

CLOTHILDE V. HEWLETT  
Commissioner  
MARY ANN SMITH  
Deputy Commissioner  
MIRANDA LEKANDER  
Assistant Chief Counsel  
DANIELLE A. STOUMBOS (State Bar No. 264784)  
Senior Counsel  
Department of Business Oversight  
320 West 4th Street, Suite 750  
Los Angeles, California 90013  
Telephone: (213) 503-2046  
Facsimile: (213) 576-7181

Attorneys for Complainant

BEFORE THE DEPARTMENT OF FINANCIAL PROTECTION AND INNOVATION  
OF THE STATE OF CALIFORNIA

In the Matter of: ) AMENDED CITATION AND DESIST AND  
 ) REFRAIN ORDER  
THE COMMISSIONER OF FINANCIAL )  
PROTECTION AND INNOVATION, )  
 )  
Complainant, )  
 )  
v. )  
 )  
KUHONG KIM, an individual, )  
 )  
Respondent. )

Complainant, the Commissioner of Financial Protection and Innovation for the State of California (Commissioner), is informed and believes, and based on such information and belief, finds as follows:

**I.**  
**Findings**

1. The Commissioner is the head of the Department of Financial Protection and Innovation (Department) and is responsible for administering and enforcing the California

1 Franchise Investment Law (FIL) (Corp. Code, § 31000 et seq.),<sup>1</sup> and registering the offer and sale  
2 of franchises in California.

3 2. Kuhong Kim (Kim) is or was a licensed Certified Public Accountant (CPA) in the  
4 state of New York.

5 3. Under section 31110, a franchisor must first register a franchise with the Department  
6 before it offers and sells franchises in California, unless it is otherwise exempt. To register a  
7 franchise, a franchisor must file a Uniform Franchise Disclosure Document (FDD) in accordance  
8 with sections 31111 and 31114, with the Department for review and await approval in the form of  
9 an Order Granting Effectiveness of Franchise Registration (Order). Section 31200 prohibits willful  
10 misrepresentations and omissions to the Commissioner and section 31201 prohibits willful  
11 misrepresentations and omissions to prospective franchisees.

12 4. Franchisors are generally required to include financial statements in the FDD for at  
13 least the previous two fiscal year-ends before the FDD's issuance date, prepared in accordance with  
14 Generally Accepted Accounting Principles (GAAP) audited by an independent certified public  
15 accountant using Generally Accepted Auditing Standards (GAAS).

16 5. The franchisor's financial statements for the most recent fiscal year must be certified  
17 as audited by an independent CPA, and the auditor must consent to the use of the audit report in the  
18 FDD.

19 **Kim consented to the inclusion of his audit reports in FDDs filed with the Commissioner**

20 6. A company that offers and sells restaurant franchises in California (Company)  
21 retained Kim to audit its financial statements for fiscal years ended December 31, 2016, and 2017.  
22 On January 30, 2017, and January 30, 2018, Kim provided unqualified (clean) opinions, certifying  
23 that the audits were performed in accordance with GAAS, and in Kim's opinion, the financial  
24 statements were prepared in accordance with GAAP (the Audit Reports).

25 7. On February 24, 2017, and March 12, 2018, Kim expressly consented to the  
26 inclusion of the Audit Reports in the Company's FDDs.

27 \_\_\_\_\_  
28 <sup>1</sup> All further statutory references are to the Corporations Code unless otherwise indicated.

1           8.       The Audit Reports and audited financial statements were included in the Company’s  
2 FDDs, filed with the Commissioner on March 17, 2017, and March 14, 2018, as part of its franchise  
3 registration renewal application, and provided to prospective franchisees.

4 **GAAP requires the deferment of initial franchise fees until the franchisee commences operations**

5           9.       GAAP requires that recognition of revenues from initial and area franchise sales be  
6 deferred (and not recognized as revenue) until the franchisor has substantially completed its pre-  
7 opening obligations to the franchisee, which is generally when the franchise opens for business.

8           10.      Statement of Financial Accounting Standards (FAS) No. 45, Accounting for  
9 Franchise Fee Revenue (FAS 45) set forth GAAP requirements for revenue recognition for  
10 franchise fees for individual and area franchise sales for the periods covered by the Company’s  
11 financial statements that Kim audited.

12          11.      FAS 45 required franchise fee revenues from an individual franchise sale ordinarily  
13 to be recognized when all material services or conditions relating to the sale had been substantially  
14 performed or satisfied by the franchisor. The commencement of operations by the franchisee is  
15 presumed to be the earliest point at which substantial performance occurred, unless it can be  
16 demonstrated that substantial performance of all obligations has occurred before that time.

17          12.      The notes to the Company’s financial statements for fiscal year ended 2017, audited  
18 by Kim, stated, “The company’s standard franchise agreement requires the franchisee to pay an  
19 initial non-refundable fee, as well as royalty based on sales. Initial franchise fee revenue is  
20 recognized upon substantial completion of the services required by the Company as stated in the  
21 franchise agreement, which is generally upon opening of the respective restaurant. Franchise fee  
22 and development fee received before the restaurant opens are recorded as deferred revenue.”

23 **The financial statements Kim audited did not defer revenue and instead overstated net worth by**  
24 **over \$2 million and overstated income by \$1 million**

25          13.      The Company’s financial statements for fiscal years ended 2016 and 2017, prepared  
26 by the Company and audited by Kim, failed to record initial franchise fees as deferred revenue (a  
27 liability) on the balance sheet. Initial franchise fees were instead reported as revenue on the income  
28 statement. As a result, the Company reported positive net worth and net income, and the

1 Commissioner did not impose the protections in section 31113 and accompanying regulations,  
2 requiring franchisors to place initial franchise fees in escrow or impound initial franchisee fees,  
3 where the franchisor lacks adequate financial arrangements to fulfill its obligations. (Title 10 CCR  
4 310.113 through 310.113.5).

5 14. GAAS are a set of systematic guidelines used by auditors when conducting audits.  
6 GAAS requires auditors to obtain a sufficient understanding of the entity and its environment,  
7 including its internal control, to assess the risk of material misstatement in the financial statements  
8 whether due to error or fraud.

9 15. The Company subsequently retained another New York state independent auditor,  
10 (the Auditing Firm) to re-audit its 2016 through 2017 financial statements. The Auditing Firm  
11 discovered that the financial statements audited by Kim failed to defer initial franchise fee revenue,  
12 and therefore failed to apply GAAP.

13 16. As a result of the GAAP deferred revenue departure and other errors, the Company's  
14 net worth and net income were materially overstated on the Company's financial statements audited  
15 by Kim. Net worth was overstated on the December 2016 and 2017 balance sheets by \$2.4 million  
16 and 2.6 million, respectively, and net income was overstated on the 2016 statement of income by  
17 over \$1 million.

18 17. Based on the foregoing, the Commissioner finds that Kim failed to obtain a  
19 sufficient understanding of the Company and its environment, including its internal control, to  
20 assess the risk of material misstatement in the financial statements whether due to error or fraud,  
21 and therefore, contrary to the statements made in the Audit Reports filed with the Commissioner,  
22 Kim did not conduct the audits in accordance with GAAS.

23  
24 **II.**  
25 **Citation and Desist and Refrain Order**  
26 **Violation of Corporations Code Section 31200**

27 18. Corporations Code section 31200 provides:

28 It is unlawful for any person willfully to make any untrue statement of a  
material fact in any application, notice or report filed with the commissioner

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under this law, or willfully to omit to state in any such application, notice, or report any material fact which is required to be stated therein, or fail to notify the commissioner of any material change as required by Section 31123.

19. Based on the foregoing findings, the Commissioner is of the opinion that Kim, in violation of 31200, willfully made untrue statements of material facts in the Audit Reports filed with the commissioner in 2017 and 2018, by representing that the audits were conducted in accordance with GAAS when they were not.

20. Pursuant to section 31406, Kuhong Kim is hereby cited and ordered to desist and refrain from further violations of the Franchise Investment Law, including section 31200.

21. This order is necessary, in the public interest, for the protection of investors and franchisees and consistent with the purposes, policies and provisions of the Franchise Investment Law.

Dated: March 1, 2022  
Los Angeles, California

CLOTHILDE V. HEWLETT  
Commissioner of Financial Protection & Innovation



By \_\_\_\_\_  
MARY ANN SMITH  
Deputy Commissioner  
Enforcement Division