December 15, 2010

Technical Director
Financial Accounting Standards Board
407 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

File Reference No. 1850-100
RE: Exposure Draft of a Proposed Accounting Standards Update of Topic 840

J.C. Penney Company, Inc. (JCPenney) welcomes the opportunity to respond to the request for comment from the Financial Accounting Standards Board (FASB) on the Exposure Draft of the Proposed Accounting Standards Update (ASU) of Topic 840.

JCPenney is one of America’s leading retailers, operating 1,107 department stores throughout the United States and Puerto Rico, as well as one of the largest apparel and home furnishing sites on the Internet, jcp.com.

Lease accounting is important to JCPenney as we conduct the major part of our operation from leased premises that include retail stores, store distribution centers, warehouses, offices and other facilities. Our real estate property leases are of a long term nature, with the current portfolio expected to expire during the next 20 years; however, most leases will be replaced by leases on other premises, or renewal options will be exercised on existing leases. We manage our capital structure internally as if all real estate leases were on balance sheet. Our view of the real estate lease obligation has historically been that lease debt is equivalent to long term debt we issue in the public debt markets, and, as such, we disclose the present value of future lease payments, including expected lease renewals, based on interest rates in effect at lease inception.

As we indicated in our July 17, 2009 comment letter regarding the Discussion Paper on leases: Preliminary Views, we reiterate our support of the FASB’s and IASB’s joint effort to create a common standard on lease accounting designed to achieve convergence of US GAAP and IFRS. Convergence of lease accounting will facilitate the eventual conversion to IFRS by US issuers. However, under the Proposed ASU there are a few areas of concern, and certain others that require further clarification as discussed below.

Subsequent earnings adjustments and administrative burden
One of the main concerns of preparers of financial statements with the lease accounting model contained in the Proposed ASU is the potential for significant volatility in reported earnings resulting from adjustments to assumptions relating to contingent rent, and lease term. While best estimates can be made using past information and expected outcomes,
these estimates will always be just that, “best estimates,” which will carry a high probability that adjustments in the future will be required. The nature of these adjustments, in our case, will stem from projections made far into the future because of the long term nature of our leases. This is true for the retail industry as a whole. As a result adjustments will occur, and to the extent such adjustments relate to prior periods, such portion of the adjustment would be recognized immediately through the statement of income resulting in earnings volatility. We would ask the Board to consider that adjustments based on actual, and more current information relating to contingent rent and lease term assumptions be reflected on a prospective basis only in both the right-to-use asset and the lease obligation. This will serve to reduce earnings volatility and at the same time provide some lease administrative relief.

Another concern frequently heard regarding the Proposed ASU, especially for retailers, is the administrative burden it will impose on enterprises. Retailers engage in significant leasing activities for real estate as well as equipment, and the number of leases is significant. The application of the Proposed ASU requires that we track on a lease by lease basis, not only from the initial application but on an ongoing basis, the monumental amount of information required to calculate the right-to-use asset and lease obligation. The associated administrative burden and cost, from human resources to information systems, will be significant. To mitigate this burden we would ask the Board to reconsider materiality thresholds to limit the right-to-use lease model for equipment leases--leases not relating to the core business of selling merchandise in retail stores--with terms of five years or longer. Equipment leases for retailers are normally not significant, even in the aggregate. While equipment leases are not material in relation to real estate leases, the number of leases could be significant and from a cost benefit standpoint it would be difficult to justify the proposed accounting. However, if the Board chooses not to scope out a broader range of short term leases, we believe the Board should allow the same election for lessees as allowed for lessors to not recognize short term leases of up to 12 months, as defined in the Proposed ASU.

**Renewal options and Contingent Rent**

Our typical lease on real property, land and/or building, usually has a long initial term followed by several renewal options of normally 5 year periods. Because of the long initial or primary term, it is difficult at the inception of the lease to make a determination as to future renewals of the lease. Assumptions for renewals take into consideration many factors which are unknown upon the signing of a long term lease. Renewals will depend on the operating performance of the location, population shifts, real estate market conditions, interest rate environment, as well as overall economic conditions. These are all highly unpredictable at lease inception. Furthermore, lease renewals are highly influenced by future decisions to commit capital for improvements and renovations, which are also unknown and cannot be easily predicted at the start of a lease. Additionally, from a conceptual standpoint as to the definition of a liability, an argument can be made that lease renewals should only be included upon exercise when the lessee becomes obligated to make lease payments over the extended term. However, we also believe that if there is strong evidence that a lessee will exercise a lease extension prior to the start of the renewal period, that such extension should be recognized at that earlier
date and reflected as an increase in the lease liability. Therefore, we prefer a lease accounting model that provides the flexibility to reflect renewals when in the company’s judgment it is reasonably assured that future renewals will be exercised.

Certain of our leases may contain a provision to pay additional rent (contingent rent) if the sales volume exceeds a certain threshold as specified in the lease. Historically, such contingent rent has not been a significant item for us, and is not expected to be in the future. So based on materiality, as well as on a conceptual basis, similar to lease renewals discussed above, we do not believe that contingent rent as described here should be included in the determination of the lease obligation since payment of such rent is contingent on future events that have not yet occurred, that is sales in future periods above a predetermined threshold. Including a contingent rent assumption for contingent rent adds a great deal of complexity and the effort required would outweigh any benefit to be derived from its inclusion. We would agree, however, that for leases structured to provide the entire, or a significant portion of the lease payment based on a percentage of sales, that those leases should include a future rent stream assumption representing base rent in the measurement and recognition of the lease obligation and the right-of-use asset.

Scope
We are concerned that the Scope section of the Proposed ASU may be interpreted to cover a wider range of contracts and agreements that may contain certain lease like provisions, but, which under the existing GAAP rules do not qualify as leases. For example, retailers enter into licensing agreements with unrelated third parties that allow licensees to use store space to sell specified lines of merchandise in their stores in return for a licensing fee, which is generally included in the revenue line of the retailer’s statement of income. There has been an interpretation by some that such agreements may fall within the scope of the Proposed ASU. Therefore, the Scope section should be clarified to include guidance for the determination of a lease. Existing guidance under the current GAAP lease accounting rules would assure that no additional leases are contemplated by the proposed ASU.

Classification of Interest component of lease liability payments
The Proposed ASU requires entities to classify the total lease payment representing principal and interest arising from leases as financing activities in the statement of cash flows. We believe that this is inconsistent with the treatment of interest payments on other forms of debt which is included in the operating activities section. As stated above, we do not view lease debt as being different from other forms of debt as we manage our capital structure as if lease debt was on the balance sheet. As such, the interest component of a lease payment is equivalent to the interest component of other payments we make to service other long term debt instruments; accordingly, the classification of lease interest in a statement of cash flow should be consistent. Additionally, classifying lease interest in the financing section of a statement of cash flow which utilizes the indirect method for cash flow will lead to significant confusion for financial statement users due to, in effect, a gross up that will be required to remove the interest payments arising from leases, which are included in net income, from operating activities and reclassify them to financing activities. We believe it is more appropriate for interest
payments arising from the lease liability to remain in the operating activities section with a footnote disclosure quantifying the amount of interest related to leases. Alternatively, the classification of the lease payments in a statement of cash flows should be addressed in the financial statement presentation project, and not in the lease accounting model.

**Transition**
The Proposed ASU states that the date of initial application is the beginning of the first comparative period presented in the financial statements in the year in which the entity applies this guidance. For public companies such as ours, we are required to report two years of comparative statements of financial position, three years of income statements, and at least five years of selected historical financial statement data, including, but not limited to, total assets, property, plant & equipment, net and long term debt. The transition provisions should clarify the date of initial application as it relates to the required selected historical financial data included in companies’ annual reports on Form 10K.

**Executory costs and distinct service components**
A category of costs that are embedded in certain of our leases may not be separately identifiable and, therefore, inseparable from the lease payments are referred to as executory costs. These represent property taxes, common area expenses, insurance, etc. We view these costs as part of the stated lease payments and not as separate and distinct services that should be excluded from the lease liability. Furthermore, executory costs do not represent a material portion of our lease payments. We agree that if a lease contains service components, other than executory costs, that are designed to generate revenue or other income for the landlord, and that can be readily identified and quantified they should be accounted for separately from the lease payment obligation. To clarify this, the Proposed ASU should address executory costs and distinct services separately in the determination of the lease obligation.

**Landlord incentives/deferred credits**
The Proposed ASU does not address landlord incentives that may be provided to lessees at either lease inception, or in the future during the lease term. These incentives are most often paid to the lessee to cover a portion of capital improvements on the leased premises. Often times, as may be contained in the lease agreement, the landlord, or developer requires the approval of the lessee in order to make modifications to a shopping center. In this case allowances are paid to lessees in exchange for lessee’s consent. Under the current lease accounting model, landlord incentives are recorded as deferred credits on the balance sheet and are recognized in the statement of income as adjustments to rent expense over the remaining expected term of the lease. The Proposed ASU does not address landlord incentives, or how to transition the existing deferred landlord incentive balances that are carried on companies’ balance sheets. To ensure consistent treatment for all preparers of financial statements, the Board should address both the treatment of landlord incentives paid to lessees, as well as the transition of existing deferred credit balances. We would propose that lessees be allowed to adjust the right-of-use asset at the date of initial application by the amount of any deferred credits related to landlord incentives in the same way as the Proposed ASU suggests for the accounting for prepaid
and accrued lease payments that have arisen due to the recognition of straight line rent. With respect to landlord incentives paid to lessees, the accounting treatment should follow the nature of the incentive. If the incentive is provided as an offset to the cost of capital improvements incurred by the lessee, then such payments should be netted against capital expenditures, and if the incentive is provided, for example, to secure a lessee’s consent, then such payment should be recognized on a current basis in the statement of income.

The remainder of this letter is devoted to addressing specific questions contained in the Exposure Draft.

**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 lease embodies a right (asset), and at the same time creates an obligation (liability) that should be recognized in the financial statements by lessees. As stated earlier, we manage our capital structure as if real estate operating lease debt is on balance sheet.

(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. Just like in an ownership situation the asset is depreciated as it is being used in the operation, so should the right-of-use asset be amortized and the lease liability should bear interest in the same way as mortgage debt used to finance the purchase of real estate locations.

**Question 2: Lessors**
(a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?

We believe that a single approach to lessor accounting would not be appropriate. The economics of the lessors business model should determine whether the performance obligation or derecognition approach is used. We agree with FASB’s assessment that the performance obligation approach is appropriate when the entity’s business model is primarily to generate a return from the active management of the underlying assets either from leasing or from a sale at the end of the lease (i.e. retaining exposure to significant risks or benefits associated with the underlying asset). On the other hand if the lessor does not retain any meaningful risks, then in effect a sale has occurred and the derecognition approach is appropriate.
(b) Do you agree with the boards’ proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

Yes, we agree.

(c) Do you agree that there should be no separate approach for lessors with leveraged leases, as is currently provided for under US GAAP (paragraph BC15)? If not, why not? What approach should be applied to those leases and why?

Yes, we agree with FASB that there should be no separate approach for lessors with leveraged leases.

**Question 3: Short-term leases**

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?

No, we do not agree. At a minimum, lessees should be allowed to elect not to recognize leases with terms up to one year just as the Proposed ASU allows lessors to elect not to recognize short term leases. Our view of short term leases—these leases relate to equipment leases and not to real estate properties—is that leases that do not relate to the core business of the enterprise and that have terms less than five years should be excluded from the new lease standard. We believe for our business and the retail industry as a whole the new lease accounting model should apply to real estate leases which represent the core of the leasing activity and which are longer term leases that have a more material impact on an entity’s ongoing business of selling merchandise in store locations. Generally, short term leases with terms of up to five years do not result in a material impact on the statement of income or balance sheet. However, if short term leases are a material source of financing to carry on a company’s business, such as airlines leasing aircrafts, then such leases would have a significant impact on the balance sheet, as well as the statement of income and should be treated as any other longer term lease under the new lease accounting standard. For Companies like ours, short term leases do not represent a significant activity, and therefore do not have a material impact on the balance sheet or the statement of income. When short term leasing, individually or in the aggregate, does not represent a material activity (not part of the core business activity), the cost of determining the liability, tracking the amortization, etc. would outweigh any benefits to be derived from their inclusion in the Proposed ASU. Excluding non-core short term equipment leases would have an added benefit by lessening the lease administrative burden.

**Question 4: Definition of a lease**

(a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
As we noted above, we believe that the aim of the FASB should be that the scope of the proposed new lease standard should be based on the scope of existing guidance. However, we believe that the FASB’s definition of a lease as stated in the Scope section of the Proposed ASU is too broad and could lead to contracts not considered leases under existing guidance being classified as leases if the exposure draft as written now were adopted. One example where there is the potential for confusion relates to licensed departments, such as a photography studio or an optical center that retailers including JCPenney license to others to operate. The licensee operates the department on behalf of JCPenney under the JCPenney brand name and receives a fee for their services. Under current accounting guidance the contracts for these license departments would not be considered a lease. We are concerned that the contracts for these licensed departments could be classified as a lease under the Proposed ASU. We would like to see the FASB reaffirm that anything that is not a lease under existing guidance will not be a lease under the new lease standard.

(b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?

Yes, we agree with the criteria for distinguishing a lease from a contract that represents a purchase or sale under the new lease standard. If the substance of a contract is to confer ownership as viewed from a risks and rewards standpoint, then such transaction should not be considered a lease but rather a sale.

(c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

Yes we believe the guidance in B1-B4 is adequate to distinguish leases from service contracts. However, we are concerned, as stated in the response to Q4(a), that the Scope section of the Proposed ASU may be interpreted to cover a wider range of contracts and agreements that may contain certain lease like provisions, but, which under the existing GAAP rules, do not qualify as a lease. For example, as described above, retailers entering into licensing agreements with unrelated third parties to sell specified lines of merchandise in their stores in return for a licensing fee Therefore, the Scope section should be clarified to include more specific guidance, such as contained in B1-B4, in the determination of a lease. Existing guidance would assure that no additional leases are contemplated by the Proposed ASU.

**Question 5: Scope exclusions**

This exposure draft proposes that a lessee or a lessor should apply the proposed guidance to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).

Do you agree with the proposed scope of the proposed guidance? Why or why not? If not, what alternative scope would you propose and why?
We believe that all leases including subleases should be included within the scope of the Proposed ASU if the leases are associated with the primary or core activity of the ongoing business. For a retailer like us, the Proposed ASU should apply to real estate leases that represent a material impact on our statement of income and statement of financial position. Equipment leases for us are considered non-core to our business and should be excluded for the Proposed ASU. However, if an enterprise’s primary business activity utilizes equipment leasing, such as airlines leasing aircrafts, then equipment leasing in such instances should be included in the Proposed ASU.

**Question 6: Contracts that contain service components and lease components**

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?

In cases where there is a distinct service component and the service component has a profit margin then we agree that it should be accounted for separately from the lease. However, a category of costs that may be embedded in certain of our leases are referred to as executory costs. These represent property taxes, common area costs, insurance, etc. We view these costs as part of the stated lease payments and not as separate and distinct services that should be excluded from the lease liability. Further, these elements are not a material portion of our lease payments and cannot be easily estimated with any degree of accuracy. Additionally, as with contingent rent, the calculation of executory costs would be difficult and cumbersome and would not be justifiable from a cost/benefit perspective. To clarify this, the Proposed ASU should address executory costs and distinct services separately in the determination of the lease obligation.

**Question 7: Purchase options**

Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

Yes, we agree that purchase options should not be included in the measurement of assets and liabilities arising from a lease. Whether a purchase option is exercised or not represents a future decision which will be based on facts and circumstances that are not known at lease inception.

**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 with using the longest possible lease term at inception of a lease. As pointed out above, the lease term is subject to significant uncertainties and facts and circumstances in the future that are not known at lease inception. We prefer a model that
provides more flexibility to determine inclusion of renewals based on a Company’s judgment regarding whether or not it is reasonably assured that future renewals will be exercised. Our typical lease on real property, land and/or building, usually has a long initial term, 20 years or longer, followed by several renewal options of normally 5 year periods. Because of the long initial or primary term, it is difficult at the inception of the lease to make a determination as to the probability of occurrence of each future lease renewal period. Assumptions for renewals take into consideration many factors which are unknown upon the signing of a long term lease. Renewals will depend on the operating performance of the location, population shifts, real estate market conditions, interest rate environment, as well as overall economic conditions. These are all highly unpredictable at lease inception. Furthermore, lease renewals are highly influenced by future decisions to commit capital for improvements and renovations, which are also unknown and cannot be easily predicted at the start of a lease. Additionally, from a conceptual standpoint as to the definition of a liability, an argument can be made that lease renewals should only be included upon exercise when the lessee becomes obligated to make lease payments over the extended term.

**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 believe that contingent rent as described here should be included in the determination of the lease obligation since payment of such rent is contingent on future events that have not yet occurred, that is sales in future periods above a predetermined threshold. Including a contingent rent assumption for contingent rent adds a great deal of complexity and the effort required would outweigh any benefit to be derived from its inclusion. Additionally, one of the main concerns of preparers of financial statements with the lease accounting model contained in the Proposed ASU is the potential for significant volatility in reported earnings resulting from adjustments to assumptions relating to contingent rent, and lease term. While best estimates can be made using past information and expected outcomes, these estimates will always be just that, “best estimates,” which will carry an extremely high probability that adjustments in the future will be required. The nature of these adjustments, in our case, will stem from projections made far into the future because of the long term nature of our leases. This is true for the retail industry as a whole. As a result adjustments will occur, and to the extent such adjustments relate to prior periods, such portion of the adjustment would be recognized immediately through the statement of income resulting in earnings volatility. We would ask the Board to consider that adjustments based on actual, and more current information relating to contingent rent and lease term assumptions be reflected on a prospective basis.
in the right-to-use asset and the lease obligation. We would agree, however, that for leases structured to provide the entire, or a significant portion of the, lease payment based on a percentage of sales, that those leases should include a future rent stream assumption representing base rent in the measurement and recognition of the lease obligation and the right-of-use asset.

**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 and lessors should re-measure assets and liabilities arising under a significant change, and such re-measurement should be reflected in the right-of-use asset and lease liability.

**Question 11: Sale and leaseback**
Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

Yes, we agree with the criteria for classification as a sale and leaseback transaction.

**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 agree with the Proposed ASU that a lessee liability to make lease payments is a unique class of liability given that it is linked to a corresponding right-of-use asset. Therefore, they should both be presented separately from other assets and liabilities in the statement of financial position.

(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totaling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
We agree with the FASB’s assessment that this presentation approach reflects the interdependency of the underlying asset, the right to receive lease payments and the lease liability while acknowledging that netting would not be appropriate. This presentation also continues to reflect the lessor as owner of the leased asset and alleviates concerns about overstating both total assets and total liabilities.

(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

Given that the residual asset has a risk profile and measurement approach that is different from other property, plant and equipment, we agree with the FASB that it should be presented separately within property, plant and equipment. We also agree with the FASB that the separate presentation of the right to receive lease payments from other financial assets does provide more useful information to the users of financial statements given that the nature of these assets and cash flows differs from other financial assets.

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

Yes, this is consistent with the presentation requirements for lessees and lessors.

**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?

We do not believe separate line items are required in a statement of income. Footnote disclosure of this information adequately informs the users of the financial statements about the expenses that relate to leases without complicating the income statement.

**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?

No, we believe that a footnote disclosure of this information would adequately inform the users of the financial statements about the cash repayments of amounts borrowed and the interest payments arising from leases without complicating the statement of cash flows. In addition, the Proposed ASU requires entities to classify the total lease payment
representing principal and interest arising from leases as financing activities in the statement of cash flows. We believe that this is inconsistent with the treatment of interest payments on other forms of debt which is included in the operating activities section. As stated above, we do not view real estate lease debt as being different from other forms of debt as we manage our capital structure as if real estate lease debt was on the balance sheet. As such, the interest component of a lease payment is equivalent to the interest component of other payments we make to service other long term debt instruments; accordingly, the classification of lease interest in a statement of cash flow should be consistent. Additionally, classifying lease interest in the financing section of a statement of cash flow which utilizes the indirect method for cash flow will lead to significant confusion for financial statement users due to, in effect, a gross up that will be required to remove the interest payments arising from leases, which are included in net income, from operating activities and reclassify them to financing activities. We believe it is more appropriate for interest payments arising from the lease liability to remain in the operating activities section with a footnote disclosure quantifying the amount of interest related to real estate lease debt.

**Question 15: Disclosure**
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?

We applaud the Board’s decision not to require disclosure of the fair value of lease liabilities given the obvious complexities involved and limited usefulness to the users of the financial statements. Otherwise, we agree with the FASB’s proposed disclosure requirements for lessees and lessors.

**Question 16: Transition**
(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 agree with the FASB that using the simplified retrospective approach is the most cost effective and appropriate way to measure outstanding leases

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

Yes, but it should not be required.
(c) Are there any additional transitional issues the Boards’ need to consider? If yes, which ones and why?

The Proposed ASU states that the date of initial application is the beginning of the first comparative period presented in the first financial statements in which the entity applies this guidance. For public companies such as ours, we are required to report two years of comparative balance sheets and three years of comparative statement of income information, and at least five years of selected historical financial statement data, including, but not limited to, total assets, property & equipment, net and long term debt. The transition provisions should clarify the date of initial application as it relates to the required selected historical financial data included in companies’ annual reports on Form 10K, as we believe that any historical information derived from financial statements should be stated on a consistent basis.

**Question 17: Benefits and costs**

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?

In general, we believe that the benefits of the Proposed ASU outweigh the costs. However, as noted above, the proposed requirements relating to contingent rent, lease term, and short term leases not related to an entities core business add extreme complexity and administrative burdens which from a cost benefit standpoint cannot be easily justified. The lease accounting model should focus on an enterprise’s leasing activity that drives its core business. Doing so minimizes the administrative burdens and reduces costs without limiting the FASB’s goal of recognizing operating leases in enterprises’ financial statements.

**Question 18: Other comments**

Do you have any other comments on the proposals?

The Proposed ASU does not address landlord incentives that may be provided to lessees at either lease inception, or in the future during the lease term. These incentives are most often paid to the lessee to cover a portion of capital improvements on the leased premises. Often times, as may be contained in the lease agreement, the landlord, or developer requires the approval of the lessee in order to make modifications to a shopping center. In this case allowances are paid to lessees in exchange for lessee’s consent. Under the current lease accounting model, landlord incentives are recorded as deferred credits on the balance sheet and are recognized in the statement of income as adjustments to rent expense over the remaining expected term of the lease. The Proposed ASU does not address landlord incentives, or how to transition the existing deferred incentive balances that are carried on companies’ balance sheets. To ensure consistent treatment for all preparers of financial statements, the Board should address both the treatment of landlord incentives paid to lessees, as well as the transition of existing deferred credit balances. We would propose that lessees be allowed to adjust the right-of-use asset at the date of initial application by the amount of any deferred credits related to landlord incentives in
the same way the ASU proposes to account for prepaid and accrued lease payments that have arisen due to the recognition of straight line rent. With respect to landlord incentives paid to lessees, the accounting treatment should follow the nature of the incentive. If the incentive is provided as an offset of the cost of capital improvements incurred by the lessee, then such payments should be netted against capital expenditures, and if the incentive is provided, for example, to secure a lessee’s consent, then such payment should be recognized on a current basis in the statement of income.

**Question 19: Non-public entities**
Should any of the proposed guidance be different for non-public entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

No, this would limit comparability and effectively set up two different GAAP’s.

Thank you for the opportunity to present our views on this important area of accounting. We would be pleased to further discuss our opinions with you if you desire.

Very truly yours,

Dennis P Miller
Senior Vice President and Controller
JC Penney Company, Inc.

6501 Legacy Drive
MS 1311
Plano TX 75024
972-431-2041