accounting guideline AcG-2 franchise fee revenue

TABLE OF CONTENTS

TABLE OF CONTENTS	Paragraph
Purpose and scope	1
Definition	2
Revenue recognition	5
Initial franchise fees	5
Continuing franchise fees	12
Agency sales	13
Franchising costs	14
Acquisition and repossession of franchises	15
Disclosure	17
Effective date	19

PURPOSE AND SCOPE

1 This Accounting Guideline provides guidance on the recognition and disclosure of franchise fee revenue. REVENUE, Section 3400, sets out the general principles governing recognition and disclosure of revenue.

DEFINITION

2 The following term is used in this Guideline with the meaning specified:

A **franchise** is a contractual privilege, often exclusive, granted by one party (the franchisor) to another (the franchisee) permitting the sale of a product, use of a trade name or rendering of a service in a single outlet at a specified location (individual franchise) or in a number of outlets within a specified territory (area franchise). The rights and responsibilities of each party are usually set out in a franchise agreement that normally outlines specific marketing practices to be followed, specifies the contribution of each party to the operation of the business, and sets forth certain operating procedures.

3 Most franchise agreements require the franchisee to pay an initial franchise fee as consideration for establishing the franchise relationship and for initial services provided by the franchisor. The initial services may include assistance in site selection; in obtaining facilities and related financing, architectural and engineering services; in advertising; in personnel training; in administration and record keeping; and in quality control programs. Occasionally, the initial fee includes consideration for tangible assets, such as initially required equipment and inventory. However, these items are usually the subject of separate consideration.

4 Continuing franchise fees represent the consideration for the continuing rights granted by the franchise agreement and for general or specific services to be provided by the franchisor during the life of the franchise.

REVENUE RECOGNITION

Initial franchise fees

5 Revenue from initial franchise fees relating to the sale of an individual franchise or an area franchise shall be recognized, with an appropriate provision for estimated uncollectable amounts, when all material conditions relating to the sale have been substantially performed by the franchisor. Substantial performance is considered to have occurred when:

(a) the franchisor has performed substantially all of the initial services required by the franchise agreement or volunteered by the franchisor as a result of normal business practice;

(b) the franchisor has no remaining obligation or intent (by agreement, industry practice or legislation) to refund amounts received or forgive unpaid amounts owing; and

(c) there are no other material unfulfilled conditions affecting completion of the sale.

In practice, these conditions will not normally be met before the franchisee commences operations. Paragraphs 8-11 provide exceptions to the requirements in this paragraph in specific circumstances.

6 In the case of an area franchise sale, the substance of the franchise agreement determines when material conditions relating to the sale have been substantially performed. If the franchisor's obligations do not depend significantly on the number of individual outlets to be established within an area, the area franchise sale shall be treated as an individual franchise sale and revenue recognized accordingly. If the franchisor's obligations depend on the number of individual outlets established within the area, the franchise agreement shall be treated as a divisible contract. The expected number of outlets is estimated and revenue from the initial area franchise fee is recognized proportionately with the number of outlets for which the conditions in paragraph 5 have been met.

7 Franchise agreements may be structured so that the consideration received by the franchisor for establishing the franchise relationship and for providing initial services includes notes receivable. Notes receivable are accounted for in accordance with FINANCIAL INSTRUMENTS, Section 3856. If the notes are receivable over an extended period of time and there is no reasonable basis for estimating collectibility of the notes, revenue shall be recognized using either the instalment or cost recovery method. Under the instalment method, the gross profit related to the sale is recognized proportionately with actual cash collections of the notes receivable. Under the cost recovery method, equal amounts of revenue and expense are recognized as cash collections are made until all costs have been recovered. This postpones any recognition of gross profit until all costs have been recovered.

8 When an initial franchise fee includes consideration for tangible assets (for example, initially required equipment and inventory) the fair value of the tangible assets shall be recognized as revenue when title to them has passed. The balance of the fee, relating to services, shall be recognized as revenue when the conditions in paragraph 5 have been met.

9 Sometimes, the initial franchise fee is large but continuing franchise fees are small in relation to future services. When it is probable that continuing fees will not cover the costs of the franchisor's continuing services and provide a reasonable profit on those continuing services a portion of the initial franchise fee shall be deferred and amortized over the life of the franchise. The amount deferred shall be sufficient to cover estimated costs in excess of continuing franchise fees and provide a reasonable profit on continuing services.

10 A franchise agreement may allow the franchisee to purchase some or all of the inventory, supplies or equipment necessary for its operations from the franchisor. If the selling price to the franchisee is lower than the selling price of the same products to other customers or does not provide a reasonable profit to the franchisor, a portion of the initial franchise fee shall be deferred and accounted for as an adjustment of the selling price when the products are purchased by the franchisee. The amount deferred shall be sufficient to cover any costs in excess of the bargain purchase price and provide a reasonable profit on the sale.

11 A franchise agreement may give the franchisor an option to purchase the franchisee's business at a later date. If, at the time the option is given, it is likely that the franchisor will acquire the franchised outlet at a future date, the initial franchise fee shall not be recognized as revenue but shall be deferred. When the option is exercised, the amount deferred reduces the cost of the franchisor's investment in the outlet.

Continuing franchise fees

12 Continuing franchise fees shall be recognized as revenue in the period in which the services are rendered.

Agency sales

13 A franchisor may engage in transactions in which the franchisor is, in substance, an agent for the franchisee by placing orders for inventory, supplies and equipment that are then sold to the franchisee at no profit. Such transactions shall be accounted for as receivables and payables and not as revenues and expenses in the financial statements of the franchisor.

Franchising costs

14 Costs directly related to the sale of a franchise for which revenue has not been recognized shall be deferred until the related revenue is recognized. The amount of costs deferred shall not exceed expected revenue in excess of estimated additional related costs. Indirect costs of a regular and recurring nature that are incurred regardless of the level of franchise sales shall be expensed as incurred.

Acquisition and repossession of franchises

15 A transaction in which a franchisor unites with or acquires the business of an operating franchisee is ordinarily accounted for as a business combination in accordance with BUSINESS COMBINATIONS, Section 1582.

16 Sometimes a franchisor may acquire the franchise rights of a franchisee through repossession. For example, the franchisee may decide not to open an outlet or otherwise fail to satisfy the conditions of a franchise agreement. In the event that the franchisor refunds all or part of the initial franchise fee, the amount refunded shall be accounted for as a reduction in revenue in the period in which the franchise is repossessed.

DISCLOSURE

17 Revenue and costs related to franchisor-owned outlets shall be distinguished from revenue and costs related to franchised outlets.

18 The number of franchisor-owned and franchised outlets in operation at the end of the period shall also be disclosed.

EFFECTIVE DATE

19 This Guideline applies to annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted.

Terms and Conditions and Privacy Policy

Help desk: Mon-Fri, 9am-5pm ET 1-866-256-6842 Contact Us Quick Reference Guide

© 2001-2025, Knotia Canada Limited Partnership All rights reserved.