



FRANCHISE ADVISORY

July 2019

To:	Clients of Holmes Lofstrom, PC
Subject:	Additional Issues Related to New FASB Rules for 2019 Audits

Based on our prior alerts, you are already aware of the change to the Accounting Standards guidelines adopted by the Financial Accounting Standards Board (FASB), requiring franchisors to amortize initial franchise fees over the term of the franchise rather than recognizing franchise fees when received or when a unit is open. Further, you know that this will affect all franchisors' financial audits and, more particularly, franchise registration, renewal, and exemption filings that include such audits going forward. In order to minimize the financial impact of this new standard, known as FASB ASC 606, we have advised franchisors over the past two years to consider modifying their initial fee structure to "unbundle" distinct component fees from the initial franchise fees so that such revenue may be recognized when received. We have implemented such modifications for many of our franchisor clients to help them mitigate the negative impact of ASC 606, at least on a go-forward basis. Franchisors who have not made such revisions to their documents, may encounter financial assurance conditions imposed by regulators and/or delays related to renewal filings in 2020, among other issues. All franchisors should expect that the preparation of the 2019 audit will be more complicated, time consuming, and expensive than previously and, in some instances significantly so.

With this Alert, we want to bring to your attention a new "wrinkle" that has come to light related to this issue. Franchisors of larger systems with many existing units will likely feel an even greater impact from these new rules due to the need for auditors to conduct a thorough review and analysis of **all existing franchise agreements related to the new revenue restatement rules**. Accordingly, we are urging clients, especially those with larger franchise systems, to reach out to their auditors now so that this work can be completed before the end of the 2019 fiscal year. Proceeding under a "business as usual" course and waiting to have auditors begin this review at end of a fiscal year along with all other audit work, may result in missed renewal filing deadlines and having to cease franchise sales until the audit is complete.

So, although the 2019 renewal season for calendar year-end franchisors has just ended, we urge all franchisors to contact their auditors now to ascertain when the review of existing agreements should begin based on the particular system's size and complexities, in order to have the best chance to meet renewal filing deadlines in 2020 and avoid excessive downtime as far as franchise sales.

If we can assist in any way, please don't hesitate to call.

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