



Senior Vice President and Controller

YUM! Brands, Inc. 1900 Colonel Sanders Lane Louisville, KY 40213 Tel 502.874-2134

Letter of Comment No: 66 File Reference: 1082-300

Date Received: 11/26/03

November 26, 2003

Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk. Connecticut 06856-5116

Re: File Reference No. 1082-300

Ladies and Gentlemen:

YUM Brands, Inc. (the "Company" or "we") appreciates the opportunity to comment on the Exposure Draft of the Proposed Interpretation of FASB Interpretation No. 46 (the "Proposed Interpretation"). As you are aware, the Company and other franchisors had significant concerns with what were believed to be the unintended consequences of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), as originally drafted and interpreted, regarding the potential consolidation of franchise owner/operators. The Company has believed all along that consolidation of franchise owner/operators in which it possessed no equity ownership and to whom it has provided no forms of subordinated financial support was inappropriate and would result in confusing and misleading financial statements that were not consistent with a well-established and understood accounting model for franchising. We appreciate the FASB's efforts in addressing many of our concerns through the issuance of the Proposed Interpretation as well as the Proposed FASB Staff Position No. FIN 46-f, "Evaluating Whether as a Group the Holders of the Equity Investment at Risk Lack the Direct or Indirect Ability to Make Decisions about an Entity's Activities through Voting Rights or Similar Rights under FIN 46 ("FIN 46-f")." However, we have identified several areas that were addressed within the Proposed Interpretation where we believe modification or additional clarification would be helpful in achieving the FASB's stated goal of improving financial reporting by enterprises involved with variable interest entities ("VIEs").

Paragraph 3c – Exhaustive Efforts to Obtain Data

Paragraph 3c of the Proposed Interpretation would add a new paragraph 4g to FIN 46 allowing an enterprise with an interest in a VIE created before February 1, 2003 to avoid applying the provisions of FIN 46 if exhaustive efforts do not yield the necessary information for application.











The Proposed Interpretation also notes that the inability to obtain the necessary information is expected to be infrequent, especially if the enterprise was involved in the creation of the entity.

As written, we believe that the use of the exception offered by the creation of paragraph 4g will be viewed skeptically and unfavorably by regulators, auditors and users of financial statements. However, in reality we believe instances where we are unable to obtain the necessary information from our franchise owner/operators necessary to apply FIN 46 will be frequent. We have more than 23,000 franchised stores operating in over 100 countries. In the great majority of cases, we have no legal or contractual right to require franchise owner/operators to provide any significant level of financial information, let alone audited financial statements in accordance with US GAAP.

Additionally, the entities within which our franchise owner/operators operate range from large publicly held companies that trade on a variety of stock exchanges to single-store, sole proprietorship entities. Moreover, even assuming we could require financial information to comply with FIN 46, the level of financial reporting sophistication varies greatly amongst franchise owner/operators, as does the adherence to US GAAP and even the use of the English language. If required to provide such information, the franchise owner/operator would thus be required to put forth a great deal of time and expense in complying that he would otherwise have no need to put forth.

Paragraph A12 of the Proposed Interpretation states that the use of the exception will be infrequent as an enterprise that is exposed to substantial risks of another entity would normally obtain information about that entity to monitor its exposure (even if the exposure is limited). Under its normal franchise agreements, the Company does not require (and cannot compel), the franchise owner/operator to provide significant financial information other than sales. In this situation, the Company has obviously determined that it has no direct financial exposure other than the receipt of royalties and therefore there is no need for financial information other than sales. This fact by itself is strong evidence that we do not possess a controlling financial interest in our franchise owner/operators and that consolidation would be inappropriate and unrepresentative of the nature of the franchisor/franchisee relationship.

We do not believe that there is a valid business purpose to attempt to amend the multitude of franchise agreements we currently have in place that do not require that the franchise owner/operator provide the Company with financial information. Likewise, in the event a franchise owner/operator does not agree to such amendment or refuses to provide such information that may be contractually required, we do not consider it appropriate to take legal or other actions that could harm an otherwise harmonious and mutually beneficial relationship. However, both of these costly and time-consuming events might be interpreted to comprise exhaustive efforts to obtain the financial information necessary to comply with FIN 46.

To insure that the exhaustive efforts provisions of the Proposed Interpretation are consistently interpreted and do not extend to instances where the enterprise has made the conscious decision that its exposure is not significant enough to warrant requiring the level of financial information necessary to comply with FIN 46, we suggest the following paragraph be added to 4(g):

"There may be instances where the enterprise's exposure to risk is sufficiently low enough that it has traditionally determined that it was not necessary to receive the information necessary to (1) determine whether the entity is a variable interest entity, (2) determine whether the enterprise is the variable interest entity's primary beneficiary, or (3) perform the accounting required to consolidate the variable interest entity for which it is determined to be the primary beneficiary. In these instances, if obtaining/providing such information would result in additional cost or burden to the enterprise or the entity that would otherwise be considered unnecessary, exhaustive efforts will be deemed to have been undertaken."

We believe our proposed modification to the exhaustive efforts provisions should apply to entities no matter the date of creation. Otherwise, entities that may have similar characteristics but that were created before or after a particular date could be treated differently under FIN 46. We believe that any resulting inconsistency in the accounting treatment or disclosure would be confusing and misleading. At a minimum, we suggest that the guidance in paragraph 4(g) be applied to VIEs created before December 31, 2003. In light of the timing of the issuance of the Proposed Interpretation, related FASB Staff Positions, as well as the evolving nature of the interpretations of the provisions of FIN 46, we do not believe that its implications to many entities (particularly franchise owner/operators) have been well understood to this point. Thus, in practice, we do not believe that substantial modifications have been made to agreements entered into after February 1, 2003 to provide for the necessary information that would allow for the appropriate application of FIN 46.

Paragraph 5 – Reconsideration Events

We appreciate the clarity the FASB has proposed in the determination of reconsideration events. Particularly, we appreciate the clarity that neither the occurrence of operating losses by an entity nor renegotiation of the entity's debts or other contracts caused by the incurrence of operating losses shall cause a change in the determination of whether an entity is a VIE (absent the characteristics of the equity investment at risk or the level of subordinated financial support provided to the entity being modified).

As noted in paragraph 5 of the Proposed Interpretation, reconsideration should occur, "whenever the design of the entity or ownership of interests in the entity changes in a manner that could change that determination." However, we believe that certain of the examples of the reconsideration events are written so broadly that they would necessitate reconsideration even though the basic principle noted in the previous sentence is not met. Specifically, we have concerns that the reconsideration examples in paragraphs 7b and 7c of FIN 46 are written so broadly that they may require reconsideration where it was not intended. Additionally, a broad interpretation will lead to frequent reconsideration that is both impractical (potentially impossible) and unnecessary. This is of particular concern given the strict interpretations certain parties, including our external auditors, have taken with the provisions of FIN 46.

The example in paragraph 7b requires a reconsideration event when the equity investment or some part thereof is returned to the investors, and other interests become exposed to expected losses. As previously mentioned, in many cases we do not require ongoing financial information regarding our more than 23,000 franchised stores. Even in instances where we do require

ongoing financial information, we are not in a position to restrict or monitor a franchise owner/operator's modifications to his capital within the business. For instance, a franchise owner/operator may dividend out all equity of his business, recapitalizing his entity with bank debt. As such, the bank will now be exposed to expected losses of the entity and a reconsideration event as per paragraph 7b will have occurred. However, neither the design of the entity nor ownership of interests in the entity has changed.

Similarly, the Company's franchise owner/operators often open new stores within an existing entity that is currently operating stores. The number of openings can be well beyond openings that were anticipated at inception of the entity. All other factors being equal, the increase in the size of the entity's operations will increase the entity's expected losses proportionately. Thus, a reconsideration event has occurred in accordance with paragraph 7c. Once again, neither the design of the entity nor ownership of interests in the entity has changed.

The Company has made a conscious business decision that it will not monitor on an ongoing basis the capital structure of its franchise owner/operators nor hold them to certain equity requirements when opening new stores. Once again, we believe that this is an indication that we do not possess a controlling financial interest in our franchise owner/operators and that consolidation would be inappropriate and unrepresentative of the nature of the franchisor/franchisee relationship. In addition, the franchise owner/operator's ability to either replace equity with debt or finance new stores is a strong indication that his entity is able to finance its activities without additional subordinated financial support. Thus, even upon reconsideration the franchise owner/operator would not be expected to be determined to be a VIE.

Given our more than 23,000 franchised stores and our inability to effectively monitor and track changes in equity ownership, the burden of reconsideration upon the occurrence of the events in paragraphs 7b and 7c would be great. In fact, we would most likely be forced to expand the use of the exhaustive efforts exclusion as described in the first comment to this letter. The events described in paragraphs 7b and 7c would not generally change the determination of whether an entity is a VIE absent additional risk of loss being incurred by the evaluating enterprise. Thus, we suggest that qualifying language be added to that effect. Specifically we suggest paragraphs 7b and 7c be modified as follows:

- 7b "The equity investment or some part thereof is returned to the investors, other parties become exposed to expected losses and the evaluating enterprise's exposure to the entity's expected losses increases."
- 7c "The entity undertakes additional activities or acquires additional assets beyond those that were anticipated at inception of the entity that increases both the entity's expected losses and the evaluating enterprise's exposure to those expected losses relative to other variable interest holders."

Paragraph 19 - Variable Interests

Paragraph 19 of the Proposed Interpretation deletes paragraphs B1-B10 of FIN 46. In doing so, the FASB indicates that some of the descriptions of variable interests were difficult to apply without additional context in which they were intended to apply. As the FASB continues to deliberate guidance regarding variable interests, we ask that clarity be provided as to whether a royalty as a percentage of sales should be considered a variable interest. A royalty as a percentage of sales does not appear to meet the definition in paragraph 2c of FIN 46 for a variable interest, as it does not necessarily change with changes in the entity's net asset value. Additionally, as noted in FIN 46-f, a royalty effectively represents a license payment to a franchisor. Provided that the royalty is at a market rate, it seems inconsistent to conclude that a royalty is a variable interest while a market rate lease, supply contract or any other license agreement is not.

We appreciate the opportunity to comment on the Proposed Interpretation and FIN 46.

Very truly yours,

Gregory N. Moore Senior Vice President and Controller