.

### **Consolidation Would Not Result in Better Financial Reporting**

- If required to move to consolidation accounting for its franchisees, a franchisor's financial statements would include all assets, liabilities, revenues and expenses of its franchisees even though the franchisor has no legal obligations associated with the debt.
- The end result will be financial statements that do not reflect economic reality. Most troublesome is the likelihood that the reporting regime will require additional and cumbersome disclosure to explain the consolidated financial results - not to provide better information but necessary to provide clarity to allow financial statement users to understand the consolidated financial statements presented.
- Significant concerns exist about the accuracy and consistency among franchisors of the actual application of FIN 46 given the uncertainty of its applicability to franchise arrangements. SEC registrants with upcoming filings could report dramatically different financial statements thereby adding to confusion. Due to the potentially dramatic impact of FIN 46 on the financial statements of franchisors for fiscal years or interim periods beginning after June 15, 2003, immediate clarification regarding the applicability of FIN 46 to franchise arrangements is needed.
- There has been a longstanding concern expressed by some observers, including the Securities and Exchange Commission (SEC) staff, about the usefulness of "system wide sales" information (i.e., combining franchisee sales with franchisor company sales) in "selected financial data" and "management's discussion and analysis" as potentially misleading.

### **Limitations/Challenges to Franchisor and Franchisee Ability to Consolidate**

- If required to consolidate, franchisors will need to gather timely GAAP financial information from franchisees that they may not have the legal right to obtain and which the franchisee may not even maintain.
- Franchisors with international operations would be presented with an even greater challenge given the complexities that international franchisees would introduce to the consolidation process.
- Achieving consistency of the information reported would be a major challenge. Different accounting policies, systems and compensation philosophies would all present challenges that would result in anything but more useful financials.
- Costs would be substantial to the companies involved. The franchisor's auditors would have to include franchisees in the audit scope, thereby significantly increasing audit costs and potentially resulting in modifications to the auditors' report when the auditors are unable to complete the audit of the franchisee due to unavailable (e.g., the franchisee refuses to cooperate) or unauditible GAAP financial information. This would be extremely costly and could result in serious liability if audits cannot be completed.

### **Burdens and Consequences on Small, Independent Businesses**

- All franchisees within a system would be required to use the same outside auditor.
- It would require all franchises within a system to adhere to accounting principles dictated by the franchisor.
- All franchises within a system would be forced provide full financial statement information to franchisor.
- All franchisees within a system would be required to provide internal control reports to franchisors and adhere to internal control dictates of franchisor.

### **Impact of the Sarbanes-Oxley Act of 2002**

- The CEO/CFO certifications required by Sarbanes-Oxley would require the franchisor and its auditors to be familiar with the internal control structure of its franchisees.
- It does not appear to be within the spirit of the Act to require CEO/CFO certifications regarding the internal controls of independently owned franchisees that have their own management, accounting systems and internal controls.
- Similar concerns exist as to the attestation requirements of the independent auditors under Section 404 leading to unreasonable audit costs and increased likelihood of modification of the auditors' report on management's assertions.
- Criminal sanctions would apply to inaccurately certified results. Given the scope and nature of the

challenges of collecting and synchronizing information, it is hard to conceive that financial statements would not be compromised at some point in the process, exposing corporate officers to unreasonable and unfair liability.

**Solution**

- The franchise industry seeks clarification in the instance where the franchisor has no equity ownership and its only interest is the fixed rate royalty fee it receives in connection with the franchise agreement.
- Franchisors should continue to apply the consolidation guidance of ARB 51 and continue to follow FASB Statement No. 45, *Accounting for Franchise Fee Revenue*.
- Defer the effective date of the Interpretation as it pertains to franchisors to allow thoughtful deliberation of the appropriate accounting for such arrangements and to address the unwieldy transition and implementation issues posed by FIN 46.

Thank you for your consideration to this incredibly important and potentially disastrous FASB interpretation.

Sincerely,

Daniel F. Kirwan  
Executive Vice President  
The Maids International