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Loretta Cangialosi Vice President and Controller

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Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116 Letter of Comment No:

File Reference: 1201-100

Date Received: 9-8-04

Subject: File Reference No. 1201-100 - Exposure Draft entitled Fair Value Measurements.

### Dear Sir/Madam:

Pfizer is a research—based, global pharmaceutical company with its principal place of business in New York. We discover, develop, manufacture and market leading prescription medicines for humans and animals and many of the world's best-known consumer products. The Company's 2003 total revenues were \$45.2 billion and its assets were \$116.8 billion. We appreciate the opportunity to respond to the FASB Exposure Draft (ED) entitled Fair Value Measurement.

Overall, we agree with the FASB's initiative to provide enhanced guidance in applying the fair value measurement objective in generally accepted accounting principles (GAAP). The lack of clear guidance, particularly in the absence of quoted prices, has presented significant challenges to constituents resulting in financial statements that may not be consistent and comparable. Generally, we believe the ED is a step forward, but we do not believe it has provided enough guidance to achieve its objectives. Additionally, we believe that the omission of the ED to address the "why" of fair value, to permit exceptions from general valuation measurements, and to defer consideration of certain issues would not meaningfully enhance the value of financial statements to the user community.

While this proposed standard does not seek to specify when fair value should be used, only how fair value should be measured, we wish to stress our belief that investors and other users of financial statements are best served when standard-setters recognize the limitations of the accounting model. The accounting model works best when it measures, records and summarizes past transactions and events. It becomes increasingly inadequate as it departs further and further from this baseline. The challenge is to recognize the point at which the usefulness of the measure is defeated by the complexity and/or appropriateness or variability of its calculation.

We believe that the Board must recognize that fair value is not an appropriate measurement for all financial statement line items and that pursuing fair value in inappropriate situations can actually interject unnecessary risk and variability into the financial statements. We are most concerned about situations requiring level 3 valuations or situations where there is no intent to enter into a sale transaction.

Requiring fair value to be used in multiple "level 3 situations" or in situations where there is an absence of an intent to sell could result in: false valuation risk being introduced into the financial statements; reduced comparability among similarly situated companies; and/or confusion for users of the financial statements. We are especially concerned with investors being able to understand these concepts and the difficulties and subjectivity of their application in level 3 situations. As well as their potential of being misled into believing that only one price exists for such items. Further, simply adding disclosures is unlikely to remedy the issue as current users are already laboring under the current volume of disclosures.

Extensive use of level 3 valuations could harm audit effectiveness and widen the audit expectation gap.

We are concerned that the Board may presume that all hypothetical transactions can be fair valued. While "a value" may be derived for all hypothetical transactions, we do not believe that in all cases a "fair value" can be derived. Further, we are concerned that the Board may not appreciate the significant amount of work, record-keeping and stress that level 3 valuations may place on an organization not to mention incremental costs in hiring third parties to assist in performing these valuations.

Attached are our comments, which include responses to the issues included in the "Notice for Recipients of This Exposure Draft." Once again, we appreciate this opportunity to comment and encourage the FASB to continue to engage its constituents. If requested, we would be pleased to discuss our observations with you at any time

Sincerely,

Loretta V. Cangialosi

Fretto V. Cargialini

Attachment

cc: David L. Shedlarz

Executive Vice President and Chief Financial Officer

## Issue 1: Definition of Fair Value

This proposed Statement would define fair value as "the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties" (paragraph 4). The objective of the measurement is to estimate the price for an asset or liability in the absence of an actual exchange transaction for that asset or liability. Will entities be able to consistently apply the fair value measurement objective using the guidance provided by this proposed Statement together with other applicable valuation standards and generally accepted valuation practices? If not, what additional guidance is needed?

We believe that companies will be able to develop a consistent internal approach for applying the fair value measurement objective using the guidance provided by this proposed statement, but we stress that it is unlikely that this guidance, particularly for level 3 valuations will result in consistency among preparers. We believe that the Board recognizes the inherent difficulty and variability of level 3 valuations and our concern is not related to the definition except in that we do not believe one price exists as the definition seems to imply, but rather to the circumstances under which level 3 valuations will be required in the future. For example, developed technology rights for a pharmaceutical product can have very different values even amongst knowledgeable, unrelated parties since those parties are likely to factor into their future cash flow expectations their own experiences and views on subjective factors such as strength of underlying patents, potential for competitive threats, the company's past marketing success or strength of its franchise in the disease state area, etc.

Generally, we agree with the proposed definition of fair value; however, we are uncertain as to why the following caveat was included in paragraph 5: "in all cases that price shall be estimated without regard to an entity's intent to currently enter into such a transaction" as 'intent' is an important component of 'willingness' which is an important component of the definition. Our concern is less a concern about the definition of fair value and more a concern about how the definition will be applied in the future. For example, fair value is currently not the standard for measuring "held-to-maturity" securities. In this case, intent has priority. To avoid confusion in the future, we would like to see this last sentence removed.

Further, the cross reference to Example 1 in Appendix B did not clarify the sentence, but presents another issue. The first sentence in B3 states "buyer-specific synergies are inconsistent with fair value and would only be included in investment value" while the last sentence says that the "price [which would "reflect the amount that the particular buyer is willing to pay over the other bids to acquire those synergies] ... would represent fair value." This seems directly contradictory. Please consider clarifying this whole section.

## **Issue 4: Valuation Premise**

This proposed Statement would provide general guidance for selecting the valuation premise that should be used for estimates of fair value. Appendix B illustrates the application of that guidance (Example 3). Is that guidance sufficient? If not, what additional guidance is needed?

We appreciate the ED articulation of the valuation premise that asset and liabilities have a "going concern/fair value in use" or "exchange (for sale) fair value."

But we believe that the guidance in Example 3 is insufficient - - it doesn't address the fact that market participants can have different goals for the same "unit of account." Under the notion that the sum of disaggregated parts may be greater or lesser in value than the value of the aggregated whole, we believe that additional guidance must be provided for selecting among market participants that may view the same unit of account differently. We would be concerned about applying the "most advantageous market" concept to this dilemma as other factors could likely impact the willing seller's decision. For example, a company might choose a less advantageous market (one that would purchase the unit of account as a whole) because it would result in other less tangible benefits such as: a more timely transaction that would be less distracting to management or better public relations because it would result in fewer employee terminations and therefore result in improved relationships with continuing employees and the community; etc. But, in any case, we believe that additional guidance is warranted.

Note: These same comments can be applied to the guidance around "Unit of Account," although the Board has elected to defer these issues until a later phase in the project.

### Issue 6: Level 1 Reference Market

In this proposed Statement, the Level 1 reference market is the active market to which an entity has immediate access or, if the entity has immediate access to multiple active markets, the most advantageous market. Appendix B provides general guidance for selecting the appropriate reference market (Example 5). Is that guidance sufficient? If not, what additional guidance is needed?

We believe that the reference market should be the market in which a company ordinarily operates rather than the most advantageous market, consistent with our view that fair values in accounting should represent an average fair value (see Pricing in Active Dealer Markets in Issue 7). Use of the most advantageous market could require a company to constantly perform a number of evaluations of price and transaction costs in markets that it is unlikely to use. A company may use a particular active market for a variety of reasons (e.g., contractual arrangements, confidence in performance, confidentiality concerns or established relationships), and this valuation reference point should be available. Further, we understand that all markets have limitations, some more obvious than others, and, we believe that ferreting out those differences is not cost beneficial.

# Issue 7: Pricing in Active Dealer Markets

This proposed Statement would require that the fair value of financial instruments traded in active dealer markets where bid and asked prices are more readily and regularly available than closing prices be estimated using bid prices for long positions (assets) and asked prices for short positions (liabilities), except as otherwise specified for offsetting positions. Do you agree? If not, what alternative approaches should the Board consider?

# A. Bid and asked prices

We believe that the main purpose of, the "why", of fair value, is to evaluate performance. Secondarily, it provides a point in time indication of value. We think that fair value evaluates performance as it impacts the income statement. This is true in the case of trading account investments and measurements of long-

term asset impairments but, less obvious in purchase price allocations whose fair value-based allocated cost will be recognized subsequently in the income statement and reveals how a company adds value to such acquired net assets. We suspect that the FASB has focused on a point in time indication of value, a preference to a balance sheet rather than an income statement perspective, but are uncertain why that is necessarily the best perspective.

We believe that pricing in active dealer markets should be the mean of the bid and asked prices and not, as stated in the ED, as the bid price for assets and the asked prices for liabilities. If there is an actual transaction, it will more likely than not be executed at the mean of the bid and asked price. If an actual transaction is executed at other than the mean of the bid and asked price, it suggests that one of the parties to the transactions has better negotiating ability. Such negotiating ability may arise, for example, as a consequence of a larger than normal purchase transaction (block trade), reliability of execution, or the ability to wait for an optimal time. Such abilities are not objectively known until that actual transaction.

Additionally, not all companies can achieve bid prices upon purchase. Therefore, we believe we should not adopt a policy that is not reality for many companies. Lastly, the use of an average of the bid and asked prices also is more readily understood by the user community.

## B. Post-Balance Sheet Date Valuations

We are concerned about the theory and practicality of valuing an asset based on post-balance sheet changes in values. As the balance sheet is a point in time estimate, the values after the balance sheet date are not as meaningful in relation to the other financial statement data. For example, after the balance sheet date, hedges may be purchased to negate the effect of value declines. Therefore, we don't believe GAAP should report such post-balance sheet transactions as if they occurred at the balance sheet date. At best, post balance sheet values provide secondary evidence of the value at the balance sheet date.

# Issue 8: Measurement of Blocks

For unrestricted securities with quoted prices in active markets, many FASB pronouncements (including FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*) require that fair value be estimated as the product of a quoted price for an individual trading unit times the quantity held. In all cases, the unit of account is the individual trading unit. For large positions of such securities (blocks) held by broker-dealers and certain investment companies, the AlCPA Audit and Accounting Guides for those industries (the Guides) permit fair value to be estimated using blockage factors (adjustments to quoted prices) in limited circumstances. In those cases, the unit of account is a block.

The Board initially decided to address that inconsistency in this proposed Statement as it relates to broker-dealers and investment companies. The Board agreed that the threshold issue is one of determining the appropriate unit of account. However, the Board disagreed on whether the appropriate unit of account is the individual trading unit (requiring the use of quoted prices) or a block (permitting the use of blockage factors). The majority of the Board believes that the appropriate unit of account is a block. However, the Board was unable to define that unit or otherwise establish a threshold criterion for determining when a block exists as a basis for using a blockage factor. The Board subsequently decided that for measurement of blocks held by

broker-dealers and certain investment companies, current practice as permitted under the Guides should remain unchanged until such time as the Board fully considers those issues.

For those measurements, do you agree with the Board's decision? If applicable, what approaches should the Board consider for defining a block? What, if any, additional guidance is needed for measuring a block?

We observe that the ED attributed the issue of valuing blocks only to financial institutions. However, we note that accounting for block trades is applicable to many other areas. For example, block trades can apply to a purchase business transaction. The ED does not change GAAP for a company with readily traded stock to use the unit price of readily traded stock, but that may be adjusted (paragraph D24d and SFAS No. 141 paragraph 22). Perhaps one method to value a purchase business transaction at the purchase date is to record the fair value of the securities after the market has had an opportunity to absorb the impact of the merger (e.g., in the US on NYSE two business days after an announcement). This could lead to using the quoted market prices with no other adjustments for such items as volume or control.

We are concerned about valuing identical securities at the same price as stated in paragraph 7a. Conceptually, most things are not identical; though they may be similar. What many people think of as identical is often distinguished from being identical by, for example, time, place, volume or valuation premise-- whose effects are not seen as significant to economic value.

Practically, valuing securities that are identical at the same price, leads to the idea that, in the simple case, the value of one share of Common Stock A is equal to the value of another share of Common Stock A. However, if there are many shares of Common Stock A, one may not necessarily be sold for the same as another at one point in time. This economic situation could then lead to a value that reflects a block factor. While we do not endorse the use of a block factor in valuations, we point this out as a theoretical issue. The theoretical issue can be cured by removing the term identical from the ED. We also observe that the term "similar" or "otherwise comparable" have the same meaning.

### Issue 9: Level 3 Estimates

This proposed Statement would require that in the absence of quoted prices for identical or similar assets or liabilities in active markets, fair value be estimated using multiple valuation techniques consistent with the market approach, income approach, and cost approach whenever the information necessary to apply those techniques is available without undue cost and effort (Level 3 estimates). Appendix B provides general guidance for applying multiple valuation techniques (Examples 6-8). Is that guidance sufficient? If not, what additional guidance is needed?

# **Use of Multiple Valuation Techniques**

We are concerned about the level 3 valuation guidance in paragraph 22 in that it implies that multiple approaches are required unless unduly costly - - "If information necessary to apply multiple valuation techniques is not available without undue cost and effort ..."

We do not agree with the required use of multiple valuation techniques in level 3 estimates, seemingly the most subjective estimates, when the data is available without undue cost and effort. Despite "best practices" for valuations efforts, recently codified by the AICPA, we suggest there is no theoretical reason

that the three techniques will necessarily result in the same value. For example, a non-traded dividend paying securities value may be valued using the income approach that suggests estimating the discounted cash flows related to the performance of that entity. However, the market approach suggests that the non-traded dividend paying securities value may be similar to a traded dividend paying equity security. All things remaining equal, a traded equity security must have a value different than a non-traded security. The market value technique can not value a non-traded security at the same value as the income approach. While the income approach might be equated by adjusting for marketability, it no longer is the income approach. We suggest that management judgment prevail as expressed at the end of paragraph 22 - - "the valuation technique that best approximates what an exchange price would be in the circumstances shall be used." We believe that Appendix B is helpful.

We observe that if all three techniques resulted in approximately the same values, then the ED would have permitted an averaging of such values—a common traded securities valuation technique in an active dealer market. It did not.

We are concerned that the Board may presume that all hypothetical transactions can be fair valued. If the market place has wide bid-offer spreads with no recent transactions or there is no marketplace, (e.g., environmental liabilities) determining fair value may not be possible. We think that the ED should discuss what to do in such situations, which may lead to using the present value of the costs to settle a liability.

#### Issue 10: Restricted Securities

This proposed Statement would require that the fair value of restricted securities be estimated using the quoted price of an otherwise identical unrestricted security, adjusted for the effect of the restriction. Appendix B provides general guidance for developing those estimates, which incorporates the relevant guidance in SEC ASR No. 113, Statement Regarding "Restricted Securities." Is that guidance sufficient? If not, what additional guidance is needed?

The guidance regarding the valuation of restricted securities notes that such restrictions must be acknowledged in the fair value, but it is too broad. It does not provide reasonable boundaries for how to conduct a valuation of restricted stock, though it is proscriptive in saying what one can not do. This lack of guidance will limit comparability. Likewise, the guidance in Example 4 that states that "the value be adjusted as appropriate" is not clear enough to ensure consistency and comparability across companies.

Of particular concern is that this ED states that it excludes the fair value of equity securities issued by a company (paragraph 2A). In contrast, the ED entitled *Share-Based Payments* defines the concept of value in terms of fair value as detailed in Concepts Statement No. 7 entitled *Using Cash Flow Information and Present Value Accounting Measurement*. Concepts Statement No. 7 refers explicitly to assets and liabilities. However, the Share-Based Payments exposure draft states that the "concept of value in a *current exchange* embodied in it applies *equally* to the equity instruments subject to this statement." Presumably, Concepts Statement No. 7 deliberately did not include equity. We do not believe the concept of value in a current exchange applies to employee stock options because they are not exchangeable; options can not be converted to cash at any price. Contrasting the two EDs leads to inconsistency. Restricted stock issued by a company is reported at fair value without consideration for any restrictions, while this ED says that restricted stock value must consider the restriction.

# Issue 11: Fair Value Disclosures

This proposed Statement would require expanded disclosures about the use of fair value to remeasure assets and liabilities recognized in the statement of financial position. Appendix B illustrates those disclosures. This proposed Statement also would encourage disclosures about other similar remeasurements that, like fair value, represent current amounts. The Board concluded that those disclosures would improve the quality of information provided to users of financial statements. Do you agree? If not, why not?

We appreciate the fair value hierarchy (Issue 5) that aids financial statement preparers in identifying the appropriate basis for making valuation estimates. Since the greatest risk of mis-valuation occurs in level 3 valuations, we believe that disclosure guidance should be restricted to these valuation elements.

#### Issue 13: Other Issues

This proposed Statement represents the completion of the initial phase of this project. In subsequent phases, the Board expects to address other issues, including issues relating to the relevance and reliability of fair value measurements and the unit of account that should be used for those measurements. What, if any, other issues should the Board address? How should the Board prioritize those issues?

Generally, we think the ED should not have been issued until the creation of a Concepts Statement regarding using fair value. The production of a Concepts Statement would have assured practitioners and standard setters that consistent theory is developed because the full weight of the FASB's resources, authority and ability could have been applied to now clarify the key issues-- FASB's functional expertise. Therefore, practitioners could now focus on testing the proposed theory against previous practice-- their functional expertise.

We are concerned that separating the "how" fair value in the ED from the "why" of fair value unnecessarily constrains the improvement of old and the development of new accounting standards.

We are apprehensive that some twist of a phrase in the ED or some exception in the ED will be revisited in the future only to be applied as a matter of consistency with the finalized ED without a vetting of all the issues. For example, the ED states that "transaction costs shall be accounted for in accordance with the provisions of applicable pronouncements". Under APB 21 paragraph18, debt "issue costs shall be reported in the balance sheet as deferred charges". Debt issue costs can reflect the tradeoff between a costly legal opinion that assuages debt holders that they will recover their loan and a higher interest rate. Meanwhile, the ED in paragraph A23 asserts that "the fair value of a liability is the price in a market at which that security trades as an asset", which perforce ignores debt issue costs.

The notice to recipients states that the effective date of this standard would be for fiscal years beginning after June 15, 2004 while the proposed standard states that the effective date of this standard would be for fiscal years beginning after June 15, 2005. Please clarify.