Letter of Comment No: 5296 File Reference: 1102-100

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Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference No. 1102-100, Propose Statement of Financial Accounting Standards, Share Based Payment, an amendment of FASB Statements 123 and 95.

Wendy's International, Inc. wishes to take the opportunity to provide comments to the Financial Accounting Standards Board ("Board") regarding the Exposure Draft on stock compensation. A summary and then discussion of each of our three primary areas of our concern relative to the Exposure Draft follow.

- 1. The Exposure Draft proposes to essentially "true-up" and separately account for the tax effects of share based awards, but not adjust the estimated fair value of the stock based award itself. Identifying and separately accounting for positive and negative tax effect estimation errors is logically inconsistent, is asymmetrical, increases volatility in reported results that would not be easily understood and would add financial reporting costs and complexities to track. We recommend the Board reach a more balanced approach.
- 2. The Exposure Draft does not fully take into account the significant impact this new accounting pronouncement will have on the reported profitability of many companies. Given the significance of this proposed change in accounting, companies should be provided the opportunity to restate prior year financial statement to promote clarity and efficiency for users of financial statements.
- 3. We do not agree the front end loading of expense necessarily better reflects the exchange of an employee's services for equity instruments that have graded vesting schedules. We recommend the alternative approaches permitted in Statement 123 for expense recognition of a graded vesting award be continued.

Accounting for income tax effects

Although we agree that share based grants have a value at the time of grant, one of the primary issues faced by the Board over the years is the lack of a reliable approach to determine the fair value of a grant. It has been well discussed over the years and is now a widely held view that the Black-Scholes valuation method produces misleading information. We note the Board, in its redeliberations, appears to have found no definitively reliable valuation answer.

There are significant assumptions made in both the Black-Scholes and, as an example, the binomial models. As a result, all currently available mathematical approaches are unable to accurately identify the value independent parties and investors would be willing to pay for stock options - or even non-vested shares. On this topic, the Board has concluded that for recording of compensation expense, "... recognition of amounts that are approximately right is preferable to the alternative - recognizing no amounts." While maybe justifiable from a practical perspective, all acknowledge the valuation methodologies available today are estimates and should be treated as such.

In specifying the accounting treatment for tax related stock compensation matters, the Exposure Draft appears to not fully recognize that any stock compensation valuation technique, including the related tax effects, produces only estimates. Instead, the Exposure Draft effectively bifurcates positive and negative tax effect differences between a stock award's estimated value at date of grant and the value when the award is subsequently exercised or vests. Once quantified, the Exposure Draft assigns separate characteristics and management intentions to the positive and negative differences. The differences in an award's value at date of grant and when exercised can at least include a) the inherent valuation error of Black-Scholes or a lattice model, b) value created or lost by a company after a stock award is granted, and c) changes in overall stock market conditions. The latter two variables occur after the stock award grant date, but cannot be adequately addressed by any currently available valuation technique.

We therefore disagree with the proposed treatment of recording tax benefit deficiencies as tax expense and recording excess tax benefits received as an inflow of cash in the financing section of a statement of cash flows for the following reasons:

- Tax benefit deficiencies and excess tax benefits represent nothing more and nothing less than estimation error as a result of using imprecise valuation tools. To characterize one side of the valuation error resulting in excess tax benefits as a financing cash inflow and to classify the other side of the same valuation error resulting in tax deficiencies as a charge to income tax expense loses sight of the fact that all the amounts to be used as of grant date are estimates. The implication is that the "approximately right" standard used to record compensation expense related to an award is not good enough to record the related tax effects.
- If certain aspects of the estimation error for a stock award are, essentially, to be "trued up", why are not all the components of the estimation error trued up? For example, to charge income tax expense for tax deficiencies without a true up of the related stock compensation expense cannot be logically sustained.

- The proposed isolation and classification of excess tax benefits in the financing section of the statement of cash flows suggests a company considers these amounts as part of its strategy to raise capital. This is not the case. In addition, it is inconsistent to effectively state the fair value of a stock based grant is compensation expense while the corresponding tax amounts are related to a company managing its capital structure.
- Part of the rationale offered in the Exposure Draft for the proposed accounting treatment for income tax effects is that the granting and exercise of an award are two separate transactions. If one were to assume a transaction requires action, the concept of two transactions would not apply to non-vested stock awards that subsequently vest and become shares through no action of the employee. The separate transactions approach also appears counter to the argument in paragraph C20 that states the exchange transaction is complete at date of grant.
- A conclusion previously reached in Statement 109 and broadly accepted is that companies' tax positions are comprised of numerous components and that tax allocations between various components are arbitrary. We believe this conclusion continues to be applicable for tax differences related to changes in the intrinsic value of an award. For example, should companies use their effective or marginal tax rates when recording the proposed income tax deficiencies and excess tax benefits? Also, how should changes in a company's effective tax rate between the period an award is granted and the period the award is exercised be treated?
- Under the proposed treatment for tax deficiencies, the recorded income statement tax benefit for stock compensation will always be at a lower effective rate than economically realized. The rationale for the proposed approach provided in paragraph C131 implies that not over-recording a tax benefit for an individual employee is qualitatively better than under-recording the overall tax benefit for the company as a whole. The question is, why should companies be required to "true up" through the income statement only the negative income tax benefit differences, but not the positive income tax benefit differences or the underlying compensation expense? The proposed approach here seems intentionally harsh and fails to recognize all stock based compensation amounts are recorded using estimates that, at the very best, will hold to be reasonably accurate in the aggregate. Bifurcating one side of the valuation estimation error and treating it separately from the other side of the error is logically inconsistent.
- The proposed treatment to record tax deficiencies as tax expense would require
 companies to continually try to anticipate and explain income statement variability in
 order to keep investors, analysts and other financial statement users aware of potential
 income statement implications. These income statement impacts are totally beyond
 the control of any company, stem from a valuation method that is known to be
 imprecise at date of grant and will provide confusion rather than clarity to users of
 financial statements.
- The proposed approach would add administrative costs and complexities to track and account for stock award exercise and vesting activity by employee, by individual award. The Exposure Draft was unclear as to whether the tracking system for millions of stock option grants, as an example, would need to distinguish between tax benefits received from each individual stock option awarded to an employee or only the aggregate tax benefits received from all the stock options awarded to a particular employee.

Paragraph C20 of the Exposure Draft argues why compensation cost should be recognized for a stock option award that vests but expires unexercised because it is under

water. The argument offered is that the agreement for the exchange of employee services for share based instruments is complete at the time of the award. Paragraph C20 does not address, however, the implied fundamental valuation error of Black-Scholes, lattice models and other current valuation methodologies when stock options expire under water. This valuation error can be extremely significant. Millions, even tens of millions, of options with an attributed value under the Black-Scholes and lattice models have expired worthless for some companies. These scenarios demonstrate the weaknesses and inherent valuation error in the currently available valuation methodologies.

In paragraph C22, the Board cites three examples where there are uncertainties inherent in the measurement of amounts already recorded in financial statements. However, for each of the examples cited, Generally Accepted Accounting Principles require continual review and adjustment of the recorded amounts through the income statement as new and better information becomes available. In the Exposure Draft, the Board proposes to not adjust the fair value of a stock based award estimated at the date of grant - even if new and better information becomes available. However, the Exposure Draft does propose adjusting for the estimated tax effects directly related to an award. This proposed approach is internally inconsistent, is asymmetrical, would increase volatility in reported results that would not be easily understood and would add financial reporting costs and complexities to track. We recommend the portfolio approach specified in Statement 123 requiring the aggregation of tax valuation errors be retained.

Restatement of prior periods

As a result of the new compensation expense requirements, companies will be compelled to provide comparative earnings per share results in order to educate investors and analysts on the significant impact of the new accounting standard for share based compensation. Paragraph C159 of the Exposure Draft states the Board prefers retroactive restatement when practicable. In establishing a relatively early effective date, the Board acknowledged that public companies have been using and understand fair value accounting for stock based awards. Also in the Exposure Draft, the Board clearly states that pro forma disclosure is not an acceptable substitute for recognition. We agree with the Board's comments relative to pro forma disclosures, the effectiveness of retroactive restatements and the familiarity of public companies in dealing with the fair value of stock based awards.

Nevertheless, the Exposure Draft proposes companies adopt the new accounting standard on a "modified prospective" basis. The rationale included in the Exposure Draft for the modified prospective approach is that companies a) may be required to make estimates as of a prior period and b) might conclude that some aspects of prior year estimation methods should be revised.

We understand and agree that companies may change fair value estimation methods over time, and these changes may prevent direct comparability of amounts between years. We also note, however, that the modified prospective approach proposed in the Exposure Draft already prevents direct comparability of recorded compensation expense until after all awards issued prior to 2005 fully vest. That is, the impact of prior year estimation methods will impact expense recognition after adoption of the new standard. As companies make changes to their valuation methodologies after adoption of the new standard, reported compensation expense will include awards valued differently. The desire to change estimation methods does not appear to be a significant consideration in

determining whether prior year results should be restated. The proposed standard already acknowledges there will be a lack of direct comparability of valuation methods between years.

Given the significant impact the proposed new standard will have on companies' financial statements, we do not find the rationale prohibiting restatement to be persuasive. We recommend the Board allow or mandate restatement of prior years to promote clarity and efficiency for users of financial statements - as was permitted in Statement 148. Companies are already required to provide the compensation expense impact in footnotes, so restatement of expense could be determined without the recalculation of past amounts. The probability that some companies will change estimation methods does not appear to prevent restatement, and we believe reconsidering the proposed accounting for tax effects (see above) will help eliminate concerns of requiring companies to make estimates as of a prior period that may not be practicable. At a minimum, we believe companies should be granted the latitude, based on available information, to apply the new accounting standard retrospectively - as was permitted in Statement 148. If desirable, the Board could establish standards for retrospective application.

Expense recognition for awards with graded vesting provisions

The Exposure Draft proposes only the up front weighting of expense recognition be permitted for equity grants with a graded vesting feature because a) accounting for a graded vesting award as separate awards better reflects the exchange of employee services for the equity instruments, and b) the Board wishes to eliminate alternative approaches to what is arguably the same set of facts and circumstances.

Statement 123 provided alternatives to expense recognition based on how an award was valued -that is, depending on whether a four year graded vesting award was separately valued as four awards or treated as one award when valued. The Board has acknowledged that many companies do not currently have the necessary information to individually value each of the four grants using the lattice model.

We do not agree the front end loading of expense recognition better reflects the exchange of an employee's services for equity instruments with graded vesting schedules. We recommend the alternative approaches permitted in Statement 123 for expense recognition of a graded vesting award be continued. Reasons to retain the Statement 123 alternative approaches include:

- Under the proposed approach, for a four year graded vesting award, over fifty percent
 of the award's total fair value will be expensed in the first twelve months after the
 grant date. The remaining expense recognized for the award will decline significantly
 over the remaining three years. However, few, if any, employers believe over fifty
 percent of the value received from an employee in exchange for equity instruments
 vesting over four years is received in the first year.
- Similarly, an employee completing three years of a four year graded vesting schedule does not believe s/he has earned, or has a right to, a three fourths pro rata share of the award that vests only at the end of the fourth year. The proposed treatment, however, would require a company to expense as of the end of the third year three fourths of the portion of the award that does not vest until the end of the fourth year.
- By allowing companies to choose between valuation models and model assumptions
 and inputs, the Exposure Draft is already proposing alternative approaches that will
 result in the recognition of different expense amounts more significant, in our view,
 than only a difference in timing for the same set of facts and circumstances.

• The proposed front end loading of expense would add administrative costs and complexities compared to the straight line method of expense recognition used by most companies today. For example, if an employee should leave the employment of a company at the end of year three under a four year graded vesting award, the amount of expense that should not be recognized (i.e. 25%) can be quickly calculated under the straight line method. Under the proposed front end loading method, companies will be required to track and account for pro rata portions of stock awards to arrive at the amount of previously recorded expense that should not be recognized.

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We appreciate the opportunity to express our views to the Board on the proposed accounting changes for share based payments. The Exposure Draft proposes changes in accounting that will have a significant impact on the financial statements of many companies. We ask the Board not to underestimate the impact of these changes. If you have questions about our comments or wish to discuss any of the matters addressed herein, we would be happy to do so.

Sincerely,

Kerrii B. Anderson

Executive Vice President and Chief Financial Officer

Wendy's International, Inc.

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