

Letter of Comment No: 5494 File Reference: 1102-100

June 29, 2004

Ms. Suzanne Q. Bielstein
Director of Major Projects
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Proposed SFAS Share-Based Payment (File Reference No. 1102-100)

McDonald's appreciates the opportunity to provide comments on the above referenced proposed SFAS entitled "Share-Based Payment". We do have some concerns regarding the fair value methodology and certain other aspects of the exposure draft. Specifically our comments address:

- Fair Value Measurement
- Attribution of Compensation Cost
- Income Taxes
- Disclosures
- Transition
- Cash Flows

Fair Value Measurement -

We have significant concerns with the fair value measurement of employee stock options in terms of the reasonableness of value using these option pricing models, the complexity of the models (and related assumptions) and the cost of compliance with the use of a binomial lattice model. In addition, we have concerns regarding the availability of information relating to potential behavior variables that might be applied in valuing theses options.

Our concern related to the reasonableness of value centers around the key assumption inputs for the option pricing models. The Board has done a great job of providing a discussion around these very subjective assumptions in Appendix B paragraphs 13-30. Historical experience is obviously a starting point in determining the assumptions. However, determining to what extent future experience is reasonably expected to differ from historical experience is a very subjective process that will have significant impact on the net fair value results. Accordingly, consistency and comparability between companies and industries will be very difficult to achieve.

These complex models were developed for valuing short-term traded options, not employee stock options. There are substantial differences between short-term traded options and employee stock options. The end result is only as good as the input assumptions. The longer term nature of employee stock options lessens the reliability of

the input assumptions. Stock option terms are generally in the ten year range. Given unknown future changes in the marketplace and with the competition within an industry, it is extremely difficult to predict key assumptions over the long term regarding employee behavior and the impact of expected option life, the volatility of a company's stock price, the future interest rate environment and how the company may change policies relating to dividends. If there was reliability in the use of these option valuation models for longer term options, there would probably be an established market for trading longer term options. We believe that the FASB should field test the proposed fair value method to determine that the binomial lattice model provides reasonable results appropriate for expense recognition.

Lastly, the efforts that will be undertaken before final approval of this standard will be significant and costly in order to be able to adopt in the first quarter of 2005. Not many companies have experience using binomial lattice models as described in the exposure draft. Availability of the history of exercise data to analyze employee behavior patterns will be a significant challenge for most companies. The need to contract with an outside expert to adapt a binomial model to our Company will be costly not only upfront, but also going forward as employee behavior patterns change. Accordingly, consideration should be given to delay the effective date. Such delay will help to ensure that significant costs are not incurred prior to final approval of the standard in case changes are made related to the fair value measurement component of the proposal. In addition, companies most likely will undertake a serious review of their compensation programs as a result of this exposure draft. Additional time (along with field testing) will allow companies to do thorough analysis of the implications of the exposure draft and make the most informed decisions regarding any compensation program changes.

Attribution of Compensation Cost --- Awards with Graded Vesting -

We believe that the single method of accruing compensation cost for awards with a graded vesting schedule called for in the exposure draft will create additional complexities in the valuation process in determining input assumptions. Determining employee behavior patterns for graded vesting options will be even more subjective than trying to determine a single set of assumptions to value a particular grant. For example, if an employee exercises a portion of his or her options, what tranche of vested options do you allocate the exercise? Having the ability to value the graded vested option in total with straight line recognition is a fair, reasonable and practical approach, especially in light of the highly subjective result from the fair value measurement process.

Income Taxes -

We disagree with the accounting for income taxes for employee stock options in the exposure draft. We believe the amount of income tax expense recognized for equity-based compensation should be reflective of the amount of compensation costs recognized in earnings. Subsequent differences in all realized tax effects, both higher and lower, should be recognized in additional paid in capital for these equity transactions. We believe this would be consistent with the position of not adjusting compensation costs for the ultimate intrinsic value of the option. In addition, the exposure draft change will create additional complexities in tracking tax impact of each option exercise on an

employee by employee basis versus the related compensation cost recognized previously for each option grant. We believe our view of these tax benefits is fair and reasonable, along with simplifying the financial statement users understanding of the accounting associated with an already very complex and highly subjective area.

Disclosures -

The following comments relate to the minimum disclosure requirements and illustrative disclosures in Appendix B paragraphs 191 - 193:

- Eliminate required disclosure of the income tax benefit (or expense) recognized in income. We are not sure the importance of highlighting the tax impact for just this specific area in the footnotes.
- Option activity for number of shares and weighted average exercise price should be disclosed for all income statement periods presented. We feel this history of information would continue to be useful for the users of financial statements.
- Eliminate any disclosure related to intrinsic value of options outstanding, options exercisable, and options exercised. Intrinsic value disclosures only add to the confusion surrounding option valuation and expense recognition.
- We could not determine from the disclosure illustration on page 111 of the exposure draft what minimum requirement "the fair value of shares vested during year" covered.

The level of disclosures will be substantial and eliminating non essential disclosures will help the understandability of the remaining disclosures for the user.

Transition -

We are not sure how significant the differences will be between the fair value based preferred valuation method in the Exposure Draft and the previous fair value method used by most companies. As stated earlier, we believe that companies will require a significant amount of resources to research and analyze data necessary for the preferable method in addition to working with outside consultants familiar with the binomial model. Thus, we believe a relatively early effective date would not be reasonably feasible for public entities even though those entities already have been either recognizing or disclosing the effects of compensation cost based on the fair value of awards to employees. Companies should not be expected to expend significant resources on a proposed accounting standard change until it has been approved. We believe the effective date for the exposure draft should be for fiscal years beginning after December 15, 2005.

In addition, we believe that retrospective application of transition for public companies is an appropriate alternative that should be allowable under this proposal. Under the modified prospective method of transition, the combination of cost recognition in the income statement for the current year and pro forma footnote disclosure for prior years presented creates confusion for the reader of the financial statements in terms of comparability across years. If companies use the existing fair value information provided in the pro forma disclosures for the retrospective application, there would be no required significant estimates as of a prior period that would make this method of transition

impractical. Allowing a public company a choice between retrospective or modified prospective transition methods under this proposal would be appropriate. In addition, allowing retrospective application is in line with the recent FASB proposal on accounting changes and error corrections.

Cash Flows -

We support retaining the provisions of Statement 95 on classification of taxes paid as an operating cash payment. We agree with the Board that both views have merit. However, we believe making this change will create certain practical issues in terms of tracking specific exercise activity and related tax benefits. We don't see any significant benefits to this change in terms of allocation of income taxes paid from operating activities.

We appreciate the opportunity to comment on the proposed changes. We are hopeful that the final statement ensures a practical application of these accounting changes including allowing sufficient time after final approval for companies to fully analyze and understand the implications of the new standard. If you have any questions related to our comments or views, please call me at (630) 623-3162.

Sincerely,

/s/ David M. Pojman

David M. Pojman McDonald's Corporation Senior Vice President and Controller