



McDonald's Corporation
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September 13, 2013

Russell G. Golden, Chairman
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International Accounting Standards Board
30 Cannon Street
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Submitted via electronic mail to director@fasb.org

Re: File Reference: No. 2013-270, Exposure Draft: *Leases (Topic 842)*

Dear Board Members:

McDonald's Corporation appreciates the opportunity to comment on the Exposure Draft of the Proposed Accounting Standards Update of Topic 842, *Leases* (the "Proposed ASU") as well as being part of the formal outreach efforts of the project team. Leasing is an important part of McDonald's operations from both a lessee and lessor perspective, and the proposed changes to the lease accounting standards would have a significant effect on the Company. We appreciate the Boards' willingness to listen to and understand views and concerns of preparers, users and auditors of financial statements.

We are supportive of the overall objective of ensuring that users of financial statements have the information needed to gain a full understanding of companies' leasing activity and resulting obligations. However, we know that many users of financial statements, including the FASB's Investor Advisory Committee as well as several equity and credit analysts, do not support the proposed new rules and have stated that they believe the proposal is not an improvement to current accounting. Instead, many of them have recommended that the rulemaking authorities focus on enhanced disclosures to provide more useful information regarding companies' lease obligations. Since there is not a consistent method that analysts use to adjust for leases, several analysts have indicated that they will still make adjustments to any new accounting treatment.

While we believe the Boards' intent has been appropriate, it appears that the complexities of the issues make it too difficult to achieve a beneficial change in accounting and reporting without causing significant confusion to users of financial statements and significant costs to preparers. Based on all of this information, we believe that the Boards should maintain the current accounting rules and refocus their effort on ensuring there are meaningful disclosures regarding companies' leasing activity and obligations.



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If the Boards determine it is vital that companies reflect lease obligations on their balance sheets, we strongly believe that new rules should only focus on reporting an appropriate amount on the balance sheet for lessees and should not change either the current reporting in income statements and cash flow statements or lessor accounting. We do not believe that either current lessee income statement accounting or current lessor accounting is flawed, so there is no need to change the way lease expense is currently recognized in income statements or cash flows statements (especially since any potential new rules would have no effect on actual cash flows), and no need to change the way lessors reflect leased assets. This will minimize the confusion that users of financial statements will experience from a change in accounting rules and minimize the costs to preparers of implementing new rules.

Notwithstanding the above, if the Boards decide to move forward with the current proposal, we want to share our views on various aspects of the current Exposure Draft. We commend the Boards for some positive changes from the original proposal, specifically:

- Dual model approach – we agree that there are two fundamentally different types of leases, a financing lease and a non-financing (operating) lease. We believe that the characteristics and strategic intent of a 20-year property lease are very different than a 3-year copier lease and; therefore, different accounting treatment is appropriate.
- Lease term – we agree with the modification to include only option periods for which there are economic incentives to extend.
- Variable lease payments – we agree that variable lease payments, other than those that are in-substance fixed, should be excluded from the obligation and ROU asset as they are too judgmental and subject to significant change.

The following comments reflect some concerns and additional considerations related to other aspects of this Exposure Draft.

Classification of leases

As noted above, if the Boards are going to change the current accounting for leases, we support two accounting models for both lessee and lessor transactions. However, we believe that a single, principle-based classification approach should be applied, eliminating the need to specifically differentiate between property leases and non-property leases. We believe the current approach is too complex with the quantitative exception tests difficult to apply in a manner that accurately estimates consumption of the economic benefits and difficult to understand from a user perspective. Based on the current proposal, the classification guidelines could result in us classifying some leases as Type A and some leases as Type B in our financial statements even though all of the leases are very similar in terms of characteristics and strategic intent. This would result in the leases being treated inconsistently from an income statement perspective which would be extremely confusing to users of our financial statements and would not enhance their understanding of our lease portfolio or obligations.

One example relates to land only leases. Under current guidance, these land leases are always classified as operating leases unless there is a bargain purchase option or title transfers at the end of the lease. Under the proposal, the present value of the payments may account for a significant portion of the fair



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value of the underlying asset and require Type A lease treatment for some land leases and Type B treatment for others. This test does not properly reflect the fact that there is little to no consumption by the lessee for these land only leases.

To classify the two types of leases – financing in nature and operating in nature, we believe that a sound principles-based solution should be centered on the substance of the transaction. It is important to assess the level of control transferred to the lessee, risks/rewards of the lessee and lessor, and the lessor's contractual performance obligation. It should be primarily a qualitative assessment based on these principles, and any quantitative assessment should only support a determination that may not be clear from the qualitative review. Bargain purchase options and transfer of title would remain as key criteria for identifying a financing lease and other factors may include economic life and consumption.

Finally, we believe it is unclear, under the modified retrospective approach for transition, whether entities would classify arrangements, previously accounted for as operating leases, using information as of the commencement date or the beginning of the earliest comparative period presented. The final statement should clarify this requirement, as it is very possible that lease classification could be different under the proposal depending on the assessment date. Regardless, we believe that the classification of existing leases under current accounting rules should be allowed to remain the same upon transition to new rules in order to reduce the time, effort and costs of implementing the new standard.

Lessee accounting

Under the proposed guidance, the most significant issue related to lessee accounting will be resolved in that lease obligations would now be included on the balance sheet. However, significant changes to the income statement and cash flow statement would not add incremental value as there are not issues related to these today.

For operating leases, while a lessee's lease obligation can be calculated for each reporting period based on the proposal with a corresponding asset recorded, the income statement and cash flow statement do not have to change for these leases. Keeping the income statement and cash flow statement treatment the same as today would be a more cost effective method of achieving the objective of ensuring that lease obligations are reflected on the balance sheet without creating more complexity or confusion with the other financial statements.

Lessor Accounting

We do not believe that there are issues with current accounting related to lessor accounting; therefore, the proposal does not represent an improvement over current guidance. In our business, we lease land and buildings to franchisees and receive rental payments. The proposed classification test and exception criteria may result in us reflecting some of these leases under Type A classification and some under Type B classification, even though all of the transactions are very similar. Having both types of leases in our financial statements for similar lease activities will create confusion and added complexity for users of our financial statements.



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We do not believe there needs to be complete symmetry between lessee and lessor accounting approaches. The substance of the transaction should be a key indicator of the lease classification. The current operating lease accounting works well for property lessors and provides decision useful information to the users of the financial statements. If a lessor specifically prices and structures a lease as a financial investment, we recognize and agree that these leases should be classified as financing leases.

Lease Payments

With regards to variable rents based on sales or usage when calculating the lease obligation to record, we feel the proposal, which excludes these variable rents, is the only practical and reliable solution. To include these variable rents would require a significant amount of judgment and estimation that could change substantially as the lease term progresses. We strongly believe the Boards' decision in this area should not change in re-deliberations. We feel disclosures related to these types of variable rents provide the most useful information to financial statement users.

For Type B lessor leases, the proposal allows recognition of lease payments over the lease term on either a straight-line basis or another systematic basis if that better represents the pattern in which income is earned from the underlying asset. For example, if a contract includes stepped rent increases that are expected to reflect market rental rates, these rents are allowed to be recognized based on the contractual cash flows. This same concept should be applied to the lessee side for Type B leases. Recognition based on the contractual cash flows for these types of rents, along with variable rents based on an index or rate, may create some simplification for preparers (from a process and system perspective).

Transition

We support providing preparers with options for implementation as stated in the proposal. We also believe that under the modified retrospective approach, an option similar to the Revenue Recognition project that allows for current period implementation (without comparative periods being restated and with appropriate disclosures) should be considered, especially if the impact to a reporting entity is primarily limited to the balance sheet.

Classification assessment tests at transition would be very onerous and the calculation of fair value and economic useful life information for property at a transition date, if required, would be a significant challenge. In addition, historical information for assessment as of a commencement date may not be readily available.

We believe that a minimum of three full years from final standard to implementation is necessary along with implementation as of the beginning of the following fiscal year for a reporting entity. Some of this is due to the fact that most software developers will not begin to develop appropriate software solutions until a final standard is issued.



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Disclosures

We believe that this project should incorporate a principles-based approach to disclosure. We are concerned that certain specific disclosure requirements such as reconciliations and non-lease components will become rules-based requirements in practice. We believe these and other disclosures identified should be incorporated into the guidance as potential disclosures that might add some clarity and transparency for the users of the financial statements. However, preparer judgment, coupled with the external auditors' assessment, should drive the appropriate disclosure for a reporting entity.

Discount rate

We believe the most appropriate discount rate that reflects the economics of the transaction should be utilized. We understand that the implicit rate in the lease may not always be readily available; however, we believe preparer judgment in estimating the implicit rate in the lease would be appropriate. An incremental borrowing rate or risk-free rate of return could be used if it is not possible to estimate the implicit rate in the lease, especially for property leases.

Cost/Benefit

McDonald's is a lessee of over 14,000 restaurant locations through ground (land only) and improved (top leases – land and building) leases. We are also the lessor at over 20,000 restaurant locations. Thus, the proposed ASU will have a significant impact on our processes and IT systems, and the costs related to these changes will be substantial. These costs include abstracting lease contract data; purchasing, designing and building a global lease accounting system; changing Accounting, HR, Legal and Development processes, policies and procedures; and developing stakeholder communications. As we indicated earlier, it does not appear that the benefits to users of financial statements warrant these costs. We believe it is crucial that any final standard be cost effective, practical to implement and make substantial improvements over current accounting and reporting.

In closing, we believe the concerns and alternatives that are discussed in our letter reflect widespread views that need to be considered before proceeding any further with this proposal. We do not believe the proposal represents an improvement over current accounting; therefore, we believe the project should focus on enhanced disclosures. If the Boards move forward with the proposal, we believe the biggest benefit for users of our financial statements will relate to capitalizing the lease obligation for lessee operating leases; therefore, any costs incurred should be solely related to that benefit and not to changes in the income statement recognition of these leases or to lessor accounting.

We appreciate the opportunity to express our opinion on this matter and would be pleased to discuss our comments in greater detail if requested.

Sincerely,

/s/ Kevin M. Ozan

Kevin M. Ozan

Corporate Senior Vice President – Controller

McDonald's Corporation