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FRANCHISE ADVISORY 11.06.17:

To:	Clients of Holmes Lofstrom, PC
Subject:	Financial Accounting Standards Board (FASB) Guidelines

The fourth quarter is generally a good time for clients with a calendar year end to consider possible franchise model adjustments. Upcoming changes in the Financial Accounting Standards Board (FASB) Accounting Standards guidelines may make this particularly true as we head towards 2018.

As we notified you in our May memorandum to clients, the revised accounting standards calls for the application of different accounting principles involving revenue recognition. One effect of the guidelines is that initial franchise fees are expected to be amortized and accounted for as income over the term of the franchise, which may have a significant impact on your financial statements. Under current practices, franchisors routinely recognize initial franchise fees for financial statement purposes when their pre-opening obligations to the applicable franchisees are satisfied.

The upcoming change has prompted some franchisors to reevaluate with their accountants the way their fees are structured. For example, a franchisor with a $35,000 initial franchise fee that includes the initial training fee or site evaluation fee might choose to "unbundle" the initial franchise fee. By reducing the initial franchise fee to $20,000, charging a $10,000 initial training fee and assessing a $5,000 site evaluation fee, you may be able to recognize more revenue sooner under the changed guidelines, if the other pre-opening services are distinct and provide benefits to the franchisee independent of the license to use the brand.

The updated guidelines are scheduled to be in effect for non-public companies for reporting periods *beginning* after 12/15/18. Companies have the option to adopt the new standard retrospectively to each period presented (full retrospective method), or retrospectively with the cumulative effect of the change recognized at the date the new guidance is applied (modified retrospective method). This is an especially pertinent question for franchisors, which prepare Franchise Disclosure Documents containing financial statement information that spans a 3-year period. It is also unclear how and in what manner area development fees may be impacted by the revised guidelines as we are awaiting more definitive guidance on these matters.

We encourage clients to consult with their accountants before the end of this calendar year to consider if and to what extent they might wish to revise the economic terms of their agreements. Taking the opportunity to have the accounting discussion now allows you time to work with us to draft related changes in your franchise agreement and franchise disclosure document which can be implemented in annual renewal documents. Using the fee “unbundling” example described above, additional fee provisions for initial training and site evaluation services would need to be drafted into the franchise agreement. Those changes would drive FDD revisions to items 6 and 7 and related notes.

Holmes Lofstrom is not an accounting firm and does not provide any accounting advice. Our recommendation is that you turn to your accountants for a discussion on how the revised guidelines may impact your company and its financial statements.

We stand ready to assist you in implementing any term changes you and your accountant consider advisable.

Best regards!