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The Franchise Valuations Reporter

We've Moved!

Franchise Valuations Ltd. and Franchise Technology Risk Management have moved 5 blocks north to new offices at:

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Our Expertise

Within the franchise, distribution and dealership context, we are experts in:

- Finance, Accounting and Tax
- Damages, Valuations & Expert Testimony
- Cyber Security and E-discovery of Electronically Stored Information

Franchisor Accounting for Initial Franchise Fees

New Accounting Release Basically Preserves and Clarifies Financial Accounting for Franchise Fees

With special thanks to that eminent CPA and all around good guy, Aaron Chaitovsky of the Citrin Cooperman accounting firm, people involved in franchising should know that FASB No. 45 which prescribed the financial accounting treatment for initial franchise fees has been superseded and somewhat modified by FASB ASC 952-605-25-1 through 25-17.

The general rule that franchise fee revenue cannot be recognized until the opening of the franchise unit is somewhat modified by FASB ASC 952-605-25-10 and 25-11 which clarifies that revenues received for tangible property as part of the franchise fee may be recognized at the time of the transfer of the property while revenues received for services provided to the franchisee will be subject to the general rule.

Franchisors Keeping Two Sets of Books: Financial Accounting vs. Tax Accounting

How Start-Up Costs and Up-Front Franchisee Fees Are Treated

All entities that begin a new franchise business, whether structured as partnerships, corporations, LLCs, LLPs or any of the other alphabet soup of operating forms, incur **organization and start up costs** in forming the new business. Start-up costs are those incurred to investigate the creation or acquisition of a franchise or in creating the franchise.

Financial accounting differs from federal income tax accounting in the treatment of these costs - hence the obligation to keep two sets of books. For financial accounting, start-up costs are currently deductible and a present charge against earnings. For tax purposes, only $5,000 is currently deductible with the remainder generally amortizable over 15 years.

The treatment of up-front **franchise fees** also requires two sets of books. For financial accounting purposes, the recognition of the fee as income must be postponed until the time the site is opened for business. But for tax purposes, payments of franchise fees are income in the year received, provided no restriction has been placed upon their use.

More. . .

Duration of Distributorship: Perpetual or Not

Two Cases, Two Interpretations

An issue that comes up frequently in franchise litigation (particularly in valuation cases and in breach of contract and wrongful termination

We offer a free initial consultation. If any readers have questions, you are welcome to email or phone us and we will provide our best answer as quickly as possible.

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Franchise Technology Risk Management

Our franchise law and computer forensics experts provide consulting and implementation of all aspects of cyber security, ESI management and e-discovery for franchise systems - from preparation of cyber security and ESI-related policies and procedures manuals through collection, preservation, processing, production and presentation.

To inquire about our services, please e-mail Henry@FTRM.biz or call (212) 689-0400

claims) is the length of the term of either the contract that was allegedly breached or the franchise that was alleged to be wrongfully terminated.

We have been involved as experts in two cases - both on the winning side - where the duration of the contract was at issue, with starkly different results.

In *Ross Angel, et al., v. H&R Block, Inc*. the decision of the appellate court was that the law abhors a "perpetual" contract as against the public policy of Missouri. Therefore, the franchisor was allowed to buy out its franchisees at fair market value taking account of the duration as defined by the court.

Conversely, in *Southern Wines v. Mountain Valley*, the holding was that under Nevada law a contract which the parties apparently wrote to be perpetual unless mutually terminated was just that - "perpetual" - and one side's termination without the other's consent was "wrongful" leading to liability.

More. . .

Discount Rate for Lost Profits and Franchise Valuations

What Is the "Risk-Free Rate" in Light of the S&P Downgrade of the USA?

Another issue that comes up frequently in franchise litigation (particularly in valuation cases and in breach of contract and wrongful termination claims) is the discount rate to be applied to the valuation or lost profits calculations. Frequently, a damages or valuation expert will arrive at their opinion for the appropriate rate by starting with a "risk-free" rate and building in the considerations that a well informed buyer would use to determine the appropriate rate of return for such an investment, i.e. the "discount rate".

As you are probably aware, Standard and Poor's recently downgraded the sovereign debt of the United States which, historically, was used as the starting point for a "risk-free" rate. But what are experts supposed to use as a proxy for a risk-free rate after the downgrade?

Four analysts from the well-respected firm of Houlihan Lokey recently offered some replacement benchmarking options including the following:

- 'AAA'-rated (or equivalent) sovereign debt of other countries.
- 'AAA'-rated U.S. corporate bonds.
- Analysts might derive a risk-free rate by removing the portion of yield attributable to credit risk from U.S. Treasury yields; or,
- Remove credit risk from U.S. Treasury yields by estimating the additional required rate of return for a non-'AAA' rated security compared to an 'AAA'-rated security.

In our opinion, each of these scenarios offers far more problems than merits, and working appraisers and damages experts will ignore the S&P downgrade until some other country's sovereign debt is deemed superior to that of the USA and S&P gets its own house in order. For an insightful analysis of S&P's action, see Nobel Prize-winner Paul Krugman's op-ed, Credibility, Chutzpah and Debt."

Cybercrime: More Reasons to Harden Your

Network Security

Links to Recent Articles on Cybercrime

Hacking Encouraged, Even Prized, at Vegas Geek Fest

In Latest Breach, Hackers Impersonate Google to Snoop on Users in Iran