FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: April 21, 2020
Comments Due: May 6, 2020

Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842)

Effective Dates for Certain Entities

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topics 606 and 842 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2020-300, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until May 6, 2020. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2020-300
- Sending a letter to "Technical Director, File Reference No. 2020-300, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

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FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842)

Effective Dates for Certain Entities

April 21, 2020

Comment Deadline: May 6, 2020

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The Coronavirus Disease 2019 (COVID-19) pandemic is adversely affecting the global economy and causing significant and widespread business and capital market disruptions. The Board is committed to supporting and assisting stakeholders during this difficult time.

The Board is proposing a limited deferral of the effective dates of the following Updates (including amendments issued after the issuance of the original Update) to provide immediate, near-term relief for certain entities for whom these Updates are either currently effective or imminently effective:

1. Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (Revenue)
2. Accounting Standards Update No. 2016-02, *Leases (Topic 842)* (Leases).

The proposed deferral for Revenue is limited to franchisors that are not public business entities because of a specific issue related to the application of Revenue to initial franchise fees. The proposed deferral for Leases is limited to (1) entities for whom Leases is currently effective and that have rapidly approaching year-end dates and (2) entities for whom the effective date for Leases is imminent.

Revenue from Contracts with Customers

On May 28, 2014, the Board issued Update 2014-09, with an effective date for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, for public business entities, certain not-for-profit (NFP) entities, and certain employee benefit plans. The effective date for all other entities was for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018.

In August 2015, the Board issued Accounting Standards Update No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*. The amendments in that Update deferred the effective date of Update 2014-09 for all entities by one year. Public business entities, certain NFP entities, and certain employee benefit plans were required to apply the guidance in Update 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. All other entities were required to apply the guidance in Update 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. Early adoption was permitted.

In accordance with the effective dates described above, public business entities, certain NFP entities, and certain employee benefit plans are already required to adopt the new guidance. In contrast, many private companies are currently preparing and having their first annual financial statements under the new guidance audited.

Stakeholders in the franchise industry raised concerns about the adoption of the new guidance. Those stakeholders raised issues about the application of Revenue to franchise agreements, specifically to revenue recognition of initial franchise fees. The initial franchise fee is a fee paid to a franchisor in exchange for establishing a franchise relationship, along with the provision of services. This fee typically is paid in a lump sum to the franchisor when a franchise agreement is executed. The primary question raised by stakeholders is how to determine (1) the amount of the initial franchise fee that may be recognized as revenue upon the opening of the franchise location and (2) the amount of the fee that should be deferred for accounting purposes (and recognized as revenue over the franchise license period). The timing of the revenue recognition of the initial franchise fee can have a significant effect on a franchisor's financial statements, particularly franchises that are in the start-up or growth phases. The FASB staff worked with this industry to facilitate a successful adoption, including numerous outreach meetings and the issuance of educational materials. Notwithstanding those efforts, the application of Revenue to franchise fees appears to continue to pose significant challenges for private companies.

The Board is proposing to defer the effective date of Revenue for franchisors that are not public business entities to provide the Board with time to explore whether a cost-effective solution to apply Revenue can be developed to address this issue. Contemporaneous with its decision to defer the effective date of the guidance, the Board added a research project to its agenda to further explore the issue.

Leases

In February 2016, the Board issued Update 2016-02, with an effective date for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for public business entities; NFP entities that have issued or are conduit bond obligors for securities that are traded, listed, or quoted on an exchange or an over-the-counter market (referred to as public NFP entities); and employee benefit plans that file or furnish financial statements with or to the U.S. Securities and Exchange Commission (SEC). For all other entities, Leases was effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

In November 2019, the Board issued Accounting Standards Update No. 2019-10*, Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*. The amendments in Update 2019-10 deferred the effective dates for Leases for entities in the "all other" category by an additional year. Therefore, Leases is effective for all other entities for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early application is permitted. The deferrals responded to feedback from stakeholders and the Board's monitoring of the implementation of major Updates, which provided a greater understanding of the implementation challenges encountered by all types of entities when adopting a major Update.

In Update 2019-10, the Board noted that challenges associated with transition to a major Update are often magnified for private companies, smaller public companies, and NFP entities. Those challenges have been significantly amplified by the current business and capital market disruptions caused by the COVID-19 pandemic. Furthermore, the Board had previously scheduled a roundtable discussion to address implementation by public companies to assist private companies in their efforts and to determine whether additional practical expedients or other amendments are warranted as private companies prepare for final implementation. This roundtable has been postponed because of the COVID-19 pandemic, and the Board anticipates that the earliest it could be held would be later this year. Therefore, the Board is proposing to defer the effective date of Leases for entities in the "all other" category and public NFP entities that have not yet issued their financial statements. The Board decided that the proposed deferral for those limited entities was needed at this time because of the rapidly approaching year-end dates for public NFP entities and because the effective date for entities in the "all other" category is imminent.

Who Would Be Affected by the Amendments in This Proposed Update?

Revenue from Contracts with Customers

The deferral of the effective date would apply to a franchisor—the party who grants business rights (the franchise) to the party (the franchisee) who will operate the franchised business, as defined in the Master Glossary of the Codification. The deferral would apply to franchisors that are not public business entities.

The option to defer Revenue should be made and applied at the entity level and would include (or be applicable to) all of an entity's revenue streams (for example, this deferral also would apply to equipment sales or sales of consumables used in the franchise business or to revenue from franchisor-owned locations).

Leases

The deferral of the effective date would apply to entities in the "all other" category and public NFP entities that have not yet issued their financial statements.

What Are the Main Provisions?

Revenue from Contracts with Customers

The amendments in this proposed Update would defer the required effective date of Revenue for franchisors that are not public business entities. Those entities may elect to adopt the guidance for annual reporting periods beginning after December 15, 2019. This deferral is optional. Those entities may elect to follow the original effective date of annual reporting periods beginning after December 15, 2018.

Leases

The amendments in this proposed Update would defer the effective date for one year for entities in the "all other" category and public NFP entities that have not yet issued their financial statements. Therefore, under the proposed amendments, Leases would be effective for entities within the "all other" category for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. Additionally, Leases would be effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, for public NFP entities that have not yet issued financial statements. Early application would continue to be permitted, which means that this deferral is optional, and an entity may choose to implement Leases before those deferred effective dates.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Revenue from Contracts with Customers

Question 1: Should the effective date of Revenue for franchisors that are not public business entities be optionally deferred to annual reporting periods beginning after December 15, 2019, and interim reporting periods within annual reporting periods beginning after December 15, 2020? Please explain why or why not.

Question 2: Is the scope of the Revenue deferral (franchisors that are not public business entities) clear? If not, please explain why.

Leases

Question 3: Should Leases be effective for entities in the “all other” category (such as private companies and private NFP entities) for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022? Please explain why or why not.

Question 4: Should Leases be effective for NFP entities that have issued or are conduit bond obligors for securities that are traded, listed, or quoted on an exchange or an over-the-counter market that have not yet issued financial statements for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years? Please explain why or why not.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–4. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Add the following Master Glossary term to Subtopic 606-10 as follows:

Franchisor

The party who grants business rights (the franchise) to the party (the franchisee) who will operate the franchised business.

Amendments to Subtopic 606-10

3. Amend paragraph 606-10-65-1, by adding item I, and its related heading as follows:

Revenue from Contracts with Customers—Overall

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Updates No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net),* No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing,* No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients,* No. 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers,* ~~and~~ No. 2017-05, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial*

Assets*, and No. 2020-XX, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities

606-10-65-1 The following represents the transition and effective date information related to Accounting Standards Updates No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net),* No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing,* No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients,* No. 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers,* ~~and~~ No. 2017-05, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*, and No. 2020-XX, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities:* [**Note:** See paragraph 606-10-S65-1 for an SEC Staff Announcement on transition related to Update 2014-09.]

l. An entity that is a **franchisor** and is not a public business entity may elect to apply the pending content that links to this paragraph for annual reporting periods beginning after December 15, 2019, and interim reporting periods within annual reporting periods beginning after December 15, 2020, in financial statements for fiscal years that have not yet been issued or made available for issuance as of **[the exact date that a final Update on effective dates for certain entities is issued, for example, May 31, 2020].**

Amendments to Subtopic 842-10

4. Amend paragraphs 842-10-65-1 and 842-10-65-4 and their related headings and amend pending content transition date for all paragraphs that link to paragraphs 842-10-65-1 and 842-10-65-4 as follows:

Leases—Overall

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Updates No. 2016-02, *Leases (Topic 842)*, No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*, No. 2018-10, *Codification Improvements to Topic 842, Leases*, No. 2018-11, *Leases (Topic 842)*: *Targeted Improvements*, No. 2018-20, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*, No. 2019-01, *Leases (Topic 842): Codification*

Improvements*, ~~and~~ No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*, and No. 2020-XX, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities

842-10-65-1 The following represents the transition and effective date information related to Accounting Standards Updates No. 2016-02, *Leases (Topic 842)*, No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842,* No. 2018-10, *Codification Improvements to Topic 842, Leases,* No. 2018-11, *Leases (Topic 842): Targeted Improvements*, No. 2018-20, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*, No. 2019-01, *Leases (Topic 842): Codification Improvements*, ~~and~~ No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*, and No. 2020-XX, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*: [**Note:** See paragraph 842-10-S65-1 for an SEC Staff Announcement on transition related to Update 2016-02.]

a. A **public business entity**, a **not-for-profit entity** that has issued or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market (with an exception for those entities that have not yet issued their financial statements as described in the following sentence), and an employee benefit plan that files or furnishes financial statements with or to the U.S. Securities and Exchange Commission shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. A not-for-profit entity that has issued or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market that has not yet issued financial statements or made financial statements available for issuance as of **[the exact date that a final Update on effective dates for certain entities is issued, for example, May 31, 2020]** shall apply the pending content that links to this paragraph for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Earlier application is permitted.
b. All other entities shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2021 ~~2020~~, and interim periods within fiscal years beginning after December 15, 2022 ~~2021~~. Earlier application is permitted.

[The remainder of this paragraph is not shown here because it is unchanged.]

Pending Content:

Transition Date: *(P) December 16, 2018; (N) December 16, 2021 ~~2020~~* │ **Transition Guidance:** 842-10-65-1

Note: These transition date changes will be made in a Maintenance Update.

> Transition Related to Accounting Standards Updates No. 2019-01, *Leases (Topic 842): Codification Improvements*, ~~and~~ No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*, and No. 2020-XX, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*

842-10-65-4 The following represents the transition and effective date information related to Accounting Standards Updates No. 2019-01, *Leases (Topic 842): Codification Improvements*, ~~and~~ No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*, and No. 2020-XX, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*:

a. All entities within the scope of paragraph 842-10-65-1(a) shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years (with an exception for those entities that have not yet issued their financial statements as described in the following sentence). A **not-for-profit entity** that has issued or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market that has not yet issued financial statements or made financial statements available for issuance as of **[the exact date that a final Update on effective dates for certain entities is issued, for example, May 31, 2020]** shall apply the pending content that links to this paragraph for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. All other entities shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2021 ~~2020~~, and interim periods within fiscal years beginning after December 15, 2022 ~~2021~~. Earlier application is permitted.
b. An entity shall apply the pending content that links to this paragraph as of the date that it first applied the pending content that links to paragraph 842-10-65-1 and shall apply the same transition method elected for the pending content that links to paragraph 842-10-65-1 in accordance with paragraph 842-10-65-1(c).

Pending Content:

Transition Date: *(P) December 16, 2019; (N) December 16, 2021 ~~2020~~* | **Transition Guidance:** 842-10-65-4

Note: These transition date changes will be made in a Maintenance Update.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Susan M. Cosper
Marsha L. Hunt
R. Harold Schroeder

Background Information, Basis for Conclusions, and Alternative View

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. The Coronavirus Disease 2019 (COVID-19) pandemic is adversely affecting the global economy and causing significant and widespread business and capital market disruptions. The Board is committed to supporting and assisting stakeholders during this difficult time.

BC3. The Board is proposing a limited deferral of the effective dates of the following Updates (including amendments issued after the issuance of the original Update) to provide immediate, near-term relief for certain entities for whom these Updates are either currently effective or imminently effective:

a. Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (Revenue)
b. Accounting Standards Update No. 2016-02, *Leases (Topic 842)* (Leases).

BC4. The proposed deferral for Revenue is limited to franchisors that are not public business entities because of a specific issue related to the application of Revenue to initial franchise fees. The proposed deferral for Leases is limited to (a) entities for whom Leases is currently effective and that have rapidly approaching year-end dates and (b) entities for whom the effective date for Leases is imminent.

Revenue from Contracts with Customers

BC5. On May 28, 2014, the Board issued Update 2014-09, with an effective date for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, for public business entities, certain not-for-profit (NFP) entities, and certain employee benefit plans. The effective date for all other entities was for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018.

BC6. In August 2015, the Board issued Accounting Standards Update No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*. The amendments in that Update deferred the effective date of Update 2014-09 for all entities by one year. Public business entities, certain NFP entities, and certain employee benefit plans were required to apply the guidance in Update 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. All other entities were required to apply the guidance in Update 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. Early adoption was permitted.

BC7. In accordance with the effective dates described above, public business entities, certain NFP entities, and certain employee benefit plans are already required to adopt the new guidance. In contrast, many private companies are currently preparing and having their first annual financial statements under the new guidance audited.

BC8. Stakeholders in the franchise industry raised concerns about adoption of the new guidance. Those stakeholders raised issues about applying Revenue to franchise agreements, specifically to revenue recognition of initial franchise fees. The initial franchise fee is a fee paid to a franchisor in exchange for establishing a franchise relationship, along with the provision of services. This fee typically is paid in a lump sum to the franchisor when a franchise agreement is executed. The primary question raised by stakeholders is how to determine (a) the amount of the initial franchise fee that may be recognized as revenue upon the opening of the franchise location and (b) the amount of the fee that should be deferred for accounting purposes (and recognized as revenue over the franchise license period). The timing of the revenue recognition of the initial franchise fee can have a significant effect on a franchisor’s financial statements, particularly franchises that are in the start-up or growth phases.

BC9. The Board is proposing to defer the effective date of Revenue for franchisors that are not public business entities on the basis of stakeholders’ feedback in order to provide the Board with time to determine whether any cost-effective solutions to apply Revenue can be developed to address this issue. Contemporaneous with its decision to defer the effective date of the guidance, the Board also added a research project to its agenda to further explore the issue.

BC10. The Board observes that because the deferral is optional, some franchisors that are not public business entities may decide to adopt the guidance as of the original effective date. Additionally, franchisors that are public business entities are already required to adopt the guidance. Therefore, while the deferral may only apply to a subset of franchisors, the Board’s intent is that the research project would evaluate solutions that may reduce the cost of applying the guidance for all franchisors, not only entities that elect the deferral. The FASB staff worked with this industry to facilitate a successful adoption, including numerous outreach meetings and the issuance of educational materials. Notwithstanding those efforts, the application of Revenue to franchise fees appears to continue to pose significant challenges for private companies.

Leases

BC11. In February 2016, the Board issued Update 2016-02, which was effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for public business entities; NFP entities that have issued or are conduit bond obligors for securities that are traded, listed, or quoted on an exchange or an over-the-counter market (referred to as public NFP entities); and employee benefit plans that file or furnish financial statements with or to the SEC. For all other entities, Leases was effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

BC12. In November 2019, the Board issued Accounting Standards Update No. 2019-10*, Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*. The amendments in Update 2019-10 deferred the effective dates for Leases for entities in the "all other" category by an additional year. Therefore, Leases is effective for all other entities for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early application is permitted. The deferrals were in response to feedback from stakeholders and the Board's monitoring of the implementation of major Updates, which provided a greater understanding of the implementation challenges encountered by all types of entities when adopting a major Update.

BC13. In Update 2019-10, the Board noted that challenges associated with transition to a major Update are often magnified for private companies, smaller public companies, and NFP entities. Those challenges have been significantly amplified by the current business and capital market disruptions caused by the COVID-19 pandemic. Therefore, the Board is proposing to defer the effective date of Leases for entities in the "all other" category and public NFP entities that have not yet issued their financial statements.

Benefits and Costs

BC14. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The

Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC15. The Board does not anticipate that entities will incur significant costs as a result of the amendments in this proposed Update. The proposed amendments for Topic 606 would defer the effective date, for a limited subset of entities, of generally accepted accounting principles (GAAP) that are not yet effective, while permitting application of that GAAP as of the original effective date. The proposed amendments for Topic 842 would defer the effective date of GAAP for one year for entities in the "all other" category and public NFP entities that have not yet issued their financial statements while continuing to permit early application. On the basis of outreach with stakeholders, the Board expects that the proposed amendments would reduce implementation costs for some organizations.

BC16. The Board believes that the amendments in this proposed Update could potentially and temporarily increase costs for users of financial statements because of noncomparability resulting from different effective dates. However, the Board believes that absent a deferral of the effective date, some entities may have insufficient time to implement the guidance in Update 2014-09 and Update 2016-02 because that guidance is either currently effective or imminently effective, which could affect the quality of financial information provided to users of financial statements and could be more costly for those users in the long term.

Basis for Conclusions

Revenue from Contracts with Customers

Deferral of the Effective Date

BC17. The amendments in this proposed Update would defer the required effective date of Revenue for franchisors that are not public business entities. Those entities may elect to adopt the guidance for annual reporting periods beginning after December 15, 2019.

BC18. The Board decided that this deferral should be optional. That is, entities may elect to follow the effective date in Update 2015-14, which is annual reporting periods after December 15, 2018. Because of the timing of the issuance of this proposed Update, the Board observes that entities may have already completed their financial statements under Revenue or may be near the completion of their audits. The Board did not want to disrupt the implementation for those entities and, therefore, decided to make the deferral optional. Additionally, the Board observes that the initial franchise fee issue does not materially affect the financial statements for all franchisors and, accordingly, did not want to require deferral for all entities.

BC19. The deferral of the effective date would apply to franchisors that are not public business entities and as defined in the Master Glossary of the Codification as the party who grants business rights (the franchise) to the party (the franchisee) who will operate the franchised business. The Board did not extend the deferral to public business entities because those entities were required to adopt the guidance for annual reporting periods beginning after December 15, 2017.

BC20. The option to defer Revenue should be made and applied at the entity level and would include (or be applicable to) all of an entity's revenue streams (for example, this deferral also would apply to equipment sales or sales of consumables used in the franchise business or to revenue from franchisor-owned locations). The Board believes that it would be impractical to allow entities to defer application of Revenue only for an entity's franchise fee revenue.

BC21. The deferral of the effective date is limited to franchisors because the Board is aware of a particular implementation issue in the franchise industry that cannot be addressed before the currently required effective date of Revenue. The purpose of the deferral is to provide the Board with additional time to determine whether a cost-effective solution to apply Revenue exists for the revenue recognition of initial franchise fees.

Initial Franchise Fees

BC22. The proposed deferral of the adoption of Revenue for franchisors is primarily related to questions raised by stakeholders in the franchise industry about the timing of recognizing revenue for initial franchise fees. The initial franchise fee is a fee paid to a franchisor in exchange for establishing a franchise relationship, along with the provision of goods or services. This fee is typically paid in a lump sum to the franchisor when a franchise agreement is executed. Before the adoption of Revenue, under Topic 952, Franchisors, the initial franchise fee typically was recognized when the franchise location opened. Because of the existence of industry-specific GAAP, franchisors historically have not had to assess whether pre-opening services have separate deliverables.

BC23. Under the Revenue guidance, a franchisor should determine whether the pre-opening activities (for example, training, site selection, and so forth) contain any distinct goods or services. The transaction price is then allocated to distinct performance obligations on the basis of standalone selling prices. If the franchisor determines that some or all of the pre-opening services are distinct, then it would recognize revenue when (or as) those services are performed (that is, typically up front).

BC24. When implementing Revenue, the question raised by the industry is whether an initial franchise fee relates to a single performance obligation for the license of intellectual property, which must be spread over the term of the arrangement, or whether the initial franchise fee may be allocated to separate performance obligations associated with the activities of the location opening, which would be recognized up front consistent with the guidance in Topic 952. Because the allocation of revenue depends on determining whether the goods or services are distinct (which some, all, or none may be), as well as determining the standalone selling price for each distinct good or service, the answer may differ from franchisor to franchisor.

BC25. In November 2018, the FASB staff issued an educational paper[1] on this issue. That paper describes the analysis required to be performed under Topic 606 and also explains that when assessing the guidance, entities should consider the facts and circumstances of their specific arrangements and not overgeneralize. Franchise arrangements vary considerably. Whether pre-opening services are distinct will depend on "what" the franchisor is doing. That is, the franchisor should understand the nature of the services it is performing and whether some, none, or all of those service are distinct in order to arrive at an appropriate accounting conclusion.

BC26. Despite educational efforts on this issue, the Board observes that many in the industry have continued to struggle with applying the Revenue guidance to initial franchise fees. The industry has raised concerns about the significant cost of adopting the guidance and potential diversity arising in how preparers and auditors are applying the guidance. Stakeholders asserted that some audit firms are requiring franchisors to defer the initial franchise fee over the term of the franchise license, without considering whether pre-opening activities are distinct services. Stakeholders also asserted that preparers that believe that a portion of their pre-opening activities are distinct have incurred significant costs in analyzing and documenting the nature of the services. Additionally, determining the standalone selling price has been especially difficult for those entities. Typically, the initial franchise fee is set by the franchisor on a cost-recovery basis (that is, so the fee covers the opening costs of a new unit); however, those costs may or may not correlate to distinct goods or services in Topic 606. Therefore, the Board is proposing to defer the effective date of the guidance to provide the Board with time to explore a cost-effective solution to apply Revenue for this issue.

Leases

BC27. The development of systems to effectively implement Leases may be delayed for some entities because of constraints on internal and external resources. Although many public business entities did not have fully operating lease systems to transition to Leases, they were able to perform manual workarounds with their available resources. Many entities in the "all other" category

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[1] Update on Implementation Activities for Franchise Industry.

do not have those resources. Considering the current state of the economy and business priorities, it is unclear whether even large public business entities would have been able to effectively implement Leases during this pandemic considering the imminent effective date. Further complicating the situation is that many leases will be renegotiated and restructured to temporarily alleviate some of the financial burden on certain lessees until the economic effects of COVID-19 are resolved. Therefore, the Board anticipates that accounting resources will be spending a significant amount of time over the next several months supporting and negotiating changes to lease contracts as opposed to supporting the implementation of Leases.

BC28. Because of those challenges, the Board considered whether to defer the effective date of Leases for certain entities because of business disruptions from COVID-19, specifically for those in the “all other” category and public NFP entities that have not yet issued their financial statements. The Board decided that the proposed deferral for these limited entities was needed at this time because of the rapidly approaching year-end dates for public NFP entities and because the effective date for entities in the “all other” category is imminent.

Private Companies and NFP Entities, excluding Public NFP Entities

BC29. The Board had planned to consider potential ways to assist private company and NFP stakeholders in a public roundtable in May 2020. The purpose of the roundtable is, in part, to obtain further feedback on critical implementation areas from public companies and public company auditors to determine whether Board action is required to simplify the application of Leases without compromising its objectives for private entities and NFP entities. This roundtable has been postponed because of the COVID-19 pandemic, and the Board anticipates that the earliest it could be held would be later this year. This delay, compounded with the possibility of a backlog of normal operating activity increasing in the summer months, would provide the Board with insufficient time to perform the necessary actions to assist private company and NFP stakeholders before Leases is effective for those entities (if implementation-related activities are necessary).

BC30. The amendments in this proposed Update would defer the effective date of Leases by one year for entities in the “all other” category. Therefore, Leases would be effective for those entities for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. The Board believes that this deferral would ensure that there is adequate time for preparers to implement Leases, considering the rapidly approaching year-end dates for public NFP entities and because the effective date for entities in the “all other” category is imminent. Early application would continue to be permitted, which means that the proposed deferral would be optional, and an entity may choose to implement Leases before the deferred effective dates.

Public NFP Entities

BC31. During the Board's deliberations preceding the issuance of Update 2019-10, a deferral for public NFP entities was requested by certain stakeholders, including a member of the FASB's Not-for-Profit Advisory Committee (NAC). At that time, the Board decided against deferring the effective date for public NFP entities. Specifically, the Board rejected deferring Leases for those entities primarily because Leases already was effective for those entities. Additionally, the Board reasoned that deferring the effective date for those entities could cause confusion and add complexity to the effective date requirements. Considering the current state of the economy and business priorities, the Board considered whether public NFP entities should be afforded a similar one-year effective date deferral for Leases.

BC32. The Board observed that public NFP entities mostly comprise higher education (colleges and universities) and healthcare organizations. Public NFP entities are required to post GAAP-compliant financial statements in the Electronic Municipal Market Access (EMMA) system on an annual basis. EMMA is governed by the SEC and the Municipal Securities Rulemaking Board (MSRB). The content and timing of the required filings are negotiated between the issuer (the public NFP) and the underwriter (typically a broker-dealer) and are included in the initial offering circular as a continuous disclosure agreement. The requirements of continuous disclosure agreements vary and are market driven; some require only annual information, while others require certain interim financial information or interim financial statements. Continuous disclosure agreements in healthcare often require some form of interim information, but the timing of the posting (for example, 90 days after fiscal year-end) also is negotiated between the issuer and the underwriter. However, public NFP entities also may have earlier reporting requirements to satisfy, for example, bank covenants or grantor requirements.

BC33. Almost all higher education institutions have fiscal year-ends ending on or after May 31. Assuming a fiscal year-end of May 31, 2020, those entities are required to reflect the adoption of Leases as of June 1, 2019, in their annual financial statements as of and for the year ended May 31, 2020. However, those entities may not have commenced or finalized their implementation of Leases because, per the Board's preliminary research, public NFP higher education institutions generally do not issue GAAP-compliant interim financial statements. Additionally, the Board learned that those organizations (not considering any other reporting requirements) may have negotiated up to nine months after fiscal year-end to post their financial statements in EMMA.

BC34. Public NFP healthcare organizations have fiscal year-ends that vary between December 31 and on or after June 30. Therefore, the population of NFP healthcare organizations that may not have commenced or finalized their implementation of Leases are those issuing financial statements for fiscal years ending on or after June 30, 2020. The Board's preliminary research indicates that many public NFP healthcare organizations may be required to post interim financial information or interim financial statements to EMMA. Therefore, those organizations that post quarterly financial information may have already adopted Leases as of the first day of their fiscal year ending in 2020 (for example, July 1, 2019, for a public NFP with a fiscal year-end of June 30, 2020). Depending on specific negotiations, it is the Board's understanding that the public NFP healthcare organizations have between 90 and 180 days to post their financial statements in EMMA (and generally a shorter period for interim financial information).

BC35. Feedback from NAC members at the April 2020 NAC meeting indicated that public NFP entities, especially those in the higher education and healthcare sectors, could benefit from a deferral because operational and regulatory COVID-19 issues have been consuming almost all preparer resources over the past few weeks. While the NAC members explained that those organizations' readiness to adopt Leases varies, many use the last quarter before the effective date to finalize their implementation, which is not feasible in the current environment. NAC members mentioned that it would be beneficial to provide a one-year deferral of Leases so that those organizations can give implementation the time and attention it deserves once normal conditions return. They said that while some organizations may decide to implement Leases as of the original effective date, others—particularly smaller organizations—would take advantage of a deferral. Users of public NFP financial statements were not concerned about a lack of comparability among those organizations that adopt as of the original effective date (or early adopt) or who decide to implement upon the deferred effective date because they are used to adjusting their analyses for varying dates of adoption.

BC36. The amendments in this proposed Update would defer the effective date of Leases by one year for NFP entities that have issued or are conduit bond obligors for securities that are traded, listed, or quoted on an exchange or an over-the-counter market that have not yet issued financial statements. Therefore, Leases would be effective for those entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early application would continue to be permitted, which means that the proposed deferral would be optional, and an entity may choose to implement Leases before the deferred effective date. The Board believes that this deferral for public NFP entities is needed at this time because Leases is currently effective for those entities and because the year-end dates of higher education and healthcare organizations are rapidly approaching.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would not require improvements to the current U.S. GAAP Financial Reporting Taxonomy (Taxonomy). However, the provisions of this Exposure Draft may affect the timing of changes to references and deprecations in future Taxonomies. Any stakeholders who believe that improvements to the Taxonomy are required should provide their comments and suggested improvements through Proposed Taxonomy Improvements provided at www.fasb.org.