Gap Inc.

GPS Services 2 Folsom Street San Francisco, CA 94105

December 10, 2010

Mr. Russell Golden Technical Director Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, Connecticut 06856-5116

File Reference No. 1850-100: Exposure Draft – Leases (Topic 840)

Dear Mr. Golden,

We appreciate the opportunity to respond to the Exposure Draft of the Proposed Accounting Standards Update for *Leases* (Topic 840). The retail industry will likely be one of the most impacted industries and for that reason we believe it is important to share our perspective on the proposed guidance.

Gap Inc. is a leading international specialty retailer offering clothing, accessories and personal care products for men, women, children, and babies under the Gap, Banana Republic, Old Navy, Piperlime, and Athleta brand names. Gap brand includes Gap, GapKids, babyGap and gapbody and we also operate Gap and Banana Republic outlet stores. Our business includes more than 3,000 stores worldwide with locations throughout the United States, as well as in Canada, the United Kingdom, France, Ireland, Japan, China, and Italy.

Our real estate lease portfolio is made up of complex lease terms including minimum rent, percentage rent, various consumer price index rent increases, fair market rents, co-tenancy clauses, and lease incentives. About 90% of our leases contain contingent rent provisions and many contain multiple contingencies. We generally have lease actions on more than one-third of the leases in our portfolio each year. This is common for mall-based retailers because of the nature of the business to relocate, expand, contract, and consolidate locations. The impact of market conditions also necessitates changes in financial terms. Further, many of our leases are gross rent leases which contain service components (e.g., common area maintenance, real estate taxes, and utilities).

We understand that operating leases are significant off-balance sheet arrangements and we understand certain of the merits of applying a rights and obligations model to such transactions. We conceptually agree with many of the approaches outlined in the exposure draft, but we have strong concerns about the application of the proposed guidance as it relates to determining the lease term and including performance-based and market-based contingent

rent in the liability to make lease payments calculation. We believe the inclusion of these highly subjective elements in the initial calculation will lead to frequent subsequent adjustments as we reassess the balances each period using updated estimates. As a consequence, we will be required to constantly reset the monthly amortization and interest expense which will create volatility in our financial statements. In addition, we firmly believe that the boards should consider the significant effort involved in implementing the standard and allow ample time to understand, interpret, and operationalize the final pronouncement.

Lease Term Considerations

Our lease portfolio includes thousands of store leases and the leases are often structured with base terms followed by one or more exercisable option periods. Exercisable option periods allow us to maintain the flexibility we need in our real estate strategy to be able to adjust to market shifts. We believe that implementing the "more likely than not" approach of estimating the probability of occurrence for each possible lease term as proposed in the exposure draft would reduce the reliability of such estimates by introducing an unnecessary level of subjectivity. We believe this approach will drive frequent subsequent adjustments as "more likely than not" is too low of a threshold. In addition, performing a lease-by-lease assessment using this approach will be very costly. For these reasons, we propose to maintain the current guidance of "reasonably assured." The current guidance would allow us to estimate the lease term based on our expectations without the extensive and subjective calculation of estimating the probability of occurrence.

<u>Contingent Rent Considerations</u>

We fundamentally disagree that rent payments contingent on future performance or future market conditions should be included in the assessment of the liability to make lease payments. We do not believe they meet the definition of a present obligation at the inception of a lease and instead they represent obligations as the future performance targets are achieved or as future market conditions are realized. As such, we do not believe performance-based and market-based contingent rent should be included in the liability to make lease payments. Our store leases typically include a performance-based contingent rent clause such as percentage rent, which is additional rent based on achieving a specific level of sales. The proposed guidance would require that we develop extensive forecasting of sales over an extended number of years for each store lease. The success of our business, and by extension the level of sales we achieve in any given period by store, is heavily dependent on general market and economic conditions as well as consumer spending patterns and consumer acceptance of our products across our various brands, channels, and geographies. Because of this, such longrange forecasts can be unreliable which would cause volatility in our financial statements every reporting period as we update one estimate with another estimate before amounts are actualized. In addition, our store leases may also include a market-based contingent rent clause (e.g., consumer price index or fair market value) which is also difficult to estimate due to our inability to accurately predict future business conditions, inflation, and changes in the consumer price indices.

Gap Inc. Comment Letter Re: Exposure Draft - Leases

Transition Considerations

The implementation of such fundamental changes to lease accounting will require significant investments in resources and systems. In order to ensure that we execute such major changes with the appropriate level of accuracy and control, we will need sufficient time to process and interpret the final standard before we are able to move forward with the necessary decision making (e.g., selecting and implementing new systems, hiring and training employees, designing and implementing enhanced processes and controls). It is our belief that the complexity of the proposed accounting standard combined with the size of our lease portfolio will mean that such a transition will take years to successfully implement and for that reason we propose a prospective approach rather than either a simplified or full retrospective approach to eliminate the burden of preparing comparative financial statements. Given the unprecedented number of new standards on the horizon, we urge the boards to consider the significant effort involved in this implementation, among others, when issuing the final transition guidance.

Our detailed responses to the individual questions posed in the exposure draft are attached. We have only answered questions as they relate to us as the lessee and excluded questions that are not directly applicable to Gap Inc. or for which we have no comments at this time.

Thank you for your consideration of our comments and concerns. If you have any questions, or if you would like to discuss our responses further, please contact me as indicated below.

Sincerely,

Lori Kopansky

Gap Inc. Vice President, Corporate Controller

2 Folsom Street, San Francisco, California 94105 lori kopansky@gap.com | 415.427.2258

Question 1: Lessees

(a) Do you agree that a lessee should recognize a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

Yes, we agree that a lessee should recognize a right-of-use asset and a liability to make lease payments. However, it is our position that measurement of the asset and liability should reflect only the base, non-cancelable lease term and any subsequent renewal periods that are considered to be reasonably assured (see our response to Question 8). Additionally, measurement of the asset and liability should only include the discounted cash flows related to minimum lease payments and not contingent payments that are performance-based or market-based (see our response to Question 9).

(b) Do you agree that a lessee should recognize amortization of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

Yes, we agree that a lessee should recognize amortization of the right-of-use asset and interest on the liability to make lease payments. We believe such an approach fairly presents the consumption of economic benefits as well as the costs incurred to obtain such economic benefits. Regarding amortization of the right-of-use asset, the exposure draft refers to Topic 350 which states that the method of amortization "should reflect the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up." However, we would like the boards to consider providing further clarification and implementation guidance to address establishing appropriate methods of amortization.

When preparing such guidance, we ask the boards to consider the following:

- The amortization method should be simple and easy to execute and defend regardless of the size or composition of a company's lease portfolio.
- Adequate specific guidance around selecting a method of amortization should be provided in order to preserve comparability between companies with similar lease portfolios.
- The combined impact of amortization and interest on the income statement should not yield a drastically different result than current lease accounting because the underlying economics of the transaction have remained the same.
- The right-of-use asset and the liability to make lease payments are inherently linked and establishing an amortization method that would cause a dramatically different rate of consumption of the asset versus the liability would change that relationship.

Question 3: Short-term leases

This exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is 12 months or less:

(a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognize lease payments in the income statement over the lease term (paragraph 64).

(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognize assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other Topics and would recognize lease payments in the income statement over the lease term (paragraph 65). (See also paragraphs BC41–BC46.)

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

Lease terms less than 12 months are not prominent or practical in the retail industry and although we do not disagree with the simplified requirements for short-term leases, we would not experience any relief from such simplified requirements.

Question 6: Contracts that contain service components and lease components

This exposure draft proposes that lessees and lessors should apply the guidance in proposed Accounting Standards Update, Revenue Recognition (Topic 605): Revenue from Contracts with Customers, to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:

- (a) The FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.
- (b) The IASB proposes that:
- (i) A lessee should apply the lease accounting requirements to the combined contract.
- (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.
- (iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the guidance in the exposure draft on revenue from contracts with customers.

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

Yes, we agree with the FASB's approach to accounting for leases that contain service and lease components. We believe that service costs should be bifurcated from the lease component of a

contract as service costs represent a distinct component of a lease agreement that should be expensed as services are rendered. In the retail industry it is not uncommon for service costs such as common area maintenance, real estate taxes, and utilities, among others, to be included in the lease payments and we agree that such costs should be recognized as the services are incurred.

We propose the guidance surrounding the determination of distinct service components be broadened to include the specific language and definitions provided in the Proposed Accounting Standards Update, *Revenue Recognition* (Topic 605). We believe the inclusion of such language would provide clarity as to how the proposed revenue recognition guidance should be applied to contracts that contain both lease components and service components.

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

No, we do not agree that the lease term should be the longest possible term that is more likely than not to occur. Implementing the "more likely than not" approach would require estimating the probability of occurrence for each possible term and it would inherently reduce the reliability of such estimates by introducing an unnecessary level of subjectivity. This approach would require an individual review and cumulative probability analysis of possible lease terms for every single lease which would require significant assumptions and reduce objectivity in a manner that would not provide significant incremental benefit.

Our store leases are often structured with base terms followed by exercisable option periods, which allow us to maintain the flexibility we need in our real estate strategy to be able to adjust to market shifts. Based on our own portfolio and our current lease term assessments, we believe the current guidance of "reasonably assured" will reflect the company's reasonable expectation of what the lease term will be. We also believe "reasonably assured" will provide a higher threshold than "more likely than not" which would result in less frequent adjustments to the expected lease term.

The concept of defining a lease term under current FASB guidance states that a lease term should include "all periods, if any, for which failure to renew the lease imposes a penalty on the lessee in such amount that a renewal appears, at lease inception, to be reasonably assured." A penalty is defined under current guidance as:

"Any requirement that is imposed or can be imposed on the lessee by the lease agreement or by factors outside the lease agreement to do any of the following:

- a. Disburse cash
- b. Incur or assume a liability
- c. Perform services

- d. Surrender or transfer an asset or rights to an asset or otherwise forego an economic benefit, or suffer an economic detriment. Factors to consider in determining whether an economic detriment may be incurred include, but are not limited to, all of the following:
 - 1. The uniqueness of purpose or location of the property
 - 2. The availability of a comparable replacement property
 - 3. The relative importance or significance of the property to the continuation of the lessee's line of business or service to its customers
 - 4. The existence of leasehold improvements or other assets whose value would be impaired by the lessee vacating or discontinuing use of the leased property
 - 5. Adverse tax consequences
 - 6. The ability or willingness of the lessee to bear the cost associated with relocation or replacement of the leased property at market rental rates or to tolerate other parties using the leased property."

By following the current guidance, the lease term is determined based on contractual factors (explicit lease terms) and non-contractual/business factors (economic detriments) which will properly reflect the company's reasonable expectation of what the term will be.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why? Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be reliably measured? Why or why not?

No, we do not agree that performance-based and market-based contingent rent should be included in the measurement of the right-of-use assets and liabilities to make lease payments using an expected outcome technique. In the retail industry, contingent rents typically take the form of incremental rent over and above minimum rent and the amounts are based on future performance or future market conditions. We fundamentally disagree with the proposal that such rent payments should be included in the initial assessment of the liability to make lease payments. We do not believe they meet the definition of a present obligation at inception of a lease and instead they represent obligations as the future performance targets are achieved or future market conditions are realized.

Our store leases typically include a performance-based contingent rent clause of percentage rent, which is additional rent based on achieving a specific level of sales. Under the proposed guidance, we would need to determine the present value of the probability-weighted average of the cash flows for a reasonable number of outcomes. This would require developing multiple estimates of sales by store for the estimated term of the lease which could extend well beyond our normal forecasting parameters. Assigning probabilities to potential scenarios only increases

the subjectivity applied to the calculation which dilutes its utility. Estimating sales for the estimated lease term by store is subject to changes in economic conditions and forecasts that cannot be reasonably projected in our unpredictable industry. Because of the unreliable information, there will be volatility in our financial statements every reporting period due to changes in forecasts. As an example, in the most recent economic downturn many retailers experienced a sudden and significant decline in sales. It would be extremely challenging to predict the timing of the economic recovery and other future economic events outside our control. These events are next to impossible to foresee, but they would have a material impact on our periodic financial statements as we try to update our estimates with new estimates. In addition, certain store leases include a market-based contingent rent clause such as a consumer price index increase or fair market value adjustment which creates even more unreliable data and thus additional volatility to our financial statements due to the inability to accurately estimate future business conditions, inflation, and changes in consumer price indices over such an extended period of time.

Furthermore, contingent rent does not have any impact on the lessee's right to use the leased space. The lessee's right to use the leased space is the same whether that specific location is performing well or performing poorly. In addition, under the proposed guidance, our financial statements would lack comparability with other lessees with substantially identical leases since lessees may value contingent rents differently based on estimation techniques and methods.

For the reasons stated above, the valuation of the right-of-use asset and liability to make lease payments should not include any inputs for performance-based and market-based contingent rent. It is our belief that the current requirement to disclose contingent rent for the last three years provides appropriate and meaningful information to our investors.

If the boards continue to require recognition of contingent rent at lease inception, then we recommend using a best estimate approach instead of a probability-weighted method. By calculating the effects of contingent rent based on expected obligations, the calculation will reflect what management believes to be the most likely outcome which would reduce the administrative burden. We propose that such calculations should not be updated every reporting period due to constant changes in forecasts. They should only be considered if significant triggering events occur or as forecasted amounts are actualized (see our response to Question 10).

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

Yes, we agree that lessees should remeasure the assets and liabilities arising under a lease as we believe this is consistent with current U.S. GAAP concepts. However, we do not agree with the approach for determining when a reassessment is required. The proposal currently requires a reassessment if there is an indication that there was a significant change in the liability to make lease payments. This would likely require a detailed examination of every lease every reporting period to support whether the change is either significant or insignificant. A review at each reporting period will require the adoption of new operational processes and will be a significant work driver on a quarterly basis. In addition, the review must be readily auditable in time for earnings release deadlines, which will create a significant burden on the teams supporting such reviews.

We propose the reassessment be based on triggering or actual events. Such an approach will eliminate the need to reassess all leases every reporting period to determine whether or not there was a significant change in the liability. Additionally, we would like the boards to consider providing further clarification and implementation guidance to address what would be deemed a significant or triggering event. For example, Topic 350 provides a comprehensive (albeit not exhaustive) list of events or changes in circumstances that should be monitored as part of the periodic assessments of impairment. We recommend that the boards provide similar guidance related to the subsequent remeasurement of right-of-use assets and liabilities to make lease payments.

Regardless of the specific approach, it is important to note that any impact from the periodic reassessments will create earnings volatility, which could be significant for a company with a very large portfolio of leases. Because it could be many years before the underlying variables are actualized, the periodic reassessments will simply update an estimate with another estimate and the adjustments to the assets and liabilities will result in constantly changing interest and amortization calculations. As such, we propose lease terms be calculated based on current guidance of "reasonably assured" versus "more likely than not" and we propose the elimination of performance-based and market-based contingent rent from the calculation of expected lease payments (see our responses to Questions 8 and 9).

Question 12: Statement of financial position

(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

We believe that the same provisions relating to the materiality of financial statement presentation as discussed in the Securities and Exchange Commission's (SEC) Regulation S-X Financial Statement Requirements should also apply to the exposure draft's proposed statement of financial position presentation. The term material as it relates to furnishing required information within financial statements is defined in Rule 1-02 as that "which an

Gap Inc. Comment Letter Re: Exposure Draft - Leases

average prudent investor ought reasonably to be informed." In addition, Section 4 of Regulation S-X addresses Rules of General Application and Rule 4-02 states, "If the amount which would otherwise be required to be shown with respect to any item is not material, it need not be separately set forth." Rule 5-02 provides for a materiality threshold of five percent when identifying other current assets or other assets (as they relate to total current assets or total assets, respectively) that should be separately included on the face of the financial statements.

Based on guidance provided in the various rules of Regulation S-X, we believe a threshold of materiality should be applied when determining whether to separately present right-of-use assets and liabilities to make lease payments on the face of the statement of financial position.

Question 13: Income statement

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in the income statement (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

No, we do not agree with the exposure draft's proposed guidance on presenting lease income and expense separately from other income and expense on the income statement. We include rent expense as a component of cost of goods sold and occupancy expenses which we define as rent, occupancy, depreciation, and amortization related to our store operations, distribution centers, and certain corporate functions. Currently there is no requirement to present rent expense separately on the face of the income statement and this presentation is common practice in the retail industry. We propose the final guidance contain flexibility as to the classification of lease expense given existing industry practices.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

We believe the same principles of materiality under Regulation S-X Rule 4-02 as discussed in our response to Question 12 should be applied when determining whether cash flows arising from leases should be presented separately.

Disclosure Question 15

Do you agree that lessees and lessors should disclose quantitative and qualitative information that: (a) identifies and explains the amounts recognized in the financial statements arising from leases; and (b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows? (paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

Yes, we agree that there should be both quantitative and qualitative information disclosed. However, the disclosure requirements are very robust and while we seek to provide financial statement users with the necessary information to understand our financial statements, we feel that the disclosure will only serve to overwhelm users and open us up to unnecessary questions and criticisms of valuation techniques and assumptions due to the subjective nature of the amounts included in the financial statements.

For example, we believe time and effort spent compiling data for the following disclosure requirements as indicated in the exposure draft are disproportionate to their usefulness:

- The basis and terms on which contingent rentals are determined.
- The existence and terms of options, including for renewal and termination including narrative disclosure about the options that were recognized as part of the right-of-use asset and those that were not.
- Information about the principal terms of any lease that has not yet commenced if the lease creates significant rights and obligations for the entity.
- 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 separately show the total cash lease payments paid during the period.
- An entity shall disclose information about significant assumptions and judgments and any changes in assumptions and judgments relating to renewal options, contingent rentals, term option penalties, residual value guarantees and the discount rate used when determining the present value of lease payments.

Additionally, we believe that the current disclosures in our annual lease footnote provide financial statement users with the information they need to make informed decisions about our future lease obligations. There is sufficient information for analysts and other users to perform alternative modeling or other analyses to inform them of our lease obligations in relation to other companies.

Transition Question 16

(a) This exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

We do not believe that a retrospective approach, whether simplified or full, is appropriate. The costs associated with performing either a simplified or full retrospective approach would be excessive. We propose that the transition be prospective to eliminate the burden of gathering and analyzing historical transactions, agreements, modifications, and actions to prepare comparative statements. This would allow for an earlier implementation date because the date of initial application would not have to take into consideration the comparative statements

presented. We believe that certain information could be provided in the financial statement footnotes to allow users to determine the approximate impact of the application of the proposed guidance in the year of adoption. The potential benefits gained from providing financial statement users with comparative financial statements do not outweigh the significant costs of preparing those comparative financial statements.

(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?

No, we do not believe full retrospective application should be permitted because it would reduce comparability and create inconsistent financial statement reporting among companies. It is our position that all companies should be required to comply with the same transition requirements otherwise there would be different lease expense amounts for similar leases which would impact comparability. Divergent transition methods would raise further questions for investors and analysts attempting to understand the impact of the revised standard.

(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

We recommend that the boards allow two years to implement the proposed guidance before the date of initial application under the prospective approach. After the final standard is issued and interpreted, systems must be developed and implemented, lease data must be gathered, analyzed and converted, controls must be established, processes must be redesigned, and staff must be trained.

If the boards continue to require some form of retrospective application, we recommend that the boards allow two years to implement the proposed guidance before the earliest comparative period presented in the financial statements. The Annual Report on Form 10-K as required by the SEC includes a five-year table in Part II, Item 6 Selected Financial Data, which would be the earliest comparative period. Given a two year implementation period, this would require that the effective date of the standard be no earlier than for fiscal years ending after December 15, 2018, unless significant changes are made or relief is provided relative to comparative reporting if the standard as proposed is adopted. To illustrate the time required to execute a retrospective approach, we have prepared a timeline which details the process and supports an effective date of 2018; please see the attached appendix.

Benefits and costs

Question 17

Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

No, we do not agree with the boards' assessment of the costs and benefits of the proposed requirements. Under the proposed guidance, we would be required to do an individual review

and cumulative probability analysis of possible lease terms for every single lease. Once the term is determined, we would be required to determine the present value of the probability-weighted average of the cash flows for a reasonable number of outcomes. For performance-based contingent rent such as percentage rent, this would require developing multiple estimates of sales by store by period over extended periods of time. In addition, for certain store leases, the analysis would also need to include a calculation for market-based contingent rent clauses such as a consumer price index increase or fair market rent. The sheer size of our lease portfolio and the number of lease actions in a given year make the task of applying the proposed guidance overly burdensome. We believe the amount of work required to capture, calculate, and reassess lease terms and contingent rents is excessive given the fact that we already determine our lease terms using a reasonably assured approach. We do not agree that the costs of such efforts will outweigh the perceived benefits of providing financial statement users with enhanced information.

The onerous operational, presentation, and disclosure requirements and the necessary investments in technological and human resources, primarily to model the option period and contingent rent parameters, outweigh any benefits. We estimate that the proposed standard will require significant cost and time for the company to implement. New systems will need to be developed and may take vendors substantial time to complete after the final standard is issued. Once systems are developed, we will need to undergo an evaluation of vendors in order to select the most appropriate and trusted solution and subsequently integrate and implement the new system. In addition, existing processes will need to be redesigned, employees will need to be retrained and new internal controls will need to be identified and established. The magnitude of our lease portfolio will yield an extensive timeframe and financial cost to this process. The time and costs will be magnified further by applying the proposed guidance to leases of non-core assets as well as core assets and it is our belief that the benefits of applying a right-of-use model to such leases would not outweigh the costs associated with doing so.

In addition to the monetary and operational costs to execute the proposed guidance, we believe an even greater cost will be the loss of transparency and comparability of the financial statements. The exposure draft introduces subjective measurement and valuation techniques which will vary between issuers and may eliminate comparability between financial statements of different companies. Educating our shareholders and investment analysts about the financial statement impact of these lease accounting changes will be a significant cost that may carry on indefinitely. For example, significant changes over the lease term will introduce earnings volatility that will not only decrease the comparability of our financial statements year over year, but will require ongoing explanation to shareholders and analysts. If the intent of the boards is to create more transparency and understandability in the presentation of financial data, it is our opinion that the proposed guidance does not achieve that intent.

Other comments
Question 18

Do you have any other comments on the proposals?

The exposure draft is silent as to how other lease-related balances and transactions would be treated as a result of implementing a right-of-use model. The accounting for items such as lease incentives, leasehold improvements, interest capitalization (as it relates to constructed assets), asset retirement obligations, lease rights, and key money (for certain international locations) has a significant impact on our financial statements and given the fundamental changes proposed in the exposure draft, we will need to understand how these other key elements will be affected. For example, the current accounting for asset retirement obligations is similar to the proposed accounting and it represents a cash payment upon termination of the lease. Given this, we would recommend that an asset retirement obligation be included in the calculation of the right-of-use asset and the liability to make lease payments since it represents an estimated future cash payment related to the specific terms included in the lease; however, we would like to see specific guidance and/or interpretations regarding such transactions.

With regard to assessing the right-of-use asset for impairment each reporting period, the exposure draft refers to Topic 350. However, it is not clear whether the impairment calculation would be based on the net difference between the right-of-use asset and the liability to make lease payments or whether the impairment calculation would be applied to the right-of-use asset on a gross basis, excluding the offsetting impact of the liability to make lease payments. We would like to have clarity around the application of Topic 350 to the right-of-use assets and specifically which balances should be included in the applicable asset group for purposes of the impairment test.

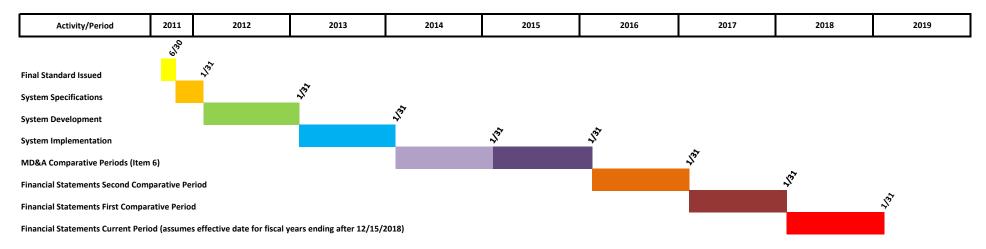
It should also be noted that changes to the composition of the financial statements will have a significant impact on traditional financial metrics used to evaluate companies. Metrics such as operating income, operating margin, earnings before interest tax depreciation and amortization (EBITDA), working capital, current ratio, free cash flow (which we define as net cash provided by operating activities less purchases of property and equipment), debt to equity ratios, asset turnover ratios, return on capital ratios, etc. will be impacted.

The changes will also create higher book versus tax differences due to the difference between cash payments for tax purposes and the recognition of interest and amortization for book purposes.

Please also consider the more detailed information and examples that were provided to you during the workshop held on November 29 and 30, 2010.

Comment Letter Appendix

*To be viewed in conjunction with our response to question 16



NOTE: January 31 is used as a proxy for typical retailer fiscal year-end timing, which is the Saturday closest to January 31.