



Audit



Fees



Businesses

FASB provides practical expedient for initial franchise fees

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Franchisors – Revenue from Contracts with Customers: Practical Expedient, introduce a practical expedient for 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 included in a predefined list set forth within the amendments.



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How do the amendments change GAAP?

Prior to the amendments, franchisors needed to apply Step 2 of the revenue model in ASC 606 to identify the performance obligations in their contracts with customers. In other words, franchisors needed to analyze pre-opening activities (such as site selection and training of the franchisee's personnel) in their arrangements to determine whether the activities represent promised goods or services and, if so, to determine whether the promises are distinct from one another and should be accounted for as separate performance obligations. Under ASC 606, an entity must determine and then allocate the transaction price among the distinct performance obligations in an arrangement on a relative stand-alone selling price basis.

The amendments offer eligible franchisors a practical expedient to account for pre-opening services as distinct from the franchise license if the service is listed in the new guidance. Further, franchisors adopting the practical expedient may make an accounting policy election to account for qualifying pre-opening services as a single performance obligation. Franchisors must disclose when they use the practical expedient and make the accounting policy election to recognize the pre-opening services as a single performance obligation.

The amendments do not change the other guidance in ASC 606, for example, determining and allocating the transaction price, or when and how to recognize revenue.

Example

Assume that Franchisor A enters into a contract with a customer and promises to grant a franchise license to operate a hotel for 10 years. In addition to the license, Franchisor A also promises to provide site selection services and training to the franchisee.

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Franchisor A determines that it is eligible to apply the practical expedient since it is not a public business entity and falls within the scope of ASC 952. Next, Franchisor A determines that its pre-opening services (training and site selection) are included within the list of services in ASC 952-606-25-2. As a result, Franchisor A elects to apply the practical expedient to account for the services as distinct from the franchise license and also makes an accounting policy election to account for all qualifying pre-opening services as a single performance obligation. Franchisor A concludes that it has two distinct performance obligations in this arrangement: a franchise license and pre-opening services.

Franchisor A applies the guidance in ASC 606 to determine the transaction price, to allocate the transaction price to the two separate performance obligations, and to recognize revenue when or as it transfers control of the related performance obligations to the franchisee.

Finally, Franchisor A discloses its use of the practical expedient and policy election in the notes to the financial statements.

Effective date

For entities that have not yet adopted ASC 606, the amendments are effective when they first adopt ASC 606, using the same transition requirements selected for adopting ASC 606.

For calendar-year entities that have already adopted ASC 606, the amendments are effective in 2021, with a cumulative-effect adjustment to opening retained earnings as of the beginning of the first reporting period in which ASC 606 was applied. Early application is permitted.

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