



December 15, 2010

Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Re: File Reference No. 1850-100; Proposed Accounting Standards Update, *Leases*

To Whom It May Concern:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Leases* (Proposed Update) issued by the Financial Accounting Standards Board (FASB). PepsiCo is a leading global food, snacks and beverage company, with annualized revenues of nearly \$60 billion and operations in over 200 countries. We do not have any significant contracts where we are the lessor and hence our comments below are related to the proposed changes in lessee accounting. Overall, we have significant concerns over the economic cost of implementing the Proposed Update, which we believe would outweigh any of its potential benefits.

### **Implementation**

We have over 10,000 leases worldwide with almost all currently accounted for as operating leases. We lease a wide variety of assets from laptops and copiers to large warehouses in over 200 countries. The Proposed Update will require us to record a right-of-use asset and a liability for future payments for all of our leases. We appreciate the Board's recognition of the difficulty in applying the full retrospective application approach for transition. However, even under the simplified retrospective approach, due to the large volume and complexity of our leases, a significant level of resources will be required, not only for the initial implementation of the Proposed Update but also for the ongoing accounting and periodic reporting. We believe that in this challenging economic environment this would not be the most efficient use of our resources, especially as we see no substantial benefit of this change to the user community. We understand that both the ratings agencies and the analyst community already factor in the future operating leases payments, currently disclosed in the financial statements, in their analysis of PepsiCo's results or Balance Sheet. Consequently, capitalization of rental payments will not provide any additional information to the user community. Based on the above and factoring the substantial economic impact of implementation, we respectfully ask the FASB to reconsider the merits of its proposal to recognize a right-of-use asset and a related liability for all leasing arrangements.

Notwithstanding our above objection to the Proposed Update, if the FASB decides to adopt this proposal, we strongly urge the FASB to modify some of its provisions based on our following recommendations.

### **Lease Term and Probability-Weighted Average Cash Flow**

The Proposed Update requires the right-of-use asset to be valued based on the longest possible term that is more-likely-than-not to occur, using the present value of the probability-weighted average of the cash flows for a reasonable number of outcomes. We have a number of leasing arrangements with renewal options exercisable five to ten years after the lease inception date. Additionally for these leases, the renewal rates are based on a number of market-based variables existing at the time of the renewal. The decision to renew a lease is based on a number of dynamic factors such as the growth rate of the business, the production process, marketing strategy and other factors that are constantly changing. Furthermore, it is very difficult, if not impossible to credibly estimate market-based variables for the purposes of calculating the probability-weighted average of the cash flows, five to ten years in advance. Doing so will lead to valuations that do not depict any recognizable economic reality. It will also result in frequent changes in estimates based on market fluctuations. As such we propose that the FASB adopt an approach similar to that used for accruing loss contingencies under ASC Topic 450 (FAS 5). We recommend that a renewal option be included in the value of the right-of-use asset only when it becomes probable and reasonably estimable. An estimate developed on this basis, will also eliminate the need for making frequent changes to the valuation.

### **Incremental Cost of Borrowing**

The Proposed Update requires that the right-of-use asset and the liability relating to the lease payments be recorded at their present value using the lessee's incremental borrowing rate or the rate the lessor charges in the lease (if known). Paragraph B13 of the Proposed Update states that the incremental borrowing rate should reflect the nature of the transaction and the specific terms of the lease. As noted above, we enter into leasing transaction for a variety of class of assets with varying lease terms in a number of different countries. Following the guidance in paragraph B13, this would result in multiple discount rates across the portfolio of our leases, which would increase the administrative cost of complying with the Proposed Update.

Further, we manage our cash through a central treasury function for our cash needs throughout the world. The cash needs of our divisions are primarily funded through equity injection from the U.S. parent or through inter-company loans. All external borrowings are managed at the U.S. parent level. Consequently, our borrowing rate remains consistent regardless of the nature of the transaction or the terms of the lease. Based on the above, we recommend that the FASB allow the use of a uniform interest rate (e.g. Corporate Weighted Average Cost of Capital) for the purposes of calculating the discounted value.

## **Short-term Leases**

We appreciate the FASB's acknowledgment of our concerns related to the administrative burden caused by leases with a maximum rental term (including renewal options) of one year or less. However, we believe that lessees should have the same elections for short-term leases as those provided to lessors (i.e. elect on a lease-by-lease basis not to recognize assets or liabilities arising from a short-term lease in the Balance Sheet). Additionally, a similar option should be provided for leases with less than one year remaining on their lease term on the date of the implementation of the Proposed Update. Rather than the currently proposed option to record undiscounted amounts, lessees should be able to recognize short-term leases on a straight-line basis over the term similar to the manner in which operating leases are recognized under current guidance. Not only does this recognition pattern align with the future cash flows, but it also avoids the significant effort and costs associated with accounting for and measuring such short-term assets and liabilities, which in our opinion will not add any value to the users of our financial statements. Expensing short-term leases as incurred would likely be consistent with the approach and practice many entities use today with respect to fixed asset thresholds in that assets with a useful life of less than a year are normally expensed as incurred. Finally, we would like to note that short-term leases involve an economic bargain that is different than that contained in longer term leases, and the varying risk profile serves as a natural control that limits the chance these transactions would provide the opportunity for abuse.

## **Impairment**

Paragraph 24 of the Proposed Update states that "A lessee shall apply Topic 350 at each reporting date to determine whether the right-of-use asset is impaired." ASC Topic 350 (FAS 142) provides guidance for determining impairment of intangible assets and calls for an annual impairment analysis. Paragraph 25(b) of the Proposed Update states that a lessee shall present "right-of-use assets as if they were tangible assets within property, plant and equipment, separately from assets that the lessee does not lease."

The above demonstrates an internal contradiction in the classification of the right-of-use asset. For impairment purposes, the Proposed Update calls for the right-of-use asset to be treated as an intangible asset, whereas for disclosure purposes, it calls for the right-of-use asset to be treated as a tangible asset. We believe that there should be consistency in the classification for impairment and disclosure purposes. We support the view that a right-of-use asset be classified as a tangible asset as it shares many of the same characteristics of a tangible asset. In most cases, there is no difference in the manner in which an asset is used regardless of whether it is leased or owned. As such, we believe that there should not be a difference in evaluating the asset for impairment. Accordingly, consistent with ASC Topic 360 (FAS 144), we recommend that it is appropriate to test the right-of-use asset for recoverability only when events or changes in circumstances indicate that its carrying amount may not be recoverable. Furthermore, this will also be consistent with

the impairment requirements for a capital lease, which is currently within the scope of ASC Topic 360 (FAS 144).

### **Financing Cash Flows**

Paragraph 27 of the Proposed Update states that all lease payments shall be classified as financing activities in the Statement of Cash Flows. Additionally, the Proposed Update calls for lease payments to be recognized as amortization and interest expense in the Income Statement. Currently, per ASC Topic 230 (FAS 95) interest payments are classified as operating cash flows in the Statement of Cash Flows. As such the Proposed Update is contradictory to existing generally accepted accounting principles. We ask the FASB to modify the Proposed Update such that all interest payments are consistently classified, as operating cash flows, in the Statement of Cash Flows.

### **Disclosures**

Paragraph 77 of the Proposed Update requires that “A lessee shall disclose a reconciliation of opening and closing balances of right-of-use assets and liabilities to make lease payments, disaggregated by class of underlying asset. The reconciliation shall show the total cash lease payments paid during the period.”

Paragraph BC 177 states that the above disclosure would be similar to that currently required for all intangible assets and property, plant and equipment. As we have discussed under the Impairment section above, the right-of-use asset and the liability relating to a leasing contract should be classified as a tangible asset. The current disclosure requirements for property, plant and equipment, under ASC Topic 360 (APB 12), do not require a reconciliation of opening and closing balances for depreciable assets. As such, the requirements above for a reconciliation of opening and closing balances would be inconsistent with existing disclosure requirements. Additionally, we struggle to identify a single benefit that this reconciliation will provide to the user, especially when there is already a requirement to provide a detailed analysis of the expected remaining lease payments. Furthermore, we have over 10,000 leasing arrangements across a wide spectrum of asset classes. Providing disaggregated information at any meaningful level would result in a huge volume of data in our financial statements, which could distract the users from other more relevant information in our financial statements. We recommend that the FASB remove the above disclosure requirement from the final standard.

\*\*\*\*\*

We ask that the FASB reconsider issues raised with respect to the Proposed Update and whether the benefits of the Proposed Update outweigh the concerns of preparers and meet the expectations of the investor community.

We would be pleased to discuss our comments or answer any questions that you may have. Please do not hesitate to contact me at (914) 253-3406.

Sincerely,

A handwritten signature in black ink that reads "Peter Bridgman". The signature is written in a cursive style with a large initial "P".

Peter A. Bridgman  
Senior Vice President and Controller

cc: Hugh Johnston, Chief Financial Officer  
Marie T. Gallagher, Vice President & Assistant Controller