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Financial Accounting Standards Board
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LETTER OF COMMENT NO. 122

RE: File Reference No. 1590-100

McDonald's Corporation appreciates the opportunity to comment on the Financial Accounting Standards Board's ("the Board") Exposure Draft of the Proposed Statement of Financial Accounting Standards, *Accounting for Hedging Activities, an amendment of FASB Statement No. 133* (the "Exposure Draft").

Although we support the Board's objective to simplify the accounting for hedging activities, resolve certain practice issues that have arisen under Statement 133, and improve the financial reporting of hedging activities, we do not believe that the current form of the Exposure Draft will accomplish these objectives. Generally, we agree with the alternative views expressed by two Board members that the proposed amendments do not significantly simplify the accounting, will produce accounting results inconsistent with risk management strategies, and will add to the differences between U.S. GAAP and International Financial Reporting Standards (IFRS) related to derivatives and hedging at a time when there is increasing emphasis on convergence.

Elimination of bifurcation-by-risk

Our main concern with the Exposure Draft is that the proposed amendments will often produce accounting results that are inconsistent with the related risk management strategies. For example, McDonald's actively manages the interest rate risk associated with certain of its debt obligations through the use of interest rate swap agreements. These agreements are highly effective at managing interest rate risk, but they do not hedge credit risk nor are they designed for that purpose. The proposed amendment's limitation on the ability to hedge the benchmark interest rate only at inception of a company's own issued debt may result in some hedges (forward-starting and late-starting swaps) not qualifying for hedge accounting as the effectiveness of the hedge is compared not only to interest rate movements but also to credit spread changes.

The elimination of the bifurcation-by-risk approach is not consistent with many companies' risk management strategies. Although the proposed amendments allow for bifurcation-of-risk at inception of a debt issuance, an entity would not be allowed to designate individual risks for forecasted debt issuances and hedges entered into after the inception of the debt, without creating potential ineffectiveness. We believe that a prudent risk management strategy inherently allows a company to respond to changes in the market that may occur before and throughout the life of a debt instrument. In addition, a company's risk management policy may involve maintaining a certain ratio of fixed rate debt versus floating rate debt. For example, if an outstanding fixed rate debt issuance is due to mature, it may become necessary to swap other fixed rate debt into floating rate debt in order to maintain these ratios and effectively manage interest rate risk.



The elimination of the bifurcation-by-risk approach on hedges of forecasted debt issuances and hedges entered into after the inception of the debt will lead to earnings volatility. Our concern is that the volatility in earnings would not be indicative of the economics of the hedging relationship and may be misleading to financial statement users. A company's income statement would be exposed to volatility due to risks (mainly creditworthiness) in which it has no desire or ability (due to lack of willingness by counterparties) to hedge. Although the earnings volatility that results from unhedged risks will reverse over time, the interim results may be misleading to financial statement users. We believe this contradicts one of the Board's stated objectives which was to make the accounting model more useful and easier to understand for users of financial statements.

Intercompany cash flow hedging

Another aspect in which accounting results may not reflect an entity's risk management strategy is in the area of intercompany royalty hedging. The Exposure Draft inserts language into paragraph 40 of Statement 133 regarding intercompany cash flow hedges only qualifying for hedge accounting if there is an earnings effect that survives consolidation. McDonald's cash flows resulting from intercompany royalties are derived from *external* transactions and are subject to fluctuations in foreign exchange rates. This foreign exchange risk is a real economic risk that affects consolidated earnings and is managed with the use of various derivative instruments. It is currently unclear as to the Board's intention regarding the change to paragraph 40 and whether it applies to this scenario. The preclusion of these derivative instruments from cash flow hedge accounting will result in increased earnings volatility. As previously mentioned, this earnings volatility would not be indicative of the economics of the hedging relationship and may be extreme and misleading to financial statement users. Once again, this would contradict the Board's objective to make the accounting model easier to understand. In addition, we are not aware of any accounting issues related to these cash flow hedges that would have caused the Board to make such a significant change to how companies currently account for them. Along with adding another difference between U.S. GAAP and IFRS, such a significant change in practice seems to contradict another one of the Board's intentions which was to resolve major practice issues.

Dedesignation of hedging relationships

We also have a concern with the proposed changes to the dedesignation of a hedging relationship. The ability to dedesignate hedging relationships is an integral part of risk management strategies as companies need to be able to respond to changes in the market. In addition, the inability to dedesignate hedging relationships would require additional trading to enter into offsetting positions, and therefore, the need to account for more hedges on a company's books. These additional transactions will lead to increased trading costs and administrative burden without changing the end result. This additional cost and administration will contradict another one of the Board's intentions which was to simplify and reduce the burden of the standard. Furthermore, our assumption is that these changes apply only to derivative instruments. Currently, external debt issuances (non-derivative instruments) may be used by companies to hedge net investment exposures. The ability to dedesignate the debt as a net investment hedge is important as exposures change over time. In these situations, it would be extremely difficult to effectively terminate the debt being used as a hedge.

Convergence with IFRS

One area in which we are in support of the Exposure Draft is the change to the effectiveness threshold necessary for applying hedge accounting from "highly effective" to "reasonably effective". We support



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the elimination of a quantitative measure as a bright line to determine effectiveness. This is a principles based change that will require preparers and auditors to use judgment and analysis (as appropriate) in assessing effectiveness.

This assessment of effectiveness is one element of the Exposure Draft in which we see convergence from the current U.S. standard towards the more principles-based international standard; however, the proposed Exposure Draft is still significantly different from the international standard. It is a widely held belief that U.S. public companies will be required to adopt IFRS in the foreseeable future. With the pending transition to IFRS, it does not seem prudent to require companies to understand, implement and interpret this proposed Statement, and then have to transition again when IFRS becomes mandatory. We believe that the IASB should be allowed to deliberate on the hedge accounting issues rather than assume that the conclusions will be similar to the Exposure Draft. Compliance with the proposed rules would require significant changes to our systems, approaches, and documentation, which would be very costly and time consuming. Any potential benefit of interim changes to Statement 133 before the adoption of IFRS would be far outweighed by the costs and administrative burden of having to change multiple times.

McDonald's appreciates the opportunity to express our opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

/s/ Kevin Ozan
Kevin Ozan
Corporate Senior Vice
President - Controller