withum

Franchise

ASC 606 CONSIDERATIONS
for Franchisors

STEP ONE: IDENTIFY THE CONTRACT

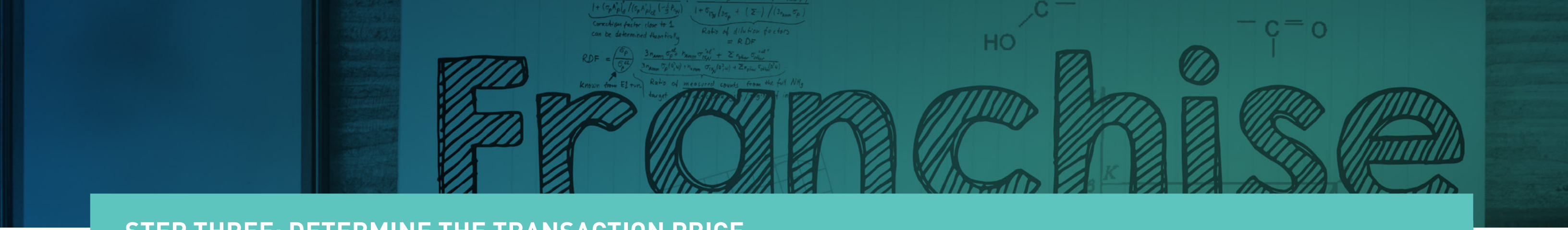
- ☐ Review each area development agreement and individual franchise agreement to ensure that they meet the criteria for an ASC 606 "contract."
- ☐ If the ASC 606 criteria are not met, further revenue recognition analysis is deferred until they are satisfied.

STEP TWO: IDENTIFY THE PERFORMANCE OBLIGATIONS

- ☐ Review franchise agreements that contain multiple promises, as these could create several performance obligations. Initial franchise fees, for example, could include franchise rights, area development fees, equipment, supplies, learning materials, training, site opening and set-up assistance. Franchisors will need to analyze these agreements in order to identify and understand the true nature of what is promised to the customer, and which of them rise to the level of an ASC 606 performance obligation.
- ☐ Each analysis will differ, but area development agreements may not contain many, ASC 606 distinct performance obligations.
- ☐ Certain discounted renewal options may provide a "material right" to the franchisee, which would be a separate performance obligation. Consult ASC 606 guidance.

EXAMPLES: The services included in the initial franchise fee may include development and startup costs such as site selection, advertising, training and equipment. If any of these goods or services are not considered distinct, they are disregarded for ASC 606 revenue accounting. Equipment, for example, is usually a distinct performance obligation. Training may be considered distinct, if it is material at the contract level, and not brand specific.

A franchisee pays a large initial up-front fee, and the contract provides for a significantly reduced fee for a renewal. That discounted renewal option may be a material right under ASC 606, and thus a separate performance obligation.



STEP THREE: DETERMINE THE TRANSACTION PRICE

- ☐ Start with the contract price and include good-quality estimates of probable variable consideration such as discounts which may relate to area development agreements or multi-unit deals.
- ☐ Identify any licenses of IP that involve sales- or usage-based royalties, as that accounting is an exception under ASC 606. These are excluded from the calculation of the total transaction price (see Step 5)
- ☐ Consider if a significant financing component is embedded in the franchise agreement for the up-front fees. Consult guidance in ASC 606 for details.

EXAMPLE: The franchise agreement has a large up-front fee which includes equipment, and the right to use the brand name. However, the timing of the transfer of the goods and services is at the customer's discretion. Per ASC 606, this feature means that a significant financing component does not exist.

STEP FOUR: ALLOCATE THE TOTAL TRANSACTION PRICE TO ALL THE PERFORMANCE OBLIGATIONS

- ☐ This step only applies if there is more than 1 performance obligation.
- ☐ Develop high quality standalone selling prices for all elements of a franchise agreement if they are not available. These are the basis for allocating a fixed fee among several performance obligations.
- ☐ Typically, most of the total transaction price is ultimately allocated to the franchise rights, given their significance to the transaction.

EXAMPLES: For multi-unit deals, the total transaction price, including volume discounts associated with the entire agreement, must be allocated amongst the units.

STEP FIVE: RECOGNIZE REVENUE AS THE CUSTOMER ACHIEVES CONTROL OF THE GOODS OR SERVICES

- ☐ Franchise rights are considered a license of intellectual property (IP). Under ASC 606, these rights are usually classified as symbolic IP, and recognized as revenue over the franchise period.
- ☐ Sales- or usage-based royalties income may only be recorded in the period in which the underlying usage or sales occurred. Franchisors may no longer record this on a time lag.
- ☐ If an advertising fund exists, the franchisor should evaluate whether gross versus net presentation of the advertising fund revenue is appropriate. ASC 606 provides indicators. Under previous GAAP, many franchisors recognized this revenue net, however under ASC 606 this may not be the case.

Email us at info@withum.com for a deeper dive into a sample of revenue transactions.

Rick Coyne, CPA, Partner
Team Leader, Franchise Services
T (609) 520 1188
rcoyne@withum.com

Lisa Morgan, CPA, Partner
Team Member, Franchise Services
T (732) 842 3113
lmorgan@withum.com