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November 5, 2020

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

RE: File Reference No. 2020-600

Dear Ms. Salo:

Wipfli LLP and Mind the GAAP, LLC appreciate the opportunity to comment on the FASB's Proposed Accounting Standards Update—*Franchisors—Revenue from Contracts with Customers (Subtopic 952-606): Practical Expedient* (hereafter referred to as the "Exposure Draft").

In general, we favor efforts to simplify existing accounting guidelines. In particular, we appreciate the work of the FASB and PCC in identifying and responding to stakeholders' concerns, and we support the introduction of practical expedients or accounting alternatives intended to reduce cost and complexity.

However, we do not support moving forward with this specific project. Our reasoning is explained in further detail below, but in summary:

- What has been described as a practical expedient in the Exposure Draft is actually introducing an exception to principles in ASC 606.
- This exception would introduce divergence in applying Topic 606 for similar transactions across various industries, which contradicts one of the main reasons why Topic 606 was promulgated.
- We do not believe that the practical expedient will result in cost savings for nonpublic franchisors.

The following provides additional information about our views. Appendix A contains our responses to the Questions for Respondents posed in the Exposure Draft.

Cost and Complexity

Our understanding is that the Board has issued the Exposure Draft to simplify the accounting in Topic 606 for private company franchisors. However, we do not believe that the practical expedient would significantly reduce the cost or effort nonpublic franchisors incur in applying Topic 606. In fact, we are concerned that the Exposure Draft introduces new layers of complexity that could make applying Topic 606 even more costly and challenging.

The proposed practical expedient would allow a nonpublic franchisor to account for certain defined pre-opening services as a single combined performance obligation. However, a nonpublic franchisor must still determine whether each individual promise (explicit or implicit) within a customer contract is a defined

service eligible for the practical expedient[1]. Because each promise must still be individually identified and evaluated, it is unclear whether the proposed amendments would result in significant cost savings when identifying performance obligations in Step 2 of the Topic 606 revenue recognition process.

Furthermore, any pre-opening services that are ***not*** specifically listed in paragraph 952-606-25-2 would require additional evaluation to determine whether they represent distinct performance obligations or should be combined with other goods and services. As a result, this means that a nonpublic franchisor that has elected the practical expedient may still incur time, cost, and effort in identifying promises within a contract and evaluating whether those promises are distinct. It is also possible that nonpublic franchisors may have contracts with customers that include services potentially analogous (but not identical) to those listed in paragraph 952-606-25-2. We are concerned that nonpublic franchisors may improperly analogize to services listed or may interpret the list more broadly than intended.[2]

In addition, even if all promised pre-opening services are within the scope of proposed paragraph 952-606-25-2 and the nonpublic franchisor elects the practical expedient in the Exposure Draft, the entity must still determine the standalone selling price of the combined performance obligation. We believe that in doing so, an entity may have to separately quantify the standalone selling prices of each pre-opening service in order to determine the standalone selling price of the combined performance obligation.

Finally, we believe that nonpublic franchisors will have difficulty in applying Step 5 of the revenue recognition process to the combined performance obligation. A nonpublic franchisor that has elected the practical expedient may perform the various promises underlying the combined performance obligation at differing times. For instance, an entity may perform site selection services in one accounting period and training services in a subsequent period. In this simple fact pattern, we are uncertain as to whether the entity qualifies for any of the conditions in ASC 606-10-25-27 to recognize revenue over time. Arguably, the site selection services would meet the condition in subparagraph (a) of that guidance to be recognized over time, had these services been a distinct performance obligation. In contrast, the training services would likely be recognized at a point in time (or multiple points in time). It is unclear from the Exposure Draft – or Topic 606 – whether the entity would recognize revenue when or as the predominant or primary service is performed, when or as the last outstanding service has been transferred to the customer, or when the franchisee opens its franchise.

In short, we believe that combining pre-defined services into a single combined performance obligation will likely increase, rather than reduce, complexity and cost for nonpublic franchisors, which is in direct contrast with the stated objectives of the Exposure Draft.

Conceptual Nature of the Practical Expedient

Paragraphs BC14-BC15 of the Exposure Draft describe the Board's belief that the practical expedient is not an exception or accounting alternative. The Board's reasoning is that an exception or accounting alternative leads to a different accounting outcome, whereas a practical expedient simply allows an entity to get to the same or similar accounting result in a more cost-effective way. However, we believe that in many cases, a nonpublic franchisor that elects the practical expedient will reach a different accounting conclusion when combining a variety of pre-opening services than would otherwise be obtained had the practical expedient not been elected. For many franchisors, site selection, site preparation, bookkeeping,

[1] See proposed paragraph 952-606-25-2.

[2] For example, assistance in recruiting and hiring staff is not a listed service in paragraph 952-606-25-2, but a nonpublic franchisor may believe it is analogous to training of the franchisee's personnel, which is a service specified by that paragraph.

and certain training and quality inspection services would not be considered distinct under the principles of paragraphs 19-22 of ASC 606-10-25. Absent electing the practical expedient, these services would be combined with the franchise license and recognized over the license term, typically five or more years. Under the practical expedient, an entity would substantially shift revenue associated with these pre-opening activities to the beginning of the license term. Accordingly, the guidance in the Exposure Draft does not appear to meet the definition of a practical expedient, but instead represents an exception to the foundational principles of Topic 606.

We also believe that a true practical expedient should be potentially applicable to any entity (whether public or nonpublic) across any industry. The guidance proposed in the Exposure Draft would only apply to nonpublic entities in a single industry. We believe that this would be inconsistent not only with the concept of a practical expedient but with one of the primary reasons for promulgating Topic 606, which was to "improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets".[3]

Comparability

As discussed previously, we anticipate that recognition of revenue would be accelerated for those entities that elect the proposed practical expedient. Therefore, we believe the Exposure Draft would introduce a lack of comparability between public and nonpublic franchisors, as well as between entities in other industries that may perform potentially analogous pre-opening activities.

We appreciate that it is sometimes appropriate to provide nonpublic entities with accommodations that are not available to public companies. However, we do not believe this is one of those times. Permitting nonpublic franchisors to elect the practical expedient would introduce a fundamental difference in the timing of revenue recognition between public and nonpublic franchisors. This loss of comparability would make it difficult for investors and creditors to assess performance and make capital allocation decisions.

In addition, other industries may undertake activities similar to the pre-opening activities described in proposed paragraph 952-606-25-2. For example, contractors will sometimes perform site preparation or mobilization work in advance of transferring construction services to a customer. Similarly, software developers may undertake certain activities such as identifying user needs in advance of commencing application development. These activities could be viewed as analogous to "architectural services" or "preparing [an asset] for its intended use" as discussed in proposed paragraph 952-606-25-2. Therefore, introducing a practical expedient limited to just nonpublic franchisors may introduce diversity in how similar activities are accounted for across different industries.

Regulatory Requirements

We are aware that many franchisors are subject to certain regulatory requirements. Of note, some regulators and state agencies require franchisors to maintain a specified level of working capital or net worth, which is calculated based off of the franchisor's U.S. GAAP financial statements. We further understand that many franchisors are concerned the adoption of Topic 606 will result in deferral of revenue as compared with legacy GAAP. This change in the timing of revenue recognition may result in decreased equity or net worth for franchisors, particularly those in early stages of commercial operations. It may also result in a decrease in working capital due to deferred revenue sitting on the balance sheet, a

[3] See Page 1 of ASU 2014-09, R*evenue from Contracts with Customers (Topic 606).*

portion of which would be presented as current. To remedy these perceived deficiencies, the franchisor may be required to raise additional capital and/or to place up-front fees received from franchisees into escrow, resulting in a negative effect on liquidity.

While we are sympathetic to these concerns, we believe this is an issue that should be discussed between franchisors and their regulators. In a similar manner, some entities may have amended loan covenants with lenders, or modified arrangements with sureties, because of changes in financial reporting caused by adopting Topic 606 or Topic 842. Our view is that these sorts of matters should be resolved through conversations between the reporting entity and its lenders, regulators, or other counterparties, and not through targeted U.S. GAAP standard setting activities.

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Overall, we believe the proposed practical expedient would run counter to the Board's stated objective of establishing principles-based guidance for major accounting topics, rather than industry- or transaction-specific guidance.

In a recent Journal of Accountancy interview[4], FASB Chair Richard Jones outlined three criteria to consider when making a change to accounting standards:

- Whether the change reduces cost and complexity,
- Whether the change results in better information, and
- Whether the change clarifies or brings consistency within GAAP.

As outlined above, we do not believe the Exposure Draft will significantly reduce cost and complexity. In addition, the proposed practical expedient does not appear to result in better information or bring consistency within GAAP.

We once again thank the Board and its staff for permitting us to comment on the Exposure Draft. If you have any questions regarding the contents of this letter or our responses in Appendix A, please contact Scott Ehrlich, President of Mind the GAAP, at (773) 732-0654 or Zachary Mayer, Partner at Wipfli, at (608) 270-2909.

Sincerely,

Mind the GAAP

Mind the GAAP, LLC

Wipfli LLP

Wipfli LLP

[4] "Costs and Benefits: A Q&A with FASB Chair Richard Jones." *Journal of Accountancy*, 14, Oct. 2020.

Questions for Respondents

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.*

For the reasons outlined in the introductory section of this letter, we do not support introducing guidance for franchisors that are not public business entities to account for pre-opening services provided to a franchisee. Specifically, we do not believe that the practical expedient would reduce cost and complexity, which was a primary reason for issuing the Exposure Draft. Further, we do not feel it is appropriate to introduce industry-specific guidance to Topic 606, a principles-based standard that was intended to apply across entities, industries, jurisdictions, and capital markets. We also believe that the practical expedient would limit comparability between public and nonpublic franchisors, as well as to entities in other industries that also perform "pre-opening"-like activities, including contractors and software developers.

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 are not supportive of the proposed amendments. As outlined in the introductory section of this letter, we believe the proposed amendments represent an exception to Topic 606, rather than a practical expedient. Therefore, if the amendments were to be issued in final form, we strongly urge the FASB to limit the amendments to nonpublic franchisors. Further, we believe the FASB should add explicit language that other industries with comparable arrangements should not analogize to the amendments.

Topic 606 is a principles-based standard that should be applicable to all contracts with customers within all industries – aside from those already scoped out in paragraph 606-10-15-2. The proposed Update intends to address a specific transaction type (initial franchise fees) to certain entities (nonpublic entities) within a single industry (franchisors). The amendments in the proposed Update have been specifically tailored to address those transactions and to resolve a perceived issue arising for just this subset of organizations. Expanding the proposed exception or allowing it to be applied by analogy to other industries (no matter how comparable the arrangements), would begin to erode the fundamental principles underlying Topic 606.

Question 3: *Would the proposed amendments to simply 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.*

As outlined in the introductory section of this letter, we believe the proposed amendments could actually increase the cost and complexity in applying Topic 606 for nonpublic franchisors. For example, an entity eligible for and electing the practical expedient must still: (a) identify each promise within the contract to determine whether it is a defined service eligible for the practical expedient as outlined in paragraph 952-606-25-2; (b) determine whether any pre-opening services that are not specifically listed in the guidance should be combined with other goods and services or, instead, represent a distinct performance

obligation; (c) estimate the standalone selling price of each performance obligation including any combined performance obligation created by the practical expedient; and (d) determine whether the combined performance obligation is recognized at a point in time or over time, as well as the timing and method of recognition.

Based on these factors, it is not clear whether the cost and complexity of applying Topic 606 would be significantly reduced as a result of the proposed amendments.

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 the guidance in paragraph 952-605-25-4 is operable, as it was employed by the industry prior to Topic 606.

Our concern, however, is that more sophisticated franchisors may develop accounting models that permit just enough of the continuing fees to cover the costs of continuing services. This would allow more of the initial franchise fees to be allocated to the combined pre-opening services indicated in paragraph 952-606-25-2, potentially pulling forward revenue recognition that otherwise would have been recognized over time.

Further, it is not clear why the proposed amendments focused on reinstating superseded paragraph 952-605-25-4, but not paragraph 952-605-25-2. The language in paragraph 952-605-25-2 defines when "substantial performance" has been met and revenue can be recognized. Although the superseded paragraph relates to the timing of revenue recognition under Topic 605 and would need to be updated to reflect concepts consistent with those found in Topic 606, we believe it provides some basis for how a nonpublic franchisor who has elected the proposed practical expedient would think about the timing of recognizing revenue for the various promises combined into the single pre-opening services performance obligation. Without similar guidance in the Exposure Draft, we are concerned that there would be disparity among nonpublic franchisors as to the timing of revenue recognition for pre-opening services that qualify as a single performance obligation under the proposed practical expedient.

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

We are not supportive of the proposed amendments. However, if the proposed amendments were to be issued in final form, we believe they should be extremely narrow in scope and limited only to pre-opening services.

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 are not supportive of the proposed amendments. However, if the proposed amendments were to be issued in final form, we strongly believe additional guidance is necessary. In particular, Example 1 in the Exposure Draft (paragraphs 952-606-55-1 through 55-4) does not provide an adequate description of how

the entity determined the standalone selling price of, and allocated the transaction price to, the performance obligations. Notably, it is unclear whether the residual value method was used to determine the standalone selling price of the franchise license and, if so, why the residual value method was deemed more appropriate than directly determining the standalone selling price via an adjusted market assessment approach or an expected cost-plus margin method.[5]

Also, as mentioned in the introductory section of this letter, it is unclear how a nonpublic franchisor would determine the timing of revenue recognition for the combined performance obligation of pre-opening services allowed by the practical expedient. For instance, should the entity determine the last service provided and recognize revenue when or as that service is transferred to the customer? Should the entity identify the predominant service within the list of pre-opening services and recognize revenue when or as the predominant service is transferred to the customer? Should the entity recognize revenue when the services have been substantially performed in a manner similar to that defined in extant GAAP paragraph 952-605-25-2? We believe additional clarity on the timing of revenue recognition under the practical expedient would be beneficial if the amendments were to be issued in a final form.

Third, we believe the proposed amendments may provide inappropriate accounting outcomes or even opportunities for manipulation. For example, paragraph 952-606-25-2 includes training as a type of service that would qualify for the practical expedient. However, it does not appear to differentiate between training that is generic in nature versus training that is proprietary. It is unclear how providing proprietary training and recording revenue during the pre-opening phase – which would be the outcome under the Exposure Draft if the practical expedient is elected – is "closer to the intent of Topic 606", as suggested by paragraph BC15. Additionally, as mentioned in our response to Question 4, we are concerned that franchisors may develop accounting models that permit just enough of the continuing fees to cover the costs of continuing services, ultimately pulling forward revenue that would have otherwise been recognized over time.

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 the financial statements? If not, please explain why.*

We are not supportive of the proposed amendments, but if the Exposure Draft is finalized as proposed, we do believe that disclosure should be required for an entity that elects the practical expedient. Additionally, we would recommend two additional disclosures be required for those entities that have elected the practical expedient. First, a nonpublic franchisor who has elected the practical expedient should disclose the amount of pre-opening services revenues recognized during the period. Second, a nonpublic franchisor who has elected the practical expedient should disclose the average length of a franchise agreement entered into during the period. The combination of these two figures hopefully would provide a user with enough information to reverse engineer the effects of a nonpublic entity's adoption of the practical expedient for purposes of comparability with financial statements of public franchisors.

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.*

[5] See paragraph 606-10-32-34.

We are not supportive of the proposed amendments. However, if the proposed amendments were to be issued in final form, we believe that entities that have not yet adopted Topic 606 should be required to apply the transition provisions and effective date in paragraph 606-10-65-1.

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.*

We are not supportive of the proposed amendments. However, if the proposed amendments were to be issued in final form, it would be desirable that it be adopted on a full retrospective basis. However, if the purpose of the proposed amendments is to reduce cost and complexity, we would not object to adoption using the modified retrospective method if paragraph 606-10-65-1(d) were expanded to show the proforma effect of applying the practical expedient in the Exposure Draft to the previously adopted Topic 606 implementation. We believe that this type of disclosure provides important financial information for a user to evaluate the impact of electing the practical expedient.

Whether a full retrospective or modified retrospective basis is required, we recognize that nonpublic franchisors that have already adopted Topic 606 will incur a one-time cost associated with the election of the proposed practical expedient.

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.*

We are not supportive of the proposed amendments. However, if the proposed amendments were to be issued in final form, we believe the amendments should be effective for annual reporting periods beginning after December 15, 2020. However, we would prefer that the interim reporting requirement be pushed to interim periods beginning in the year subsequent to the first annual reporting period (that is, annual reporting periods beginning after December 15, 2020, and interim reporting periods beginning after December 15, 2021). We believe early application should be permitted.