October 24, 2003

T A & I Director - File Reference No. 1025-200
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116

Dear T A & I Director,

We appreciate the opportunity to provide our comments to the Financial Accounting Standards Board on Exposure Draft No. 1025-200 issued September 12, 2003, “Employers’ Disclosures about Pensions and Other Postretirement Benefits.” The J.C. Penney Company has always taken its fiduciary responsibility to effectively manage pension plan assets to provide financial protection to individual pension plan participants very seriously, while at the same time being cost-effective to the Company. Since the inception of the Company’s defined benefit pension plan in 1966, the Company’s policy has been to maintain a well-funded plan throughout all business and economic cycles, targeting a funded ratio in the range of 110% to 130%, calculated as a percentage of the actuarial funding liabilities under ERISA. This targeted funded ratio also translates into a healthy funded status on an accounting basis. At year-end 2002, a Wilshire Associates study reported that 11 percent of the S&P 500 companies had pension assets that exceeded the projected benefit obligation. The study also reported that the median corporate funded ratio was 78% in 2002, down from 93% in 2001. The Company’s ratio of assets to the projected benefit obligation was 102% in 2002 and 112% in 2001.

The Company manages pension assets and liabilities from a cash funding perspective and makes cash contributions to the plan not only to meet ERISA cash funding requirements, but also discretionary contributions to maintain targeted funding levels. This was the case in both 2002 and again in 2003 as the Company made a cash contribution of $300 million in each year. From a historical perspective, of the approximate $5 billion total plan value since inception, defined as $2.1 billion in cumulative benefit payments to retired associates plus $2.9 billion in plan assets at year-end 2002, the Company has provided about 13% through Company contributions while the capital markets provided the remaining 87%. The Company’s goal is to maintain its portion of the plan’s total value, to a level of 20% or less, primarily through its funding policy and asset mix strategy. Targeting the Company’s portion of the pension plan’s total value at this level is important since cash contributions to the plan utilize capital resources from investors and have an associated cost of capital.

Our goal is to maintain a leadership position in financial reporting practices, and we always strive to improve the clarity and transparency of our financial reporting. In the Company’s 2002 Annual Report, we included several voluntary disclosures relating to pension accounting and funding, including asset mix, targeted and actual funded ratios, a discussion of the ERISA funding liability, investment strategies and policies, as well as sensitivity information about changes in certain assumptions. Please refer to the attached 2002 Annual Report discussion and disclosures of pension plan information. In general, we agree that pension disclosures should be improved but we believe the most significant issue is the underlying accounting. We also believe that disclosures required by current accounting rules do not provide adequate information to readers of financial statements about the economic and financial effects of management decisions that affect the funded status of defined benefit pension plans. However, we would caution the FASB that requiring significantly more and expanded disclosures may lead to “disclosure overload,” which would add to the existing confusion and lack of understandability about the accounting for defined benefit pension plans, as well as add to the cost to gather the required disclosures and then incorporate
them into the Company’s filings. We would urge the Board to identify a few key, straightforward disclosures that drive the financial, economic, and accounting impacts of pension plans.

We also believe that pension disclosures should become more standardized to improve comparability and should clearly identify the effect that pension plans and other postretirement benefit plans have on companies’ results from both a trend and competitive standpoint.

**Current Pension Accounting Model**

It is the Company’s position that focusing solely on disclosures will not remedy the shortcomings of the current model underlying pension accounting. The current model under FAS 87 has not materially changed since that accounting standard was first issued in 1985. Since that time there have been significant changes - pension plan demographic changes and severe economic changes affecting the interest rate environment and the capital markets. For example, the accounting model has not reflected the “maturing” nature of pension plans. The model still operates in a manner that reflects “immature” plans. Yet the reality is that for the majority of the more significant pension plans in the U.S. the benefit accrual phase, which is more critical for “immature” plans, is no longer the focus. Rather the focus today is on the benefit payment phase. For example, much of the volatility experienced today by pension plans is due to the amortization of unrecognized losses. For mature plans, the majority of these losses relate to the retired population and the assets supporting their benefits, yet the amortization period is still based on the average remaining service period of active employees. The guidance in FAS 87 does not allow a different amortization period when the majority of the plan (measured in both assets and liabilities) constitutes retired employees. It is our understanding that the proportions have to reach 90% or more before a change can be made to coincide the amortization period to be more in line with an “average remaining life expectancy” period. For the JCPenney qualified defined benefit pension plan approximately two-thirds of the liability is attributable to retired, or terminated vested, employees. The average remaining life expectancy for this group is 21 years, considerably higher than the average remaining service of 8 years for active employees. But, in accordance with FAS 87, the unrecognized loss which relates predominantly to retired employees is being amortized over the shorter period of average remaining service.

Another example of the accounting model not reflecting the effects of a more mature plan is in the accounting for pre-paid pension assets. For pension plans that have accumulated substantial assets over the years, it is likely that they have also accumulated large pre-paid pension asset values. The current pension accounting model allows for return on assets to reduce annual pension expense based on the assumed rate of return. In periods when the capital markets are performing well, pension credits have the effect of creating, or adding to, the prepaid pension asset that is carried on the sponsor’s balance sheet. In times of severe market declines when the asset values fall and approximate, or even fall below, pension liabilities, sponsors are allowed to carry prepaid pension assets with no ability to perform asset impairment type analysis that is routinely done with other assets carried on the balance sheet. No judgment can be applied as to whether the decline in asset values is something other than temporary, thereby requiring an adjustment. The mechanism for an adjustment available under FAS 87, one that is not widely understood and has caused perhaps the most confusion over the past two to three years, is the “minimum liability” adjustment that is included as part of “comprehensive income.” As we discussed in the 2002 JCPenney Annual Report, the Company carried $1.1 billion in a prepaid pension asset account at the end of fiscal year 2002. Pension assets exceeded the projected benefit obligation by only $53 million, but also exceeded the accumulated benefit obligation, and therefore, no “minimum liability” adjustment was necessary. As a result, the Company was able to carry on its balance sheet $1.1 billion prepaid pension not supported by excess pension assets of an equal amount. Instead the Company ended
2002 with an unrecognized loss of over $1 billion, the character of which was indicative of an “other than temporary” decline in asset values that would not be recovered in the foreseeable future.

Related to the prepaid pension asset, the pension footnote in the 2002 Annual Report points out that this prepaid pension asset was the result of the Company’s cash funding since inception of the plan in 1966. Over 36 years, to the end of 2002, the Company made pre-tax cash contributions to the pension plan of $1.1 billion, but the accounting expense recorded through the income statement over the same period of time actually amounted to a small credit. In effect, the Company used capital resources of over $1 billion with no associated cost reflected through the income statement. Instead, it carried a prepaid asset on its balance sheet that in reality represented a deferral of pension cost to future years, but for which the economic cost had already been felt by stockholders. These results, in our opinion, did not reflect the financial and economic impacts of the Company’s pension funding decisions and strategies from 1966 to 2002.

Another area of focus in pension accounting should be the use of market related calculations, so called “smoothing,” to reflect the accounting value of pension plan assets. Among other impacts of allowing this method, the “smoothing” mechanism has delayed the full recognition of asset value declines (amortization of asset value declines) in periods of declining capital markets, such as experienced over the last several years. This in turn has led to further reductions in pension expense due to applying the asset return assumption on the higher, “smoothed” value of pension assets. In effect, an asset return is calculated on assets that do not exist. While FAS 87 discourages this practice as not being a preferred method, nevertheless, a majority of U. S. pension plans use this accounting methodology. J.C. Penney not included.

Generally, the accounting for plan assets under FASB 87 present special issues because of their treatment as sponsor “owned” assets. Changes in those assets, whether market related, or contributed by the sponsor, are effectively recognized in the financial statements of the sponsor. Capital market returns decrease pension expense on the sponsor’s income statement and increase prepaid pension assets on the balance sheet, while cash contributions decrease the cash balance but increase the prepaid pension asset on the sponsor’s balance sheet. Government rules and regulations over qualified pension plans have evolved to a point where pension assets are protected and not easily in the reach of the sponsor, even in a case where a plan has excess assets. Pension plan regulations are very sensitive to ensuring that pension liabilities can be funded, so that pension plan assets are viewed as being owned by the plan and its participants and out of the control of the plan sponsor. As such, these assets should not be reflected on the balance sheets of plan sponsors. There is a built in ERISA mechanism, through minimum funding requirements, that when asset values fall below certain pre-established thresholds as compared with pension liabilities, a sponsor is required to make contributions to the plan and that should drive the timing of pension accounting.

A New Model

In our opinion, the pension accounting model for qualified defined benefit pension plans requires a complete overhaul to one that better reflects the current state of pension benefit plans including such factors as “mature” plans, increased regulatory controls, no major new defined benefit plans being adopted, and existing plans being curtailed and converted to other benefit delivery mechanisms, such as cash balance plans and 401(k) savings plans. We believe a model based more on the accounting for the economic consequences of funding strategies and decisions made by management should be considered. Focusing solely on disclosures will not remedy the shortcomings of the current accounting model, which differentiates specifically the accounting from the funding of defined benefit pension plans. We find it difficult to separate the accounting from the funding that utilizes investors’ capital resources and has an associated cost of capital. We
believe that the accounting model for defined benefit pension plans is broken and needs to be fixed. The fix should be to align the pension accounting model more closely to the cash funding of such plans. This would thereby align the accounting with the true cash flow economics and corporate finance characteristics of pension plan management.

A model that is closely tied to funding, or a cash based model, would have significant advantages over the current accrual based model. It would eliminate the confusion about funding versus accounting that exists even among the more sophisticated readers of financial statements and management of an enterprise. A model that is focused on cash contributions being reflected in a company's income statement allocated over a period of time that perhaps matches the duration of pension liabilities at the time of the contribution would be far more reflective of the economic consequences of financial resources provided to a pension plan, and is supported by FASB Statement of Financial Accounting Concept No. 1 Objectives of Financial Reporting, which states in paragraph 37. "... Thus financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise." Further, a cash based approach more directly supports the ultimate objective, over the long term horizon of a pension plan, of expensing through the income statement total cash contributed by the enterprise.

Today, more than ever, a cash based approach is more consistent with the manner in which defined pension plans are managed. Management is far more focused on pension funding due to increased requirements imposed by regulatory bodies in compliance with federal rules and regulations regarding minimum funding requirements and pension benefit guarantees. Regulatory requirements are designed to provide increased security to pension plan participants, while at the same time, holding management more accountable for promised retirement benefits. By mandating regulatory contribution requirements, a company's pension obligation is managed almost exclusively on the basis of cash funding requirements. Failure to fund can, in extreme cases, result in federal takeover of pension plans and subsequent forced sales of company assets to provide required funding. Accordingly, pension funding decisions should ultimately drive the measurement and recognition of pension related information in a company's financial statements.

Approaching pension accounting from a funding standpoint would simplify disclosures significantly by focusing on cash resources, either contributed to pension plans, or to be contributed in the future, if asset returns are not achieved as assumed or interest rates change. It would give investors and financial analysts more useful and relevant cash flow information that would allow them to more readily assess future cash flow risk.

The remainder of this letter covers our comments on the issues presented in the Exposure Draft.

Plan Assets

Issue 1: The following information would be required to be presented for each major asset category (The broadest categories of assets for which this information would be required are equity securities, debt securities, real estate, and all other assets):

- Percentage of the fair value of total plan assets as of the date of each statement of financial position presented.
- Target allocation percentage or range of percentages, presented on a weighted-average basis
- Expected long-term rate of return, presented on a weighted-average basis
- Range and weighted average of the contractual maturities, or term, of all debt securities.
JCPenney Comment on Issue 1: In the J.C. Penney Company 2002 Annual Report, we disclosed the target allocation percentage and agree that is useful information to give the users of the financial statement some insight into management's investment strategy. We do not disagree with providing the percentage of the fair value of total plan assets as of the date of each statement of financial position presented as long as it is made clear to the reader that it is as of a point in time and asset percentages may fluctuate with the changes in market values. Also, in our case, the measurement date differs from the date of the financial statements, so that would also need to be made clear to the users of the financial statements.

Regarding disclosing the expected long-term rate of return for each major category of assets, our concern is that our company, and many other companies, uses outside investment advisors to model various portfolio scenarios and conduct research on various investment fund managers and their overall performance. We may have to request permission from the outside advisors to publish those expected rates of return. Additionally, we would be concerned that such a disclosure might imply more knowledge on the part of management than might be appropriate. Also, we have a concern that the disclosure of target asset allocation and of expected long-term rate of return by asset category would be of limited value. Each category of assets could have very different expected rates of return, but are designed to achieve an optimum overall return given certain risk tolerances and weightings to the total portfolio. The key is the expected versus actual return on the whole asset portfolio that will be available to fund the pension plan and to pay retirement benefits, so we believe that one blended expected rate of return gives users the information they need to assess a company's ability to meet its obligations to pension plan participants. A key point is to understand that pension assets exist for the sole purpose of defeasing pension liabilities. For example, as we disclosed in our 2002 Annual Report, the Company's ERISA actuarial funding liability at year-end 2002 was characterized by approximately 3% annual growth. Cash benefits paid to retirees were about 6% of plan assets in 2002. This necessitates an annual return on assets of 9% just to meet these obligations. We think it is critical, and should be required, for all companies to disclose their asset management strategy to mitigate the related pension obligation and discuss the sustainable level of cash contributions required to make payments to retirees and fund increases in the pension obligation.

Disclosing the range and weighted average contractual maturities, or term, of all debt securities only makes sense if a company has an immunized portfolio where the cash flows of the debt securities align directly with the benefit payments. In cases such as ours, where the majority of the assets are equity securities with a longer-term horizon, there is not a direct correlation between the maturities of the securities and the timing of the benefit payments. The usefulness of this information in circumstances where there is not a direct correlation of asset maturities to the duration of the related benefit obligations is limited and, in our opinion, not worth the cost and difficulty to obtain. Debt securities are in portfolios to diversify risk (i.e., volatility of return), and not to defease liabilities, recognizing that equity investment returns will exceed debt returns in the long run, given equity risk premiums required to attract equity investors.

We included a discussion of investment strategies and policies in the J.C. Penney 2002 Annual Report and believe that this information would be helpful to users of financial statements and is related to one of the proposed disclosures to include the targeted allocation percentage of each major category of plan assets.

We expected the FASB to make some changes with respect to the market-related value of pension plan assets. Among the concerns raised was that delayed recognition methods permitted by Statement 87 often result in financial outcomes that do not represent economic reality. Additionally, the current accounting rules permit too much disparity between companies with respect to what level of market fluctuation is included in the market-related value of plan assets. Under SFAS 87, the market-related value of plan assets shall be either fair value or a calculated
value that recognizes changes in fair value in a systematic and rational manner over not more than five years. Par. 120 of SFAS 87 states that, "The Board understands that measuring investments at fair value could introduce volatility into the financial statements as a result of short-term changes in fair values." Par. 121 states that, "The Board concluded that the difference between the actual return on assets and the expected return on assets could be recognized in net periodic pension cost on a delayed basis. Those effects include the gains and losses themselves. That conclusion was based on (a) the probability that at least some gains would be offset by subsequent losses and vice versa and (b) respondents’ arguments that immediate recognition would produce unacceptable volatility..." We believe that, in order to allow for comparability among companies, the FASB should either require all companies to use fair value of assets to determine the expected return on plan assets or should prescribe a certain methodology for smoothing the fluctuations in assets values over a certain time period given the long-term nature of pension plans. If no changes are made, at a minimum, companies should be required to disclose the methodology used to determine the market-related value of plan assets and the market-related value itself.

**Defined Benefit Pension Plan Accumulated Benefit Obligation**

**Issue 2:** The proposed Statement would require disclosure of the defined benefit pension plan’s accumulated benefit obligation.

**JCPenney Comment on Issue 2:** We agree that the accumulated benefit obligation should be a required disclosure as it is used in the calculation of whether a company has a potential minimum liability adjustment (MLA) or what the exposure to a MLA might be. We believe that it would be helpful to users of financial statements to see a disclosure of a company’s accumulated benefit obligation and be able to compare that to the fair value of plan assets. But of greater importance, we believe that all companies should be required to disclose the ERISA funding liabilities. This information would provide greater insight into potential future funding requirements, as these are the liabilities used to determine actual cash contribution requirements.

**Cash Flow Information**

**Issue 3:** The proposed Statement would require disclosure of:

a. A schedule of estimated future benefit payments included in the determination of the projected benefit obligation, as of the date of the latest statement of financial position presented, for each of the five succeeding fiscal years, and the total amount thereafter, with separate deduction from the total for the amount representing interest necessary to reduce the estimated future payments to present value.

b. The employer’s contributions expected to be paid to the plan during the next fiscal year beginning after the date of the latest statement of financial position, showing separately:
   1) Contributions required by funding regulations or laws
   2) Additional discretionary contributions
   3) The aggregate amount and description of any noncash contributions.

**JCPenney Comment on Issue 3a:** We do not believe that the proposed disclosure will accomplish the Board’s objectives, and therefore, should not be required. While we appreciate the intent of providing users of financial statements information regarding expected demands on cash resources of companies over time, the proposed disclosure does not represent the true cash flows of a defined benefit pension plan. In fact, the proposed disclosure would underestimate the ultimate cash flows of pension plans over time as the cash flows that are taken into consideration do not include future service accruals nor accruals for new entrants to the pension plan. Additionally, the proposed disclosure of the PBO and ABO benefit payments for the next five years and then a single total for
years after that will not allow users of the financial statements to assess the sensitivity of the plan's liabilities to changes in the discount rate as five years is too short for this purpose. Thus, companies will find this to be an added compliance expense that provides little useful information.

**JCPenney Comment on Issue 3b:** Required contributions - yes; discretionary contributions - no. We agree that any contributions that will be required by regulations or laws should be disclosed so that users of financial statements are aware of upcoming cash obligations of the company. With respect to discretionary contributions, those are subject to change and constant follow-up disclosure would be required to explain any changes. So, we would prefer that the disclosure of discretionary contributions be voluntary. In our case, there are many factors that are considered when making a decision about discretionary pension plan contributions, including principally the current and expected funded position of the plan as well as the projected cash flow position of the Company. Any pension plan contribution must be approved by the Company's Human Resources Committee and reviewed with the Board of Directors. Such approval typically occurs in the September/October timeframe, which is several months after the Annual Report would have been issued for the previous year. If such a disclosure were required, we would include the factors mentioned above that are considered in making the decision of what amount may be contributed to the pension plan, and would state that the expected amount is subject to change.

**Assumptions**

**Issue 4:** The proposed statement would require use of a tabular format for disclosure of the following key assumptions (separately identifying the assumptions used to measure benefit obligations as of the plan's measurement date and those used to measure net benefit cost or income for the period): the assumed discount rates, rates of compensation increase, and expected long-term rates of return on plan assets. Those disclosures would be reported on a weighted-average basis.

**JCPenney Comment on Issue 4:** We agree with the proposed disclosures of the assumptions used to develop net benefit cost for the period, in addition to those used to determine end-of-period obligations. We believe that the proposed disclosures would help clarify, especially in environments where companies are changing their assumptions, which assumptions were used to develop the current year's net periodic pension cost/(income), and will be used to calculate the end-of-period pension obligations and develop the following year's net periodic pension cost/(income).

**Sensitivity Information about Changes in Certain Assumptions**

**Issue 6:** The Board considered, but did not include in this proposed Statement, a requirement to disclose sensitivity information about the impact on net periodic benefit cost and the benefit obligation of a hypothetical change in certain assumptions, such as the expected long-term rate of return on assets, discount rates, and rate of compensation increase, while holding the other assumptions constant.

**JCPenney Comment on Issue 6:** J.C. Penney's 2002 Annual Report included disclosures of the sensitivity of the pension expense, and resulting earnings per share impact, to a plus or minus one-half of one percent change of both the expected long-term rate of return on assets and the discount rate. While we agree with the comments in the exposure draft that economic condition and changes therein often affect multiple assumptions, we believe that it is important to point out to the users of our financial statements just how sensitive the pension expense is to what may seem like a fairly small change in either the expected long-term rate of return or the discount rate. It also highlights the importance of understanding the long-term nature of pension plans versus a snapshot of the asset values and projected benefit obligation at a point-in-time. So in our opinion, at least some basic sensitivity information should be required to be disclosed in companies' annual filings.
Measurement Date(s)

Issue 7: The proposed Statement generally would not require disclosure of the measurement date(s) used to determine pension and other postretirement benefit measurements when different from the fiscal year-end date. Disclosure of the measurement date(s) would be required when an economic event occurs, or economic conditions change, after the measurement date(s) but before the fiscal year-end, and if those changes may have had a significant effect on plan assets, obligations, or net periodic cost, had the fiscal year-end date been used as the measurement date. The nature of the significant changes also would be described.

JCPenney Comment on Issue 7: In the J.C. Penney Company 2002 Annual Report, we disclosed our measurement date of October 31 in the table of assumptions in the retirement benefit plans footnote. Because our measurement date differs from our fiscal year-end of the last Saturday in January, we believe that this disclosure is helpful for users of the financial statement to understand when the point-in-time estimates are made of the fair value of plan assets and the present value of projected benefit obligations. Based on overall capital market conditions and economic events that may occur between the measurement date and the fiscal year-end, users of the financial statements may have expectations of the end-of-period balances relative to the prior year balances. Such expectations would be different, however, if users understand the date as of which the assets are valued and liabilities measured. The current exposure draft language appears too open-ended with respect to defining what events or circumstances would be considered “significant.” If a company is required to disclose the impact on pension assets and liabilities from changes in interest rates or asset returns from its measurement date to its fiscal year-end date, this would essentially eliminate the concept in SFAS No. 87 of having a measurement date that differs from the fiscal year-end date. This would be much more burdensome on companies to have to potentially remeasure their pension assets and liabilities as of two dates, the measurement date and the fiscal year-end date. Under the current rules, changes in equity markets and interest rates that occur between the measurement date and the fiscal year-end would not be reflected in the year-end balances. In addition, the consideration of whether an economic event or change is significant should not be based on the impact to individual components of the calculation, such as return on plan assets. It should be based on the net impact of any and all changes on the net periodic pension expense or income.

In our opinion, the Board should simply require the disclosure of the measurement date and should not require companies to evaluate post-measurement date economic changes for their significance. We believe that disclosure of the measurement date would provide users with better information since they would know the “as of” date of the information provided. Users could then evaluate for themselves whether they think the disclosure amounts should be adjusted for general economic conditions following the measurement date. The current SFAS No. 87 rules should be retained regarding the events that would require a remeasurement.

Reconciliations of Beginning and Ending Balances of Plan Assets and Benefit Obligations

Issue 8: The proposed Statement would eliminate the requirement in Statement 132 to provide reconciliations of beginning and ending balances of the fair value of plan assets and benefit obligations. The proposed Statement would instead require disclosure of ending balances and would retain key elements of the reconciliations that are not disclosed elsewhere, such as actual return on assets, benefit payments, employer contributions, and participant contributions.

JCPenney Comment on Issue 8: In our opinion, given that the proposed Statement retains most of the key components of the end-of-period reconciliations, it would be clearer for the user of the financial statements to continue to provide the reconciliations in the financial statement disclosures.
We believe that the current disclosure of the reconciliation of the changes in the projected benefit obligation, changes in fair value of plan assets, and funded status of the plan is fairly straightforward and provides the most transparent disclosure of the components and changes in the above-mentioned pension balances, and should therefore be retained.

**Disclosures in Interim Financial Reports**

**Issue 10:** The proposed Statement would require disclosure of the following information in interim financial statements that include a statement of income:

a. The amount of net periodic pension and other postretirement benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the amortization of the unrecognized transition obligation or transition asset, the amount of recognized gains and losses, the amount of prior service cost recognized, and the amount of gain or loss recognized due to a settlement or curtailment.

b. The employer’s contribution paid, or expected to be paid during the year, if significantly different from previous disclosures pursuant to paragraph 5(g) of this proposed Statement, showing separately (1) contributions required by funding regulations or laws, (2) additional discretionary contributions, and (3) the aggregate amount and description of any noncash contributions.

**JCPenney Comment on Issue 10a:** In our opinion, the proposed disclosure of the components of net periodic pension expense/(income) could be misleading as readers may assume that the information has been recalculated and updated, when in fact, it would just be an allocation of amounts calculated for the annual period. The only instance where we believe that an interim disclosure might be appropriate is if the annual pension expense/(income) has been re-estimated due to a re-measurement through a plan amendment, curtailment, or some other change. An appropriate technique for allocating the annual pension expense to a particular quarter may be complex and could vary from company to company, sacrificing comparability. Currently, when companies allocate their annual pension expense to each quarter, it is just done on a net basis, not by individual component. Individual components would be allocated in a similar manner and therefore not supportable on a stand-alone basis. The level of disclosure that might be necessary to explain interim allocations to users of financial statement could be excessive relative to any value or benefit that might be received by such users. Based on the above, we do not believe that interim period disclosures of the components of an annually calculated net pension plan expense or income would bring any more transparency to financial reporting and, therefore, should not be required.

**JCPenney Comment on Issue 10b:** We agree with the proposed disclosures of required contributions and noncash contributions to the plan. See comment 3b above regarding discretionary contributions.

**Effective Date and Transition**

**Issue 11:** The provisions of the proposed Statement would be effective for fiscal years ending after December 15, 2003. The interim-period disclosures in this proposed Statement would be effective for the first fiscal quarter of the year following initial application of the annual disclosure requirements. The disclosures for earlier annual periods presented for comparative purposes would be restated for (a) the percentages of each major category of plan assets held and (b) the accumulated benefit obligation. The disclosures for earlier interim periods presented for comparative purposes would be restated for the components of net benefit cost.
JCPenney Comment on Issue 11: While we appreciate the fact that users of financial statements are seeking additional information sooner, we are concerned that a year-end 2003 effective date will be problematic for many companies, particularly since a final standard has yet to be issued. We encourage the Board to delay the effective date to apply to fiscal years beginning after December 15, 2003, so that company actuaries can begin gathering the information in 2003 and be ready to provide comparable information in 2004. Otherwise, it will be more costly and require a much greater time commitment to have an effective date so soon plus be required to develop corresponding information for prior periods.

Other Comments

The exposure draft permits the aggregation of information for funded qualified defined benefit pension plans and non-qualified supplemental pension plans, which are normally unfunded. It states that disaggregating the disclosures should be considered if that provides useful information. The J.C. Penney Company provided disaggregated disclosures in its 2002 Annual Report for its retirement plans between the primary defined benefit plan that is funded, supplemental non-qualified defined benefit plans that are not funded, other post-retirement benefit plans, and defined contribution plans. We believe that disaggregating the disclosures provides much clearer information and provides the users of the financial statements more information about plan assets, obligations, cash flows, and the components of net benefit cost. In our opinion, separate disclosures should be required for funded defined benefit pension plans versus unfunded supplemental and non-qualified defined benefit pension plans.

We at the J.C. Penney Company appreciate the opportunity to express our views on this proposed Statement and would welcome any additional opportunities to discuss pension accounting and funding with the FASB Staff.

Respectfully,

Robert B. Cavanaugh
Executive Vice President and Chief Financial Officer
J.C. Penney Company, Inc.

Attachment: 2002 Annual Report Pension Disclosures
Cc:
Pension accounting — The fundamental components of pension accounting consist of the compensation cost of benefits promised, the interest cost from deferring the payment of those benefits and the results of investing assets to fund the pension benefit obligation. Pension benefits are earned by employees ratably over their service careers; therefore, the income statement effects of pension retirement benefits should follow the same pattern. Accordingly, changes in the pension obligation and the value of pension assets are recognized systematically and gradually as employees render service. Various assumptions are made in determining net periodic pension costs, including the discount rate used to measure the pension obligation and the expected long-term rate of return on pension assets. These assumptions require significant judgment, and the calculation of pension costs is relatively complex. The Company utilizes third parties, including actuarial and investment advisory firms, to help evaluate annually the appropriateness of the expected rate of return, the discount rate and other pension plan assumptions.

In accounting for pension costs, the Company uses fair value, which is the market value of the plan assets as of the annual measurement date, to determine the market-related value of plan assets, which is used in calculating the expected return on assets and gain/loss amortization components of net periodic pension expense. If the Company were to use a calculated value, such as a three or five-year moving average, to determine the market-related value of plan assets and recognize variances from expected results on a delayed basis, the amount of pension expense or income recognized could vary significantly from that recorded under the Company’s current methodology. This would have been especially true in 2002, given the significant decline in the global equity markets. The fair value approach, which is the Financial Accounting Standards Board’s (FASB’s) preferred methodology, required the Company to reflect the decline in the fair value of the plan’s assets in 2002. The 2002 and 2003 earnings impact is discussed below.

To develop its expected return on plan assets, the Company considers the mix of investments in the plan, historical actual returns and future estimates of long-term investment returns. The Company’s primary pension plan is well diversified with an asset allocation policy that provides for a 70%, 20% and 10% mix of equities (U.S., non-U.S. and private), fixed income (investment grade and high yield) and real estate (private and public), respectively. This allocation provides the pension plan with the appropriate balance of investment return and volatility risk, given the funded nature of the plan, its present and future liability characteristics and its long-term investment horizon. Since the inception of the Company’s primary pension plan in 1966, the average annual return has been 9.1%. However, over the past several years, the fair value of pension assets has declined as a result of the poor performance in the global equity markets. The pension surplus, defined as the excess of the fair value of plan assets over the projected benefit obligation, has declined from approximately $1.2 billion in 2000 to approximately $50 million in 2002. Over the past two years alone, the fair value of pension plan assets has declined by approximately $700 million. In 2001, related net periodic pension income contributed $76 million to pre-tax earnings. In contrast, pension expense of $24 million was incurred in 2002. Since inception, the Company’s primary pension plan has contributed cumulative pre-tax income of approximately $100 million. This is the result of cumulative pension expense during the 1966-1984 period of $366 million, cumulative pension income during the 1985-2001 period of $488 million, and pension expense in 2002 of $24 million. Given unfavorable returns over the past few years and lower expected future returns for 2003, the Company lowered the expected rate of return to 8.9% from 9.5% to reflect lower expected rates of return among all asset classes. Primarily as a result of asset performance,
JCPenney Company, Inc.  
2002 Pension Disclosures

the Company expects a significant increase in net pension costs, which will incrementally reduce earnings per share (EPS) by approximately $0.25 in 2003 compared to $0.20 in 2002. The sensitivity of the pension expense to a plus or minus one-half of one percent of expected return on assets is an increase or decrease in expense of approximately $0.03 per share.

In 2002, the Company lowered the discount rate used to measure the pension obligation from 7.25% to 7.10%, based on the yield to maturity of a representative portfolio of AA rated corporate bonds as of October 31, 2002, with similar average cash flow durations to the pension liability. This methodology is consistent with guidance in SFAS No. 87, "Employers' Accounting for Pensions," to use the rate currently available on high quality bonds and the subsequent guidance issued by the Securities and Exchange Commission that high quality bonds should be those with at least AA rating by a recognized rating agency. The sensitivity of the pension expense to a plus or minus one-half of one percent of the discount rate is an increase or decrease in expense of approximately $0.05 per share.

Pension funding — The Company's funding policy is to maintain a well funded pension plan throughout all business and economic cycles. Maintaining a well funded plan over time provides additional financial flexibility to the Company, including lower pension expense and reduced cash contributions, especially in the event of a decline in the capital markets. In addition, it ensures associates of the plan's and Company's financial ability to continue to provide competitive retirement benefits, which is the purpose of the pension plan, while at the same time being cost effective to the Company. The Company targets to maintain a funded ratio in the range of 110% to 130%, which is the plan's assets as a percent of the actuarial funding liability under the Employee Retirement Income Security Act of 1974 (ERISA).

At October 31, 2002, plan assets of $2.9 billion, which included the current year contribution of $300 million, were approximately 112% of the $2.6 billion ERISA funding liability. Since the pension assets exceeded the accumulated benefit obligation, the Company was not required to reflect a minimum liability adjustment, which would have been charged to equity under SFAS No. 87. At year-end 2001 and 2000, the funded ratio was 126% and 122%, respectively. The decline in the 2002 funded ratio resulted primarily from the declines in the global equity markets, partially offset by the Company's 2002 contribution to the plan mentioned above and further discussed on the following page. The plan's funded position and the Company's financial condition are the principal factors in determining cash contributions on an annual basis.

Since the plan's inception, the Company has contributed $1.1 billion, or approximately $650 million on an after tax basis to the pension plan. Over this time frame, actual investment return on plan assets has generated a significant portion of the $5 billion in pension plan total value, defined as $2.1 billion in cumulative benefit payments to retired associates plus $2.9 billion in plan assets at year-end 2002. In effect, the Company's cumulative cash contributions over this time frame represent 13% of the plan's total value (i.e., $650 million as a percent of $5 billion). The remainder of the plan's total value has been essentially generated by the actual investment returns since inception. The Company targets to maintain its portion of the pension plan's total value to a level of 20% or less, primarily through its funding policy and asset mix strategy. Targeting the Company's portion of the pension plan's total value at this level is important since cash contributions to the plan utilize capital resources from investors and have an associated cost of capital.

The Company made cash contributions to the primary plan annually during the 1966-1983 period in order to provide an asset base to support the accelerating liability growth in the early years of the
plan. Over the 1984-2002 period the Company made cash contributions to the plan in five years (1993-1996 and 2002), and no contributions in the other 14 years due to maintaining a well-funded plan and the actual investment return on plan assets.

The pension plan's ERISA actuarial funding liability at year-end 2002 was characterized by approximately 3% annual growth. Cash benefits paid to retirees were about 6% of plan assets in 2002. This resulted in a total annual liability requirement for the plan of about 9%. The composition of this annual liability requirement reflects the Company's associate demographics in terms of length of service, compensation and age. In contrast, during the 1966-1983 period, or the plan's early years, the liability characteristics of the plan reflected a higher annual liability growth rate and a lower cash benefit payment to retirees.

The pension plan's asset allocation strategy is designed to mitigate this annual liability requirement and result in a cost effective level of pension expense and cash contributions over time to the Company as discussed above. In effect, the plan's asset allocation strategy needs to produce an average return on assets of approximately 9% or higher in order to eliminate cash contributions to the plan on a sustainable long-term basis, given the plan's current annual liability requirement and funded position. This was the case during most of the 1984-2002 period as discussed above. In periods of significant capital market declines, such as 2001 and 2002, the plan's surplus is utilized first to mitigate the annual liability requirement, and then the Company's available cash resources are utilized to restore the plan's funded ratio to a targeted level. As discussed below, this was the case in 2002.

Even with the market declines in recent years, the Company's pension plan remains in an adequately funded position. Although no additional funding was required under ERISA, the Company made a discretionary contribution of $300 million, or $190 million after tax, to its pension plan in October 2002.

While the Company does not expect to be required to make a contribution in 2003 under ERISA, it may decide to do so depending principally on the current and expected funded position of the plan.
15 RETIREMENT BENEFIT PLANS

The Company provides retirement and other post-retirement benefits to substantially all employees (associates), except for associates hired or rehired on or after January 1, 2002 who are not eligible for retiree medical or dental coverage. These benefits are an important part of the Company's total compensation and benefits program designed to attract and retain qualified and talented associates. The Company's retiree benefit plans consist principally of a non-contributory pension plan, non-contributory supplemental retirement and deferred compensation plans for certain management associates, a contributory medical and dental plan, and a 401(k) and employee stock ownership plan. Total Company expense/(income) for all retirement-related benefit plans was $139 million, $34 million and $(35) million in 2002, 2001 and 2000, respectively. These plans are described in more detail below. See Management's Discussion and Analysis under Critical Accounting Policies on pages 5-7 for additional discussion of the Company's defined benefit pension plan and Note 1 on page 23 for the Company's accounting policies regarding retirement-related benefits.

Defined Benefit Pension Plans — Funded

The Company and certain of its subsidiaries provide associates who have completed at least 1,000 hours of service generally in a 12 consecutive month period and have attained age 21 with a non-contributory pension plan. The plan is funded by Company contributions to a trust fund, which is held for the sole benefit of participants and beneficiaries. Participants generally become 100% vested in the plan after five years of employment or at age 65. Pension benefits are calculated based on an associate's average final pay, an average of the social security wage base, and the associate's credited service (up to 35 years), as defined in the plan document. In 2001, the Company adopted an amendment to its pension to freeze benefits and participation for substantially all drugstore associates effective July 31, 2001. In its place, Eckerd adopted a new 401(k) plan which is discussed on page 35. The change in the pension plan was accounted for as a curtailment gain in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits." The reduction in the projected benefit obligation of approximately $11 million was recorded in Eckerd segment results for 2001 as a reduction of SG&A expenses.

The Company's funding policy is to maintain a well funded plan throughout all business and economic cycles. The primary pension plan is well diversified with an asset allocation policy that provides for a 70%, 20% and 10% mix of equities (U.S., non-U.S. and private), fixed income (investment grade and high yield) and real estate (private and public), respectively. Although no additional funding was required under ERISA, the Company made a voluntary contribution of $300 million, or $190 million after tax, to its pension plan in October 2002. The assets of the pension plan consist primarily of a balanced portfolio of equity and debt securities managed by third party investment managers.
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Supplemental Retirement Plans — Unfunded

The Company has unfunded supplemental retirement plans, which provide retirement benefits to certain management associates and other key employees. The primary plans are a Supplemental Retirement Plan and a Benefit Restoration Plan. Supplemental benefits are based on length of service and final average compensation. The Benefit Restoration Plan is intended to make up benefits that could not be paid by the qualified pension plan due to governmental limits on the amount of benefits and the level of pay considered in the calculation of benefits. The Supplemental Retirement Plan also offers participants who leave the Company between ages 60 and 62 benefits equal to the estimated social security benefits payable at age 62. Participation in this plan is limited to associates who were profit-sharing management associates at the end of 1995. Also included in the unfunded plans is a Voluntary Early Retirement Program, which was offered in 1997 to management associates who were at least age 55 with a minimum of 10 years of service and who elected to take early retirement. Several other smaller plans and agreements are also included.

Net periodic pension cost for the defined benefit plans follows:

<table>
<thead>
<tr>
<th>Pension Plans Expense/(Income)</th>
<th>2002</th>
<th>2001</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>($ in millions)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Service costs</td>
<td>$71</td>
<td>$82</td>
<td>$92</td>
</tr>
<tr>
<td>Interest costs</td>
<td>193</td>
<td>189</td>
<td>186</td>
</tr>
<tr>
<td>Projected return on assets</td>
<td>(283)</td>
<td>(348)</td>
<td>(354)</td>
</tr>
<tr>
<td>Net amortization</td>
<td>40</td>
<td>3</td>
<td>(19)</td>
</tr>
<tr>
<td>Curtailment gain</td>
<td>—</td>
<td>(11)</td>
<td>—</td>
</tr>
<tr>
<td>Net periodic pension</td>
<td>$21</td>
<td>$(85)</td>
<td>$(95)</td>
</tr>
</tbody>
</table>

Supplemental Plans Expense

<table>
<thead>
<tr>
<th>($ in millions)</th>
<th>2002</th>
<th>2001</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>($ in millions)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Service costs</td>
<td>$3</td>
<td>$3</td>
<td>$3</td>
</tr>
<tr>
<td>Interest costs</td>
<td>22</td>
<td>22</td>
<td>23</td>
</tr>
<tr>
<td>Projected return on assets</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Net amortization</td>
<td>9</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Net supplemental plans expense</td>
<td>$34</td>
<td>$30</td>
<td>32</td>
</tr>
</tbody>
</table>
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The following provides a reconciliation of benefit obligations, plan assets and the funded status of the defined benefit pension and supplemental retirement plans:

**Assets and Obligations**

<table>
<thead>
<tr>
<th></th>
<th>Pension Plans</th>
<th>Supplemental Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Change in projected benefit obligation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beginning of year</td>
<td>$2,754</td>
<td>$2,574</td>
</tr>
<tr>
<td>Service and interest costs</td>
<td>264</td>
<td>272</td>
</tr>
<tr>
<td>Actuarial loss</td>
<td>88</td>
<td>73</td>
</tr>
<tr>
<td>Benefits (paid)</td>
<td>(187)</td>
<td>(184)</td>
</tr>
<tr>
<td>Amendments and other</td>
<td>—</td>
<td>19</td>
</tr>
<tr>
<td>End of year</td>
<td>$2,919</td>
<td>$2,754</td>
</tr>
<tr>
<td><strong>Change in fair value of plan assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beginning of year</td>
<td>$3,074</td>
<td>$3,753</td>
</tr>
<tr>
<td>Company contributions</td>
<td>300</td>
<td>2</td>
</tr>
<tr>
<td>Actual return on assets</td>
<td>(215)</td>
<td>(497)</td>
</tr>
<tr>
<td>Benefits (paid)</td>
<td>(187)</td>
<td>(184)</td>
</tr>
<tr>
<td>End of year</td>
<td>$2,972</td>
<td>$3,074</td>
</tr>
<tr>
<td><strong>Funded status of plan</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess of fair value over projected benefits</td>
<td>$53</td>
<td>$320</td>
</tr>
<tr>
<td>Unrecognized losses and prior service cost</td>
<td>1,119</td>
<td>572</td>
</tr>
<tr>
<td>Prepaid pension cost/(accrued liability)</td>
<td>$1,172</td>
<td>$892</td>
</tr>
</tbody>
</table>

At the measurement date of October 31, 2002, the fair value of pension plan assets exceeded both the projected benefit obligation and the accumulated benefit obligation. Therefore, the Company was not required to reflect a minimum liability adjustment under SFAS No. 87, which would have removed the prepaid pension cost of $1,172 million with the offset of approximately $700 million net of taxes charged against stockholders’ equity. The prepaid pension cost carried on the Company’s balance sheet as of year-end 2002 represents pension funding as well as return on plan assets in excess of pension expense recognized through the statement of operations. The prepaid pension cost has accumulated from the inception of the pension plan in 1966 principally as a result of the Company’s policy to target a funded ratio in the range of 110% to 130%.

As a result of the weakness in the global equity markets over the past several years, the pension surplus of the defined benefit pension plans has declined from approximately $1.2 billion in 2000 to
a surplus of $53 million at the measurement date in 2002. The decline is reflected in the unrecognized losses of $1,119 million and will be amortized, subject to a corridor as permitted under SFAS No. 87, as pension expense over the average remaining service period of the covered workforce. Such amortization will reduce the prepaid pension cost.

In addition to the accrued liability for the supplemental retirement plans, the additional minimum liability balance was $97 million and $84 million in 2002 and 2001, respectively.

The following table presents significant assumptions used:

<table>
<thead>
<tr>
<th>Assumptions</th>
<th>2002</th>
<th>2001</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount rate</td>
<td>7.10%</td>
<td>7.25%</td>
<td>7.75%</td>
</tr>
<tr>
<td>Expected return on assets</td>
<td>8.9%</td>
<td>9.5%</td>
<td>9.5%</td>
</tr>
<tr>
<td>Salary progression rate</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Measurement date</td>
<td>10/31</td>
<td>10/31</td>
<td>10/31</td>
</tr>
</tbody>
</table>

Given lower asset returns over the past few years and lower expected future returns, the Company lowered the expected rate of return on plan assets from 9.5% to 8.9% as of October 31, 2002, which will be used to develop the pension expense for 2003. The Company used 9.5% to develop the 2002 pension expense, which was the expected rate of return as of October 31, 2001. The effect of the lower expected return will be reflected in the calculation of net periodic pension cost for fiscal 2003.

Other Post-Retirement Benefit Plans

The Company provides medical and dental benefits to retirees based on age and years of service. Benefits under these plans are unfunded. The Company provides a defined dollar commitment toward retiree medical costs. In 2001, the Company amended these plans to further reduce and limit Company contributions. These changes were accounted for as a negative plan amendment in accordance with SFAS No. 106. Accordingly, the effects of reducing the benefit obligation are being amortized over the remaining years of service to eligibility of the active plan participants. The Company began recognizing the costs under the amended plans in the third quarter of 2001. The decrease in the net periodic post-retirement benefit cost from 2000 to 2002 is due to the changes discussed above.
The Company’s post-retirement benefit plans were amended in 2001 to reduce the per capita dollar amount of the benefit costs that would be paid by the Company. Thus, changes in the assumed or actual health care cost trend rates do not materially affect the accumulated post-retirement benefit obligation or the Company’s annual expense. Company-provided costs for retirees over age 80 on January 1, 2002 do still increase by up to 5% per year. The Company has assumed that the full 5% increase will be granted in each future year.

**Defined Contribution Plans**

The Company’s Savings, Profit-Sharing and Stock Ownership Plan is a defined contribution plan available to all eligible associates of JCP and certain subsidiaries. Additionally, the Company has a Mirror Plan, which is offered to certain management associates. Associates who have completed at least 1,000 hours of service within an eligibility period (generally 12 consecutive months) and have attained age 21 are eligible to participate in the plan. Vesting of Company contributions occurs over a five-year period. The Company contributes to the plan an amount equal to 4.5% of the Company’s available profits, which totaled $27 million and $10 million in 2002 and 2001, respectively. Additionally, discretionary matching contributions of Company stock were made totaling $20 million and $48 million in 2002 and 2001, respectively. Associates have the option of reinvesting matching contributions made in Company stock into a variety of investment options, primarily mutual funds.

Effective January 1, 2002, Eckerd adopted a new 401(k) plan for all eligible drugstore associates. Account balances for Eckerd associates who were participants in the Company’s Savings, Profit Sharing and Stock Ownership Plan were transferred to the new plan. Eckerd provides eligible
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drugstore associates with a guaranteed match of $1.50 for each $1.00 contributed on the first 2% of pay and a $1.00 for $1.00 match on the next 1% of pay, and Eckerd contributions vest immediately. Eckerd matching contributions were $31 million in 2002.

Total Company expense for defined contribution plans for 2002, 2001 and 2000 was $81 million, $69 million and $3 million, respectively.