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Technical Director
File Reference Nos. 2015-280
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P.O. Box 5116
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Subject: Proposed Accounting Standards Update (ASU), *Investments - Equity Method and Joint Ventures (Topic 323): Simplifying the Equity Method of Accounting*

Dear Technical Director:

Pfizer Inc. is a research-based, global biopharmaceutical company headquartered 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 2014, we reported revenues of \$50 billion and total assets of \$169 billion.

Pfizer supports the intent underlying the Board's broad Simplification Initiative; that is, to reduce the cost and complexity in U.S. GAAP, while maintaining or improving the usefulness of the information provided to users of financial statements. As we explain more fully in the responses to the Questions for Respondents, we believe some elements of this proposed Update achieve that worthy goal, while other provisions do not. Also, we are concerned that some of the proposed changes go beyond the scope of the Board's Simplification Initiative.

Questions for Respondents

Question 1, part 1: Should accounting for the basis difference of equity method investments as if the investment were a consolidated subsidiary be eliminated? Why or why not?

We respectfully request the Board not approve the proposed amendment to eliminate the current requirements for accounting for the basis difference of equity method investments.

- Not Representationally Faithful – In our view, this proposal would result in financial information that is not representationally faithful, as it does not align with the economic reality. We do **not** believe that an accounting model, in which an investor records its share in the U.S. GAAP earnings of the investee but does not amortize any basis difference, is an accounting model that can generate decision-useful information or income statement results that have economic substance, as explained and illustrated in the following bullet points:
 - Since the equity-method of accounting will only require an investor to record the share in the U.S. GAAP earnings of the investee without amortizing any basis difference attributed to the assets that existed at the time of investment and which are generating the U.S. GAAP earnings of the investee, the **investor's results will be based on the historical cost of the investee's underlying assets at the time of the investment**. We believe such results are arbitrary and do not reflect economic substance. The proposed model would mean that **two comparable economic situations will result in a different income statement for the investor**, just because the investees have a different historical cost for comparable assets.

To illustrate the above, we considered a scenario where Investor A and Investor B invested, at the same time, in two different investees that had a comparable value, a comparable business and comparable future cash flows/ earnings. In that situation, theoretically, the two investors would have incurred the same acquisition price for the investments. We considered, also, that the investees would generate the cash flows that the investors expected at time of acquisition (both timing and amount) and that both investments would appreciate in value due to favorable market conditions. Intuitively, we would expect that Investor A and Investor B would report the same equity earnings each period. However, what if the investee of Investor A had no or a low book value for the assets that were generating the cash flows (such as would be the case if the assets were internally generated assets from R&D activities), while the investee of Investor B had a substantial book value for the assets that were generating the cash flows (such as would be the case if the assets were acquired from third parties **prior to Investor B's investment date**)? In this scenario, the U.S. GAAP income statements of Investor B's investee would include amortization in excess of the amortization that would exist on the books of Investor A's investee.

Under the current guidance, since Investor A would have a larger basis difference attributed to the assets existing on investment date, that difference would be amortized to earnings as the cash flows are generated; Investor A's and Investor B's income statements would reflect similar financial results, which mirrors the economic reality – as Investor A and Investor B *did* generate similar economic results.

However, under the proposed guidance, since the basis difference would not be amortized, **Investor A would continuously reflect higher recurring earnings** than Investor B (who is recording its share in the U.S. GAAP earnings of its investee that is lower due to amortization). This does not reflect economic reality.

Furthermore, we believe that this proposed model could impact future business decisions of entities looking for non-controlling investments. If an investor is looking simply to reflect higher **recurring earnings** each period, that investor may prefer investees that have no or low book values for their assets versus investees that have higher book values - - even though such investees may represent businesses that are meant to generate the same amount, or even higher, future cash flows. Alternatively, this may encourage a greater use of non-GAAP measures to communicate performance so that entities that make good, economic business decisions would not be penalized for an arbitrary circumstance – the historical cost of an asset on an investee's books.

See also our comments below in the section called "Historical Cost of Investee Assets Should Not be a Factor Influencing Investor Results".

- To illustrate another aspect where the proposed model will not generate decision-useful information or income statement results that have economic substance, we also considered a scenario in which a strategic investor acquires a 49% share in an investee in the Pharmaceutical industry. We assumed that the bulk of the purchase price was attributed to a marketed product, at the time of the investment, with a useful life of 12 years and was the strategic basis for the investment. We further assumed that three years after the acquisition date, the marketed product was harmed by unanticipated competition and that the projected cash flows generated by that product were reduced by 50%. Also at the same time, the investee's early stage pipeline had produced some compounds that, if successful, would begin producing large cash flows in 10 years.

Based on the current guidance, the investor would report its share in equity earnings and amortize the basis difference to the income statement, which would result in reflecting the real economic result – the investor had over paid for the marketed product and the earnings

generated are not recovering the investment and, as such, each period the investor is compelled to report a recurring loss rather than a recurring profit.

However, under the proposed guidance, the investor would report *recurring profits* generated from the investment, while the economic reality is that the investor is actually incurring a loss each period. Under the proposed guidance, the investor also would not have to record a one-time loss - - or its one-time loss would be substantially reduced due to the investee's appreciation in value resulting from the early stage pipeline that didn't exist at the time of the investment. In other words, rather than a 49% strategic investor having its current results penalized for an imminent and real loss of cash flows, the recurring results of the investor would be reflecting recurring earnings - - and these recurring earnings would result solely from a fair value offset attributed to the appreciation in the value of assets, that were developed after the investment date, and that are still in the R&D stage and not expected to generate any positive cash flows for a long period of time - - and may never actually generate any positive cash flows.

Moreover, under the proposed guidance, an investor would report a **recurring** profit regardless of the fact that the investor indirectly "paid" for these profits and is not actually generating any profit, or in our scenario, actually generating a loss. Also, any **non-recurring impairment** loss recorded that either offsets, or **partially** offsets, the **recurring profits** will not be recorded in the same periods as the profits and, due to the fact that it will be a one-time large non-recurring loss, it will often be "eliminated" by many financial statements users that assess a company's performance (in an attempt to get at "core" earnings).

- Finally, we believe the outcome of the proposed guidance does not reflect economic substance when two investors with the same ownership percentage in an equity method investee would report the same amount of recurring equity earnings, even though they may have paid very different amounts for their investments.

Consider a scenario where investor A and investor B both own 25% of the investee but Investor A has invested in the early stages of the investment and has paid a relatively low amount to acquire the investment, while Investor B invested a long time after when the investee had already many mature products producing ongoing cash flows and where Investor B's price contemplated these profits. Consider also that the investment is appreciating in value from the time of Investor B's investment due to favorable market conditions and promising prospects of assets under development.

Based on the current guidance, Investor A and Investor B would report very different recurring earnings, reflecting the real economic reality.

Based on the proposed guidance, Investor A and Investor B will report the same recurring earnings although the economic reality is that Investor B is not actually generating ongoing profits since Investor B "paid" for those profits. We believe that the outcome where these two investors report the same earnings does not portray the economic reality of the two separate investments and reduces the decision-usefulness of the information.

- Approach Likely to be More Complex and Costly – Notwithstanding the above, we also believe that the application of the proposed guidance could prove to be complex and costly since when the basis difference is not amortized along with the recognition of the profits, which were contemplated in the purchase price, the book value will increase and the need to test the investment for impairment will be more frequent and recurring.

In many cases, especially where the investor is strategic, the investee's shares are not traded and, in order to Fair Value the equity method investment, the required inputs would typically involve Level 3 inputs (unobservable inputs that reflect estimates and assumptions), such as cash flows for the full

business of the investee to perpetuity, long term growth rates, specific discount rates for the investment, etc. These assumptions are very difficult to obtain when the investor does not control the investee and performing such valuations is very costly. As such, we do not believe that the proposed guidance will contribute to simplification; rather, it will contribute towards more Fair Value measurements and additional complexity.

- Historical Cost of Investee Assets Should Not be a Factor Influencing Investor Results – In our view, in order to fully eliminate situations where the historical cost of the investee is the factor determining the financial results of the investor, in addition to asking the Board to reject the proposed approach of not amortizing a basis difference, we also ask the Board to eliminate the existing guidance in ASC 323-10-35-32A. Under ASC 323-10-35-32A, an equity method investor “shall not separately test an investee’s underlying asset(s) for impairment. However, an equity investor shall recognize its share of any impairment charge recorded by an investee ... and consider the effect, if any, of the impairment on the investor’s basis difference in the assets giving rise to the investee’s impairment charge”. We believe this guidance also leads to arbitrary results that are not comparable for similar economic situations.

Consider a scenario where an investor has an underlying basis difference in two different assets of the investee (Asset A and Asset B), both at the level of \$300 million. For Asset A, the investee has no book value but for Asset B, the investee has a \$50 million book value (as it was acquired in its early stages). Consider that both assets lose value from the investment date in a manner that the investee impairs its book value in Asset B to \$40 million. Consider also that the investor who has significant influence is fully aware of the loss of value from both assets. In that case, according to existing guidance, the investor would write off its \$300 million underlying difference in Asset B (due to the impairment recorded by the investee of \$10 million) but not in Asset A as the ASC does not allow to test an investee’s underlying asset(s) for impairment. We believe this impact is arbitrary and does not reflect the underlying economic reality. Rather this impact is a direct result of the investee’s historical cost of the assets, which is a factor that we believe has no economic substance and therefore should not impact the investor’s results. We believe that, if applying the equity method, the basis difference attributed to identifiable assets (i.e., assets other than goodwill) should be amortized and **impaired based on the economic circumstances surrounding those assets**, which should be known to the investor having significant influence over the investee. We believe such guidance would lead to decision-useful, representationally faithful and comparable information.

- Current Approach is Not “Too Difficult and Costly” – Finally, we do not share the sentiment attributed to Stakeholders in the proposed Update that determining the acquisition date Fair Value of an investee’s identifiable assets and liabilities may be too difficult and costly. While fair value assessments can be challenging to perform, we believe **that at the time of the investment** (as opposed to on a frequent and almost recurring basis) when investors make a sufficient investment in an entity to qualify for equity method accounting, those investors do and should know where the investment value lies.

We also note the Board’s acknowledgment in BC10 of the views of various international financial reporting bodies that have questioned the conceptual basis of the equity method of accounting. However, the proposed guidance does not eliminate equity-method accounting, rather it proposes to eliminate portions of the existing equity-method accounting model, which we believe, as described above, can lead in many cases to financial information that is not representationally faithful and/ or does not reflect economic reality.

In summary, we are concerned with the proposed guidance as we believe it can lead to financial results that are not representationally faithful, not comparable and do not align with the economic reality. We also believe that rather than introducing simplification, the proposed guidance will likely substantially increase the need to perform Fair Value measurements and introduce large costs and complexity.

Question 1, part 2: Would amortization of the entire basis difference through equity method earnings be preferable? If so, what would be the suggested amortization period?

We respectfully request the Board not approve the proposed amendment to amortize the entire basis difference through equity method earnings over a single amortization period.

As noted above, we believe that when investors make a sufficient investment in an entity to qualify for equity method accounting, those investors do and should know where the investment value lies.

We believe that determining a single amortization period based on the largest value driver could introduce a lot of complexity both in determining the amortization period and subsequently when economic circumstances change. An investee may have multiple assets constituting the main value driver and some of them may be in-process-research-and-development assets for which the related basis difference should not yet be amortized or indefinite life assets for which the related basis difference should not be amortized at all. Also, later on, when circumstances surrounding the useful life of some of these assets change and the value driver for the investment changes, it will be very complex to determine how to continue amortizing the basis difference.

In addition, we believe that an arbitrary single amortization period is likely to result in situations where an investor's financial results are not representationally faithful and do not reflect economic substance and therefore we do not support such an amendment.

Question 2: Should the accounting for capitalized interest, which adds to the basis of an entity's equity method investment and is amortized, also be eliminated for equity method investments? Why or why not?

As edited, we find the remaining guidance in 835-20-35-2 confusing as one reference to amortization of the capitalized interest has been struck out while another reference to amortization of the capitalized interest remains. Notwithstanding, since we do not support the proposed model for accounting for basis differences and as capitalized interest adds to the cost of the investment and creates an additional basis difference, we do not support eliminating the accounting for capitalized interest.

Question 3: Should an entity be required to apply the proposed amendments related to accounting for the basis difference on a modified prospective basis as of the effective date? Why or why not?

If any of the proposed amendments are approved (please see our objections above), we support application of this guidance on a modified prospective basis as of the effective date. We agree that the benefits to financial statement users of retrospective application would not justify the costs of doing so.

Question 4: Should an entity no longer be required to retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest? Why or why not?

Yes, we agree with the proposed amendment to eliminate the requirement to retroactively adjust an entity's financial statements when it increases its ownership level in an investee to a level that now qualifies for the equity method of accounting. We do not believe restating prior period financial statements to reflect the equity method for what was, at the time, an investment with no significant influence, represents either the nature of the relationship or the economics of the investment in those periods. Not only is restatement costly and may be complex (e.g. U.S. GAAP financial statements of the investee might not be readily available), we believe that the current requirements provide potentially misleading information to the users of financial statements.

Question 5: Should the proposed guidance to eliminate the requirement to retroactively adopt the equity method of accounting be applied prospectively? Why or why not?

Yes, we agree the proposed guidance to eliminate the requirement to retroactively adopt the equity method of accounting should be applied prospectively. We agree that the benefits to financial statement users of retrospective application would not justify the costs of doing so.

Question 6: How much time will be necessary to adopt the amendments in this proposed Update? Should early adoption be permitted? Should the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities?

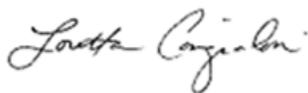
Initial implementation efforts should not be significant, but as noted in our comments to Question 1, we are concerned that on an ongoing basis, the cost and complexity of eliminating the requirement to amortize any basis difference could be higher. See our comments above.

We would not object to permitting early adoption for the proposed guidance to eliminate the requirement to retroactively adopt the equity method of accounting; however, for all other proposals, we would prefer a uniform effective date so as to reduce comparability issues.

Question 7: Would the proposed amendments meet the objective of the Simplification Initiative, which is to improve GAAP by reducing cost and complexity while maintaining or improving the usefulness of the information provided to users of financial statements? Why or why not?

As fully explained above, we do not believe that the change in accounting for amortization of basis differences meets the Board's Simplification Initiative as we believe it is likely to reduce, in many scenarios, the usefulness of the information provided to users of financial statements and it is likely to ultimately increase cost and complexity. However, we do believe that eliminating the requirement to retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest does meet the Board's worthy Simplification Initiative.

We appreciate the opportunity to provide our comments on the amendments in the proposed Update. We would be happy to discuss our comments with you further or to meet with you if it would be helpful.



Loretta V. Cangialosi
Senior Vice President and Controller

cc: Frank D'Amelio
Executive Vice President and Chief Financial Officer