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To: Technical Director
Financial Accounting Standards Board
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(sent via e-mail to director@fasb.org)

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RE: Exposure Draft - Lease Accounting

Thank you for the opportunity to comment on the Exposure Draft on *Leases (Topic 840)* issued in August of this year. As a global retailer with approximately 9,000 company-operated retail locations under operating leases in the U.S. and abroad, Starbucks Coffee Company ("Starbucks") would be significantly impacted by the proposed rule changes.

We support the effort to improve the lease accounting model with a principles-based and conceptually consistent accounting model that recognizes on a lessee's balance sheet the assets and liabilities that arise from lease contracts. However, we have significant concerns about some of the exposure draft's current proposals that we believe would lead to less useful financial reporting for many users.

Below we have summarized our views on three key areas in the exposure draft that represent our greatest concerns, along with our suggestions for an alternative approach.

The lease term

We do not agree that a lessee should determine the lease term as "the longest possible term that is more likely than not to occur" because the lessee does not have an unconditional obligation to pay rentals in optional renewal periods until the lessee has exercised the renewal option. We believe the lease term to be used for calculating the right-of-use asset and lease liability should be the contractually obligated lease term as of the balance sheet date (except when it is evident that to *not* exercise an option period would result in "economic detriment" as discussed in ASC 840). The inclusion of not-yet-exercised option periods in the calculation of the lease liability would be inconsistent with the definition of a liability[1], and would lead to inflated balance sheets failing to properly reflect a company's true underlying economic obligation, flexibility and risk profile. Further, it introduces a high degree of subjectivity that reduces the reliability and comparability of financial statements, and as a practical matter, it would require a significant ongoing investment in time to make those estimates that far outweighs any benefit.

[1] The Conceptual Framework's working definition of a liability states in part that "A liability of an entity is a present economic obligation for which the entity is the obligor." Further, "An entity is the obligor if the entity is required to bear the economic obligation and its requirement to bear the economic obligation is enforceable by legal or equivalent means."

Our business model is built on a dynamic portfolio of numerous, relatively small locations in a given market. Option periods enable us to lock in a site while preserving flexibility to exit the location if circumstances dictate. It is not a foregone conclusion that an option period will be exercised, and the assessment conducted near the end of the original lease term is very specific to the individual site, based not only on that store's performance but also other factors such as a more desirable location becoming available nearby, changing traffic patterns, and the impact of other stores in the area. Consequently, the effort to assess the "more likely than not" lease term would be a very time-consuming and imprecise process, involving several hours of work for each lease at inception and again when a renewal or other trigger requires re-evaluation. The goal of achieving comparability across companies – or even among divisions of an individual company – would be difficult to attain.

Although we believe the contractual lease term is generally the appropriate period to use, we do believe an exception should be made when there is compelling evidence of economic detriment associated with non-renewal, such that a renewal is virtually assured. This is consistent with current U.S. standards limiting the depreciable life of leasehold improvements, as well as IAS 37 recognition criteria for contingent assets, and is most relevant in certain non-U.S. markets where lease terms are customarily very short. In those markets, it is clear that the economic investment in a site would not be supported absent the ability and intent to renew. The same assumptions regarding lease term should be made for purposes of establishing the balance sheet liability and the leasehold amortization period. The balancing of these two factors would mitigate concerns about intentional structuring of lease terms to minimize the balance sheet liability.

We do recognize that some financial statement users may desire a deeper understanding of the terms of a company's lease portfolio than called for under the current rules, and suggest a set of qualitative disclosures could be developed to better explain the company's practices and intentions with regard to its leased assets. Certain meaningful and factual metrics about the lease portfolio could also be incorporated to provide greater insights.

Expense recognition pattern
We believe the proposed "amortized cost" method – which results in front-loading of expense – distorts the allocation of rent expense over the lease term, particularly for real estate leases with long lease terms. The dramatic impact, when modeled out over 10, 15 and 20 year lease terms, is surprisingly evident even when using a relatively low incremental borrowing rate as the discount factor. The economic reality is that rents generally increase over time, and leases are typically designed to provide the landlord with increasing rent payments based on expected inflation in market rents over the term. The expense recognized under the "amortized cost" approach is likely to be materially different from the market rent cost for the leased property, particularly in the early and latter periods of the lease.

Recognizing higher occupancy expense in the early part of a lease compared to the latter part is out of step with the underlying economics and would misrepresent net income. It would not enhance a user's ability to make comparisons among companies, and would significantly complicate the ability to understand trends or forecast future results. This would be compounded by the inclusion of estimated renewal periods and subsequent re-estimation of probable lease terms, as proposed.

Starbucks believes that the "linked approach" outlined in the Discussion Paper issued in March 2009 would be a better approach for expense recognition purposes. Effectively, the linked approach would accommodate the move away from off-balance sheet financing – the main criticism of the existing rules – while preserving the current straight-line rent expense recognition pattern.

Contingent rentals

We do not believe that contingent rents should be included in the determination of the right-of-use asset and related liability, unless they constitute the primary obligation under the lease. In our view, contingent rents should be recognized when the particular future events occur and actually trigger a liability.

For perspective, Starbucks' contingent rent payments represent approximately 4% of its total annual rental expense. Most of our leases that contain sales-dependent contingent rent ("percent rent") include both a fixed rent component (roughly approximating market rent for similar properties without any percent rent) and a minor percent rent component tied to exceeding a specified sales threshold. One rationale for such arrangement may be that the landlord of the particular site (e.g., a mall) has significant ability to impact the customer traffic through mall promotions, upkeep of the premises, better tenant mix, etc. In such case, the contingent rent component may be viewed as a form of revenue sharing which is earned by the landlord as traffic and sales are generated. It is inconsistent to recognize the rent expense before the related revenue is earned (as would happen under the proposed expense recognition pattern) and not appropriate to record a liability that will be generated by and entirely funded out of future revenues.

In addition, estimation of these contingent rents and the ongoing adjustments based on actual results would be highly subjective and require significant administrative effort. The detailed methodology proposed in the exposure draft, requiring probability weighting of multiple outcomes, would be a particularly onerous and costly exercise, and implies an unrealistic degree of precision and reliability. In fact, the resulting estimates would be of no use for internal management purposes and we believe they would be equally irrelevant for external users of the financial statements.

We recognize that some leases are designed so that all or a large percentage of the total rental payments would be in the form of contingent rents. In a situation where there is no base rent, or it is *clearly* well below market, we agree that an estimate of contingent rent is required in order to reflect the economic substance of the lease. We urge the boards to establish and require compliance with this principle, without resorting to detailed bright-line numerical tests that in themselves become burdensome and encourage some participants to structure leases with the intent of meeting the letter rather than the principle of the rule.

Other comments and concerns

In addition to the main concerns outlined above, Starbucks would like the boards to consider the following areas:

- **Importance of convergence** – Implementation would consume considerable time and resources and encompass complex and costly changes to systems and processes. We

therefore strongly urge that full convergence between U.S. GAAP and IFRS be achieved upon issuance of a final standard.

- **Timing of implementation** – We understand that the boards plan to seek separate input on the effective dates for several converged standards, including the lease proposal. We believe that implementation of the lease accounting changes will be complex and costly, requiring new lease accounting systems and processes, additional staffing and training, and an enormous amount of information gathering and validation work. The effective date for this proposed standard should allow for ample implementation time, particularly recognizing the level of effort for companies that have many thousands of individual leases in dozens of different countries and leasing environments.

In closing, we urge the boards to carefully consider the areas in the proposal on which we and others have commented. We believe the overall objective of the proposed standard has great merit, but also that the conceptual issues noted and the high degree of subjectivity in certain areas of the current proposal would diminish the value of this significant augmentation to the current accounting standards.

Again, we thank the boards for the opportunity to have this dialogue and for their consideration of our comments.

Sincerely,

Donna Brooks
Starbucks Coffee Company
Vice President and Controller