

Pfizer Inc 235 East 42nd Street New York, NY 10017-5755

September 13, 2013

Technical Director
File Reference No. 2013-270
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Subject: Proposed Accounting Standards Update (Revised): Leases (Topic 842), a revision

of the 2010 proposed Accounting Standards Update: Leases (Topic 840)

Dear Technical Director:

Pfizer is a research-based global biopharmaceutical company with its principal place of business in New York. We discover, develop, manufacture and market leading medicines and vaccines, as well as many of the world's best-known consumer healthcare products. In our 2012 Annual Report, we reported total revenues of \$59 billion, total assets of \$186 billion and rental expense, net of sublease income, of \$335 million. The majority of our Company's leases are classified as operating leases.

We appreciate the opportunity to respond to the Proposed Accounting Standards Update (proposed ASU) *Leases (Topic 842)* and our general and specific comments to the proposed ASU follow below. For clarity, our comments in this letter are from the perspective of a lessee.

Notwithstanding the comments to the proposed ASU in this letter, **in summary, we do not support implementation of the proposed ASU** as we believe that we would simply be exchanging one set of problems for another set of problems. Until the Board can really build a "better mousetrap," we would only support an incremental disclosure of the discounted lease obligation. In this way, in addition to the currently provided measures of future cash outflows (both the current disclosures of future minimum rental commitments under non-cancelable operating leases and the current disclosures for public companies under SEC rules in the contractual obligations table, which incorporates the timing of both operating and capital lease obligations), a financial statement user would have a measure of the discounted obligation, while the financial statement preparer would avoid many of the operational and implementation issues associated with the right-to-use asset.

We understand the motivation for this proposed ASU and we are keenly aware of the good faith, diligent and inclusive effort put forward by Board members and the staff.

We know that:

- Leasing is an important source of financing;
- The current model for leasing has been fairly criticized for its shortfalls and so-called 'bright-line' distinctions;
- The current model can and does encourage companies to structure contracts to achieve or avoid certain outcomes, and
- Current disclosures could be improved to provide better decision-useful information to investors.

However, we also know that:

- The IAC is not supportive of the proposed ASU—On August 27, 2013, the FASB's
 Investor Advisory Committee (IAC) declined to support the proposed ASU due to the
 collective view that the proposals do not represent substantive improvements to
 financial reporting. We believe that the importance of this announcement cannot
 be overstated.
- There is a lack of consensus among Board members—The proposed ASU was approved by only four of the seven Board members, with the dissenters expressing concern about decision-usefulness, among other things. Specifically, (i) Mr. Linsmeier expressed detailed concerns that the "financial reporting by the lessee [will be] so complex that it will hinder users' abilities to assess the amount, timing, and uncertainty of the cash flows arising from the lease contract;" (ii) Mr. Schroeder stated that he does "not believe the proposed disclosures provide users with certain decision-useful information;" and (iii) Mr. Siegel suggested that the "benefits of the new information will not justify the costs" and that the "proposed requirements could impede the ability of users to understand the economics of a reporting entity's lease transactions." Given the breadth and depth of the work on this project, such substantive disagreement among FASB members is an indicator that the proposal does not substantially improve the financial statements for investors and is burdensome for preparers.
- There is no convergence imperative—Current lease accounting for U.S. GAAP and IFRS are substantively similar and therefore convergence is not a significantly pressing driver. Further, as the SEC and the FASB appear to have agreed that the FASB will continue to set accounting and reporting standards for U.S. registrants, we do not believe that agreement with the IASB on this proposal should outweigh an independent assessment of its merits by U.S. constituents and U.S. preparers.
- There is a high cost associated with the proposal—The implementation and ongoing maintenance of this proposed ASU will require significant resources that we believe could be better utilized to increase shareholder value. These one-time and ongoing costs include training and education of our worldwide employees (both finance and non-finance) and our investing community; system modifications and the likely need to develop a new information technology system within global companies like ours to capture all of the disparate, detailed information required for accounting, reporting and disclosure; critical ongoing resources applied to ensure that service

arrangements and lease contracts are appropriately identified and distinguished from each other; the development of new controls and monitoring systems as the analytical review of "rent expense" will no longer be intuitive; and the development and dissemination of policies and procedures for inputs, assumptions and remeasurement triggers.

- The benefits of the proposals are modest, at best, and uncertain—With the FASB's Investor Advisory Committee and three Board members rejecting the proposed ASU from a "user" perspective and from our own analysis of the proposed ASU, we have concluded that the benefits of the proposed ASU are, at best, modest and uncertain. We agree that, upon entering a lease contract, a lessee has acquired the right to use an asset and has incurred an obligation to make lease payments and we agree that recognizing the asset and the obligation on the balance sheet would increase the visibility of this asset-financing approach. But, the benefits beyond the balance sheet are harder to validate: the dual-model income statement impacts; the dualmodel cash flow impacts; the dual-model qualitative guidelines ("less than major and less than substantially all," "major or substantially all," "insignificant," and "more than insignificant"); the dual-model classification of leases; the arbitrary nature of the property/non-property split; the confusing nature of asset amortization under Type B leases; and the need for quarterly re-measurements (that may or may not coincide with a quarter-end). While we agree that sound "theory" should underpin any accounting rules, we also know that getting from theory to practice means that we must be able to institute practical, repeatable and understandable processes on a global basis and this proposal does not achieve that at a reasonable cost.
- The incremental disclosure of the discounted lease liability, if reliable, would be a lower-cost benefit to users—A July 2013 study by the American Accounting Association, "Evidence that Market Participants Assess Recognized and Disclosed Items Similarly when Reliability is Not an Issue," observed the following (emphasis added):

"For a sample of firms with both capital and operating leases, we find that as-if recognized amounts for leases are generally reliable and that both recognized lease obligations and <u>disclosed lease obligations</u> are associated with proxies for costs of debt and equity. The magnitudes of these associations are not statistically different across accounting treatments, suggesting that <u>market participants impound as-if recognized operating</u> lease obligations and recognized capital lease obligations similarly into costs of capital."

Certain companies have leases that are important, even critical, to their businesses, but many other companies do not have operating revenues directly tied to leased assets, but rather, these leases comprise property and equipment that is utilized to support the general administrative activities within a business. The proposed ASU represents a "one size fits all" approach for the accounting and disclosure for leasing arrangements that is not critical to understanding the operations of a company.

Based on the above, we do not believe that the **potential** benefits of the proposed ASU could ever outweigh the **certainty** of its cost. As stated above, we are concerned that

we would be spending scarce resources to simply replace one set of problems for a different set of problems. We would support a more targeted, less costly approach to addressing current practice issues, such as an incremental disclosure of the discounted lease obligation.

For all of the above reasons, we do **not** support implementation of the proposed ASU.

Notwithstanding our lack of support for the proposed ASU (see above), as requested, below are our responses to "Questions for Respondents," to which we have limited ourselves to the guidance for lessees.

Questions for Respondents

Question 1: Identifying a Lease

This revised Exposure Draft defines a lease as—a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. An entity would determine whether a contract contains a lease by assessing whether:

- 1. Fulfillment of the contract depends on the use of an identified asset.
- 2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset. Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Response to Question 1:

We believe that the current guidance for determining whether a contract contains a lease is currently insufficient, particularly with respect to conveying the "right to control."

We request that **significantly** more examples be developed, particularly concerning assets that are typically, universally and traditionally thought to be "leased;" that is, copiers, automobiles, computers/servers, etc. We believe that such examples will reduce diversity in practice and allow implementation efforts to focus on more unique situations.

Question 2: Lessee Accounting

Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the

economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Response to Question 2:

As stated in our general comments, we are concerned that the proposed ASU simply exchanges one set of problems for another. Current accounting provides for a dual-model of recognition, measurement and presentation and the proposed ASU would simply replace it with another dual-model.

While the proposed ASU would increase the visibility of financing arrangements previously held "off balance sheet," the *increased* visibility will come at a very high price. And the income statement and cash flow statement outcomes are confusing and difficult to operationalize.

For example, when we consider the guidance for amortizing a "Type B right-of-use asset," (i) we find the use of a "difference" approach to measuring the periodic amortization to be a theoretically strange approach to cost allocation, particularly cost allocation of a time-based asset and we believe that such an amortization approach may expose such assets to future impairments, and (ii) we find the guidance to be operationally concerning; we will have to create a new system to operationally link the accounting for the liability with the asset and may find that we cannot use our existing fixed asset systems for the "linked" assets.

Additionally, as we don't currently have a significant number of capital leases but we do have leases originating throughout the world, when we consider the guidance for the presentation of cash flows associated with a lease, we expect that it will be difficult to operationalize the fact that the cash outflows for all leases will now have to be tracked along four different routes into the cash flow statement.

Question 4: Classification of Leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

Response to Question 4:

As stated in our general comments, we are concerned that the proposed ASU simply exchanges one set of problems for another. Current accounting provides for a dual-model of recognition, measurement and presentation. The proposed ASU would simply replace it with another dual-model of recognition, measurement and presentation. Please see also our response to Question 2.

We do not understand the theoretical or economic basis for treating property differently from non-property and we believe that this results in different accounting

treatments for similar economic situations. For example, we do not understand why hotel buildings and cruise ships would be treated differently. They are both used for a similar purpose and are similar in size. We also anticipate implementation issues associated with the definition of property as it may be difficult at times to differentiate between what might be called heavy equipment (non property) vs. buildings (property). We expect that this issue could become prevalent in manufacturing structures where equipment may be installed onto the bare walls of a building and then the question would arise as to what would be considered part of the building and what would be considered the equipment.

Question 5: Lease Term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

Response to Question 5:

Yes. We appreciate the concept of "significant economic incentive" as it decouples measurement from "intent" and eases a certain element of implementation. However, that decoupling comes at a cost. If we believe that a renewal is reasonably assured, but have no significant economic incentive to renew, we will be forced to touch the lease accounting on every renewal even as the contractual relationship is proceeding as expected. We believe that this is a very labor intensive solution for something that is not a significant issue overall. We remain concerned about the additional accounting and bookkeeping burden as well as the additional costs of software and personnel to implement the proposed standard.

Question 6: Variable Lease Payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

Response to Question 6:

We do not agree with the proposals on the measurement of variable lease payments, especially as to the guidance regarding reassessment if there is a change in an index or a rate used to determine lease payments. This will require a significant amount of work that will do not believe will justify the benefit.

During the lease term a rate or an index is certain to change from one reporting period to another; therefore the amount of effort required for remeasuring the liability and reassessing the lease payments for an index or rate at the end of each reporting period, which, in many cases, will not reflect the contractual remeasurment rate or index in the lease contract (e.g. the lease payments remeasure once a year at a date that is not the end of a reporting period), does not seem to justify the benefit.

Question 7: Transition

Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why? Are there any additional transition issues the Boards should consider? If yes, what are they and why?

Response to Question 7:

Yes. We appreciate the option of using a modified retrospective approach.

Question 8: Disclosure

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Response to Question 8:

Paragraph 842-20-50-4 would require a reconciliation of opening and closing balances of the lease liability separately for Type A leases and Type B leases. As presented, we fear that the FASB, the SEC and our auditors would expect to see all of the suggested 'sample changes' within this reconciliation. But, this type of information is **not** collected by preparers. This seemingly modest requirement would require extensive system modifications or an extensive manual data collection effort. We believe that the FASB's disclosure objectives could be effectively and, importantly, more efficiently achieved by simply requiring that significant changes be disclosed.

We request that paragraph 842-20-50-4 be revised in a manner similar to the following:

842-20-50-4 A lessee shall disclose <u>significant changes between the</u> <u>a reconciliation of</u> opening and closing balances of the lease liability separately for Type A leases and Type B leases. Those <u>disclosures</u> <u>may reconciliations should</u> include the periodic unwinding of the discount on the lease liability and other items that are useful in understanding the change in the carrying amount of the lease liability, for example, the following:

- a. Liabilities created due to leases commencing or being extended
- b. Liabilities extinguished due to leases being terminated
- c. Remeasurements relating to a change in an index or a rate used to determine lease payments
- d. Cash paid
- e. Foreign currency transaction gains and losses
- f. Effects of business combinations.
- Paragraph 842-20-50-9 would require the disclosure of a maturity analysis of commitments for the "nonlease components related to a lease." This disclosure appears to go beyond the disclosure objective of "enabling users of financial"

statements to understand the amount, timing, and uncertainty of cash flows arising from leases" [emphasis added], not related to a lease. We aren't convinced that these contractual commitments should be treated differently simply because they are "related to" a lease.

We request that paragraph 842-20-50-9 be removed.

Question 10: (FASB Only)

Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

Response to Question 10:

Yes. As related party transactions "cannot be presumed to be carried out on an arm's-length basis" and as some related party transactions may not be well documented, we believe that accounting for legally enforceable terms and conditions would be beneficial for preparers, as long as Topic 850 disclosures were robustly furnished for the benefit of users. See also our response to Question 11.

Question 11: (FASB Only)

Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

Response to Question 11:

Yes. We presume that Topic 850 would be applied in good faith and, as such, we would not provide for additional disclosures in this proposed ASU.

In closing, we thank the FASB for allowing us the opportunity to share our views on the proposed ASU on lease accounting and appreciate your consideration of these comments.

We know that the proposed ASU represents a significant amount of time, energy and passion. But, we regretfully conclude that the objectives of the project have not been met.

We would be happy to discuss these matters further.

Sincerely,

Loretta V. Cangialosi

Loute Congreson

Senior Vice President and Controller

cc: Frank D'Amelio

Executive Vice President, Business Operations and Chief Financial Officer