

Center for Plain English Accounting

AICPA's National A&A Resource Center

ASU 2021-02 **Franchisors Applying FASB ASC 606 – Practical Expedient**

On January 28, 2021, the FASB issued Accounting Standards Update (ASU) 2021-02, *Franchisors—Revenue from Contracts with Customers (Subtopic 952-606): Practical Expedient*. The amendments in ASU 2021-02 provide a practical expedient related to FASB Accounting Standards Codification (FASB ASC) 606, *Revenue from Contracts with Customers*, that permits franchisors that are not public business entities (PBEs) to account for pre-opening services provided to a franchisee as distinct from the franchise license if the services are consistent with those included in a predefined list within the ASU. Additionally, amendments in ASU 2021-02 provide an accounting policy election to recognize the pre-opening services as a single performance obligation. Entities that are not within the scope of ASU 2021-02 are not permitted to apply it directly or by analogy.

Under the current guidance in FASB ASC 606, franchisors are required to analyze pre-opening activities to identify whether the goods and services provided are distinct from the franchise license and, therefore, are performance obligations. If the goods or services are determined to be performance obligations, entities are then required to analyze each performance obligation to determine the standalone selling prices, allocation of the consideration, and timing of revenue recognition. In situations where pre-opening activities are determined to not be distinct from the franchise license (which would be common under the current guidance in FASB ASC 606), the initial franchise fees often will be recognized over the term of the franchise license (and, therefore, a substantial portion accounted for as a contract liability (deferred revenue) on the balance sheet).

Before the adoption of FASB ASC 606, under the industry specific guidance in FASB ASC 952, *Franchisors*, the initial franchise fee typically was recognized when the franchise location opened (“upfront”). The FASB issued ASU 2021-02 in response to concerns about the cost and complexity of applying FASB ASC 606 to pre-opening services and to concerns that some non-PBE franchisors presumed that the pre-opening services would

not be distinct from the franchise license and that the initial franchise fee always would be recognized over the license term.

CPEA Observation. The practical expedient provided by the amendments in ASU 2021-02 allow non-PBE franchisors to account for pre-opening services as distinct from the franchise license. Therefore, many non-PBE franchisors may be recognizing initial franchise fees upfront, rather than over the term of the franchise license.

See the CPEA's [report](#), *The New Revenue Recognition Standard - Industry Impacts: Franchisors*, for an in-depth discussion about the application of FASB ASC 606 to franchisors (that report does not reflect the amendments in ASU 2021-02).

Specific Requirements of the Practical Expedient

The amendments in ASU 2021-02 add a subtopic, FASB ASC 952-606, *Franchisors – Revenue from Contracts with Customers*, to the FASB ASC and apply to non-PBE franchisors. The practical expedient provided in the amendments allow a non-PBE franchisor to account for the following pre-opening services as distinct from the franchise license:

- Assistance in the selection of a site
- Assistance in obtaining facilities and preparing the facilities for their intended use, including related financing, architectural, and engineering services, and lease negotiation
- Training of the franchisee's personnel or the franchisee
- Preparation and distribution of manuals and similar material concerning operations, administration, and record keeping
- Bookkeeping, information technology, and advisory services, including setting up the franchisee's records and advising the franchisee about income, real estate, and other taxes or about regulations affecting the franchisee's business
- Inspection, testing, and other quality control programs

Practice Note: The list of pre-opening services is for purposes of applying the practical expedient and is not meant to imply that services not included on that list cannot be distinct from a franchise license. For services not included on the list, franchisors should apply FASB ASC 606 to assess whether such services are distinct rather than apply the practical expedient.

A non-PBE franchisor applying the practical expedient can make a policy election to account for the pre-opening services as a single performance obligation (e.g., combining site selection, personnel training, and other services on the permitted list into one performance obligation). If that policy election is not made, the non-PBE franchisor should

apply the guidance in FASB ASC 606 on determining whether goods and services are distinct (paragraphs 19-22 of FASB ASC 606-10-25) to determine whether the pre-opening services are distinct from one another.

A non-PBE franchisor should apply the practical expedient consistently to contracts with similar characteristics and in similar circumstances. Importantly, the practical expedient applies only to identifying performance obligations and entities that apply the practical expedient will still need to determine standalone selling prices in Step 4 to allocate the transaction price.

Disclosure Requirements

If a non-PBE franchisor elects to use the practical expedient provided by the amendments in ASU 2021-02, the entity should disclose that fact. Also, an entity that makes the accounting policy election to recognize pre-opening services as a single performance obligation should disclose that fact.

Effective Date and Transition

If an entity has not yet adopted FASB ASC 606, the existing transition provisions and effective date in FASB ASC 606-10-65-1 are required. That guidance allows for an option of modified retrospective transition or full retrospective transition and an effective date of annual reporting periods beginning after December 15, 2019, and interim reporting periods within annual reporting periods beginning after December 15, 2020.

If an entity already has adopted FASB ASC 606, the amendments in ASU 2021-02 are effective in interim and annual periods beginning after December 15, 2020. Early application is permitted. For those entities, this guidance should be applied retrospectively to the date FASB ASC 606 was adopted.

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