December 13, 2010

Financial Accounting Standards Board
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Dear Board Members,

COMMENT LETTER – EXPOSURE DRAFT 2010/9 - LEASES

This letter sets out Signet Jewelers Limited’s (“Signet” or the “Company”) comments on the IASB Exposure Draft ED/2010/9 – Leases (the “ED”).

Signet is the world’s largest specialty retail jeweler, with sales of over $3.3bn and significant operations in the US and the UK. The Company has over 2,000 leases, predominantly for leasehold stores from which the Company trades. As such, the new lease accounting model as proposed in the ED will have a significant impact on Signet in a number of ways as further outlined below.

While, we recognize the need to address certain aspects of lease accounting, our key concern is that the ED introduces a complex and subjective set of judgements around uncertain forward-looking events that stretch far into the future. Most retailers’ results would be extremely sensitive to even very small changes in any one these assumptions, generating changes in the reported results and financial position that obscure underlying trading patterns.

Following from the above, we are concerned that users will find financial statements more difficult to interpret and that companies will therefore create additional (potentially non-GAAP) disclosures to give users of the accounts an understanding of their results and financial position.

The Company feels strongly that any new or revised lease accounting model should be factually based, with supporting disclosures to enable users to make comparative judgements between reporting periods and against the results of other similar organizations.
The Company is also concerned that the proposal places too much focus on attempting to calculate hypothetical balance sheet values and very little focus on profitability and cash flows, the financial measures on which a retailer is mainly judged by users. Finally, the implementation and ongoing compliance to account for leases as proposed would require a substantial cost and resource commitment.

**BALANCE SHEET RECOGNITION**

For most retailers, store leases are not predominantly an alternative method of financing an asset purchase. The stores themselves are generally not for sale but part of large long-term institutional property portfolios or small elements of large shopping complexes that have no independent structural identity.

In addition, the basis of the retail leasing model is to provide the operational opportunity to trade out of a larger number of separate outlets with the flexibility to change locations as the commercial environment changes.

The Company therefore considers that the existing operating lease model, which includes an income statement charge that broadly reflects the actual cash flows incurred, is the best method to calculate the results of the Company’s retail operations. This generally aligns the income generated with the expense incurred in the relevant period.

The Company recognizes that it has significant future contractual obligations under lease agreements that are not reflected on its balance sheet, but contends that clear disclosure of operating lease obligations by way of a note to the accounts will bring this to the attention of users. This will enable users to evaluate the Company’s position based on this factual information to which they can apply their own judgements.

Professional users, including shareholders, analysts, banks, and rating agencies have consistently taken retailers’ lease commitments into account in their reviews of the business. The Company’s current disclosures assist in this process and more detailed disclosure could further assist these users.

By contrast, the ED requires an entity to book very large assets and liabilities on its balance sheet that are based on a number of highly uncertain judgements regarding the future performance for each of (in Signet’s case) around 2,000 leases. As the scale of these assets and liabilities is driven by many assumptions that will vary from company to company, this introduces a high level of additional subjectivity into the accounts and is likely to create further diversity within an industry sector. Movements in these assets and liabilities from period to period will generally be unrelated to actual cash flows and may change substantially as economic conditions and management’s view changes. Such a methodology may confuse many users and its impact may be discarded.

The creation of a discounted liability that unwinds in a different pattern to the amortization of a ‘lease asset’, and that is in turn different from the pattern of cash flows creates a complexity that will require explanation. This is likely to increase the use of ‘non-GAAP’ measures required to enhance users’ understanding.
For many retailers, if the proposals were applied as currently drafted, the lease asset and lease liability created on the balance sheet may respectively be larger than the existing total assets and total liabilities currently reported. The Company believes that the level of subjectivity employed in deriving these lease balances undermines the credibility of the entire balance sheet and detracts attention from inventory and receivables balances that are more liquid and provide an insight into the Company’s financial position.

The Company accepts however that a level of accounting consistency needs to be achieved between very disparate industries, and that recognition of some operating lease liabilities on balance sheet may be more appropriate in other circumstances. We would therefore make some additional observations below regarding the detail of the ED.

LEASE TERM

Any recognition of lease assets and liabilities on the balance sheet should only represent the costs and benefits associated with the minimum contractual lease term. Negotiation of break points or renewals is a fundamental element of retail risk management and recognition on this basis will give users a more accurate view of the judgements on which the business is based. Further, to predict the most likely lease term at the inception of the lease is not feasible as various market conditions including real estate market, demographic shifts and changes, etc are utilized in determining whether to renew a lease.

From a technical standpoint, the Company does not believe that the possible future payment of lease rentals past a break point, for which it has no contractual obligation, meets the definition of a liability.

Disclosures regarding options to extend or break could be used to give a fuller understanding of the Company’s potential future position.

Consistent with the above, the Company believes that contingent rentals should only be recognized as the obligation accrues. This is particularly important when there is a significant change to the economy, such as in 2008, making forecasting future contingent rents highly challenging.

If a minimum lease term view isn’t taken in countries such as the UK, where the tenant has a statutory security of tenure, then this could create very significant differences based on a subjective view of the most likely lease term.

FUTURE RENT INCREASES

Where rent increases are specified in the lease documentation, these should be included in the calculation of the minimum lease obligation. Where rent increases are not specified in the lease, assumptions will have to be made and these details should be disclosed.
REASSESSMENT

Following from the above, reassessment of a lease liability should only be necessary if the minimum lease term changes, or if there is a significant change in rent payable.

DISCOUNT RATE

The Company is concerned that this issue has not been as widely discussed as some of the other matters covered above. Use of the incremental borrowing rate is considered inappropriate for companies with a net cash position or with highly seasonal patterns of trade, lease acquisition and cash flow. In the current environment the incremental rate on a net cash position would be close to zero, while the company may be making a commitment that lasts in excess of 10 years. Further, companies with a good credit rating will receive a lower incremental borrowing rate resulting in a larger asset and higher depreciation expense being recorded then a company with a lower credit rating, effectively penalizing companies with stronger credit ratings. Therefore a weaker company taking on a lease will reflect a smaller liability on its balance sheet although it is taking on a larger risk.

Obtaining the actual rate implicit in a lease may encounter practical difficulties, effectively requiring past property valuations from many different landlords on all properties leased.

Also the marginal rate for each lease may well be different from the marginal rate for the whole portfolio of leases.

The Company considers that the cost of financing applied should match the role that leasing commitments play within the business. For instance, for a retailer with thousands of stores on long-term lease commitments, the use of the entity’s current debt-based Weighted Average Cost of Capital across the lease portfolio would seem to be more appropriate, and provide consistency with the requirements of other accounting standards. If this was considered too simplistic, different discount rates could be applied by matching the maturity profile of the lease portfolio to the cost of debt instruments with a similar maturity.

Where a lessee expects to continue to lease a property over a long period and applies a relatively low discount rate, the value of the lease asset in the lessee’s balance sheet may be substantially in excess of the open market value of the property. This logic is inconsistent with other accounting literature and could result in an impairment issue.

CONSISTENCY WITH LESSOR ACCOUNTING

The Company considers that the final standard should, as far as possible, enable consistent accounting between lessees and lessors. It is accepted that this may take more time to develop, but the current lessee proposals provide potential for significant distortions between lessee and lessor accounting.
TRANSITION METHOD

The transition method proposed will significantly distort results for most retailers as it will not reflect the maturity profile of the actual lease portfolio. Companies should be allowed to apply a fully retrospective approach, a task that could be more practically completed based on accounting for the minimum contractual lease term.

SHORT-TERM LEASES

The Company would support the simplification of accounting for and further guidance on the treatment of short-term leases. These are also likely to be agreements with a significant service element, and as such the Company would support the continuation of the existing operating lease accounting requirements.

SEPARATE DISCLOSURE IN INCOME STATEMENT AND CASH FLOW

Under present lease accounting, separate disclosure on the face of these primary statements is not required for the user to understand the operations of the company as the cash and profit effects are not materially inconsistent.

If the actual lease cost is to be replaced with a notional charge for lease asset amortization, the Company considers that separate disclosure will be necessary within the detailed notes in order to highlight the different methods by which the two calculations are made.

CONCLUSION

In conclusion, our main concerns with the current ED are as follows:
- Large liabilities will be reflected on the balance sheet for which the Company has no legal obligation
- The calculation of these liabilities requires many subjective judgements regarding future events
- These complex proposals are likely to confuse users and reduce clarity and will be costly and time-consuming to implement and maintain.

If the FASB and IASB were to conclude that lease commitments and corresponding assets should be included on balance sheet, this should be based on a minimum lease commitment only, and the use of forward-looking judgements eliminated or reduced to the use of readily verifiable calculations and external indices.

Yours faithfully

Ronald Ristau
Chief Financial Officer