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Letter of Comment No: 5
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August 16, 2005

Lawrence W. Smith
Director, TA&I – FSP
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116

RE: Comments on Proposed FSP No. FAS 13-b

Dear Mr. Smith:

We appreciate the opportunity to provide our comments to the Financial Accounting Standards Board on the proposed FASB Staff Position No. FAS 13-b issued July 19, 2005, "Accounting for Rental Costs Incurred during a Construction Period." As an active member of the National Retail Federation (NRF), J. C. Penney participated in writing the comment letter that was sent from the NRF to the Emerging Issues Task Force last month in preparation for the EITF meeting that was held on June 16, 2005. We will not repeat the content of that comment letter, except to reiterate that we continue to believe that current GAAP supports the long-standing industry practice of capitalizing rent during the construction period. We submit for your consideration what we believe to be a few key points on this issue.

Due Process

- The issue of whether rental costs associated with ground or building operating leases incurred during a construction period may be capitalized has already been subjected to established due process practices and procedures. It was addressed in EITF Issue No. 05-3 and discussed at the June 16, 2005 EITF meeting which we attended. There was a great deal of discussion and the opinions were divergent, however, slightly more than half of the voting EITF members voted in favor of capitalizing rent during construction, and only four members voted against allowing capitalization during construction. So it was by a narrow margin that a consensus allowing capitalization was not reached. On that basis, we expected that, as a result, current GAAP practice would continue and the SEC guidance that was issued earlier this year would remain in effect. Our understanding of that SEC guidance was that, based on current literature, they would not object to capitalization, if a company had an existing policy of capitalizing rent, or if a company had never expensed rent on any lease in the past, it would be considered a policy decision and companies could choose a policy of capitalization.

Inconsistencies in GAAP Created

- The basis for the Board's conclusion that rental costs incurred during construction should be expensed is centered around the notion that rental costs are for the right to control the use of an asset during and after the construction period, referencing EITF Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease". No distinction is made between the right to use the asset during the construction period and the right to use the asset after construction is completed. This notion could also be applied to other "right to control" costs incurred during the construction of an asset. For instance, mortgage payments and property taxes also convey the right to control the property and failure to make these payments would result in a loss of control to access and use the property. Under current GAAP, however, the portion of the mortgage payment representing interest is required to be capitalized according to SFAS No.34, "Capitalization of Interest Cost". Property taxes are also capitalizable by analogy under SFAS No. 67, which states in paragraph 6 that "taxes and insurance should be capitalized as property cost until the property is ready for its intended use". These costs are direct costs of constructing the asset and will be recoverable from future operations of the property. Rental costs, in our view, are no different than interest or property taxes.

- Another inconsistency that will be created is that two leases having the same economic characteristics could be accounted for differently, depending on how they are structured. For example, in one lease agreement, real estate taxes, insurance, maintenance, utilities, etc. are rolled into the fixed rental costs – i.e., a Gross Lease. In this case, the entire cost would be expensed during the construction period under the proposed FASB Staff Position No. FAS 13-b. Under a second lease agreement, the lessee is directly responsible for the payment of real estate taxes, insurance, maintenance, utilities, etc. and, therefore, these costs are not included in the fixed rental costs – i.e., a Triple Net Lease. In the second lease example, the lessee would capitalize the real estate taxes incurred during construction under current GAAP as they are not part of the rental costs and current GAAP allows for the capitalization of real estate taxes incurred during a construction period.

- One final point is that when the FASB reconsiders the whole area of lease accounting, which is one of the topics that the FASB Chairman, Robert Herz, has stated is a priority and one that the SEC recently recommended the FASB add to its agenda, these inconsistencies will no doubt be addressed and either the proposed FASB Staff Position No. FAS No. 13-b will have to be reversed, or other current GAAP will have to be reversed, such as SFAS No. 34.

In our opinion, maintaining the status quo seems prudent so as not to create any inconsistencies in the accounting rules until the FASB can reconsider and revisit the whole area of lease accounting.

We appreciate the opportunity to share our thoughts on this important issue. We would be pleased to discuss our comments in greater detail if requested.

Respectfully,

Robert B. Cavanaugh

Executive Vice President and Chief Financial Officer
J.C. Penney Company, Inc.