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TA & I Director
File Reference Number 1082-300
Financial Accounting Standards Board of the Financial Accounting Foundation
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Re: *FIN 46 Consolidation of Variable Interest Entities*

Ladies and Gentlemen:

I would like you to consider my thoughts concerning the proposed interpretation referenced above as it may affect the franchise community.

First of all, I would like to applaud the efforts of the FASB to rectify the abuses related to Variable Interest Entities. I have been a Certified Public Accountant for nearly 25 years, and the recent abuses have tarnished the reputation of our profession. I am proud of our profession, and we have all been negatively affected by the excesses of a few. Therefore, even though I object to the broad scope of FIN 46 in its current form, I applaud the efforts of the FASB to respond to these abuses.

I am the Chief Financial Officer of Money Mailer LLC, which is a privately held, direct mail franchisor. Our franchise community consists of approximately 240 franchise operators, the vast majority of which are home based businesses consisting of either a single individual or a married couple. Our franchisees provide advertising services to thousands of small businesses throughout the United States. Unlike many franchisors, our franchise model does not contain any provision for royalties based upon gross revenues. Accordingly, we generally do not have a need to conduct a financial audit of any of our franchisees. Likewise, the profitability of a franchisee's business is his or her private concern.

I believe one of the concerns of the FASB contained in FIN 46 is the beneficial interest in the franchisees by the franchisor. The fact that the franchisor has the right to reject potential franchisees entering the system, either through the issuance of a new license, or when a license is resold, is not a valid reason for this



concern. No franchisor has the legal right to unreasonably withhold a transfer of a license. In my view, this is not a significant restriction on license transfers, but merely the right of a franchisor to protect its brand, its operating system and, equally important, the rights of the other franchisees within the system. Therefore, this aspect of franchising should not be construed that the franchisor maintains such a significant degree of control over a franchisee that the financial statements should be consolidated.

If the consolidation requirements anticipated by FIN 46 were required for Money Mailer, the results would be devastating. Not only would it be virtually impossible for outside auditors to express an opinion on such a system-wide set of financial statements, the costs involved would be ruinous. In addition, such a set of consolidated financial statements not only would fail to serve the needs of any user of our financial statements, but would significantly distort the financial information that the users require.

Users of audited financial statements

With our company, there are three main user groups that rely on our audited financial statements. These user groups are as follows:

- Potential franchisees who review our financial statements included in the Uniform Franchise Offering Circular (UFOC);
- Banks and similar organizations who either currently or could potentially extend financing to our company; and
- Current or potential investors.

Franchising is a heavily regulated business format. As you know, any franchisor that is currently offering franchisees must issue a UFOC, which contains the audited financial statements of the franchisor for the last three fiscal years, if available. The sole reason for the inclusion of the financial statements is for the potential franchisee to evaluate the financial condition of the franchisor. If a franchisor is in a weak financial position, the potential franchisee must know this in order to make a rational investment and business decision. A financial statement that includes the results of the franchisor and all franchisees would not serve this purpose. The potential franchisee has the contract with the franchisor, not the other franchisees. If an individual obtains a franchise, and the franchisor becomes financially solvent, the strong or weak financial condition of other franchisees will not be relevant to this person. Therefore, consolidated financial statements would mislead this reader of the financial statements, either positively or negatively.

Bankers and investors would also be adversely affected by this proposal. Franchisees do not, and should not, guarantee the debts of the franchisor. If either the franchisor or, for that matter, a franchisee becomes insolvent, the lenders

normally cannot pursue the other parties to satisfy the debt. Consolidated financial statements would not be helpful to this user group, but would only distort the financial position of the borrower. Lenders and investors then would need to resort to other methods to verify the financial condition of the company. This is obviously very inefficient for everyone concerned.

Practical aspects of Franchisor/Franchisee consolidated financial statements.

Consolidated financial statements would be impractical in our situation for the following reasons:

- Our franchisees are small business owners, many of whom generate gross revenues of less than \$250,000 per year. These individuals obviously are not capable of producing financial information that can be efficiently audited in a timely matter.
- Although we have the legal right to inspect the franchisee's records, we do not have the right to require the franchisee to submit audited financial statements. A current franchisee is under no moral or legal obligation to submit to such a requirement. In other words, this requirement would violate the current legal and binding franchise agreements.
- Even if we could require that franchisees submit audited financial statements, the logistical aspects would be enormous. All franchisees would need to obtain audits from the same accounting firm within a three month time frame. The franchisor would need to select the auditing firm and dictate the accounting policies for all franchisees. The costs for all participants would be enormous.
- Since issuing such financial statements is clearly impractical, implementation of this proposal would prevent us from issuing audited financial statements. This would obviously endanger the future existence of our company, and would materially injure our investors, bankers, franchisees and employees.
- Finally, since large numbers of franchisors would be unable to comply with these requirements, these rules would likely be circumvented or ignored. Accountability would decrease, not increase, and widespread non-compliance would severely damage the credibility of our profession.

Conclusions and Recommendations

Based on the above, I strongly urge the Board to exempt franchise companies from issuing financial statements that include the results of franchisees unless the franchisor has a material equity investment in the franchisee. I cannot understate the threat this proposal has for the franchise community. In any event, franchise organizations should be exempt from implementation of this proposal until further study has been completed.

Thank you for your consideration of this matter. Please feel free to contact me at (714) 265-8270 or jcallahan@moneymailer.com if you would like any further information concerning this subject.

Very truly yours,

A handwritten signature in cursive script, appearing to read "James D. Callahan".

James D. Callahan
Vice President of Finance/Chief Financial Officer

Cc: Godfred Otuteye, Chief Executive Officer
Joseph J. Craciun, Corporate Counsel
Jacqueline Brya, Ernst and Young
Roark Capital Group
International Franchise Association