Corporate Finance
Pfizer Inc.
235 East 42nd Street
New York, NY 10017-5755
Tel 212573 3222 Fax 212 338 1815
Email loretta.v.cangialosi@pfizer.com

Loretta Cangialosi
Vice President and Controller

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Letter of Comment No: 5553
File Reference: 1102-100

Director of Major Projects
FASB
File Reference No. 1102-100

Pfizer Inc. appreciates the opportunity to respond to the FASB Exposure Draft entitled Share based Payment – An amendment of Statement No 123 and 95.

Pfizer is a research-based, global pharmaceutical company with its principal place of business in New York, USA. 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.

While we continue to be disappointed in the direction of this project, we are strong supporters of the mission of the FASB - - to establish and improve credible, concise, transparent and understandable financial statements -- even as we challenge the merits of this particular proposal.

Our more specific comments to several of the items in the proposal are set forth in the attachment. We appreciate your consideration of these comments. We would be happy to discuss these matters further or to meet with you if it would be helpful.

Sincerely,

Loretta V. Cangialosi

Loretta V. Cangialosi
Vice President and Controller
Pfizer Inc.
Enclosure (1)

cc:

David L. Shedlarz
Executive Vice President and Chief Financial Officer

Attachment

Detailed Responses to the Proposed Rule on Share-Based Payments

Summary

While we agree that employee stock options are compensation, we continue to believe that the amounts to be inserted into the income statement are not reliable and the accounting does not fairly present the cash flow effects of such instruments. We believe the FASB has not made a compelling case that the fair value of such instruments can be adequately determined and, as such, will introduce unnecessary uncertainty into the financial system in the United States.

Moreover, we do not believe that investors understand that there are a range of values for employee stock options and that the value is highly dependent on the specific model chosen and the assumptions utilized. Many valuation experts agree that the Black-Scholes model produces a higher valuation (by 10% or more) than a binomial model. Financial statements must be understandable by investors and of sufficient high quality. However, we do not believe that the expensing of stock options based on outputs of these models increases transparency or reliability of the financial statements. Transparency, in our view, means that the information in the financials should be clear, complete, apparent and reliable. In this case, investors will not know that the values in the income statement could be off by a substantial amount.

While some might wish to correct this through further disclosure, we find that bad accounting does not get fixed with disclosure. Even given knowledge of the various assumptions, most investors do not have the expertise to determine what possible ranges of values for options might exist.

One of the pertinent factors cited by the FASB in the ED as the basis for requiring the expensing of stock options is that there were "serious financial reporting failures and allegations of misconduct (C4)." We ask whether any of the financial reporting failures were a result of stock option accounting and whether any of the allegations of misconduct were a result of stock option accounting.

Our specific comments and questions are noted below and grouped by topic for your convenience.

I. Scope

We believe that evaluating the terms of a contract that permits share or cash settlement should not be based on past practice as circumstances are subject to change and the future can be uncertain. Further, deeming an instrument to be equity before it is actually equity is speculative. Rather, we believe that in the face of uncertainty, one should presume that the parties will act in their own interest, with cash deemed to be preferable over stock. Thus, if a counterparty has a choice, the accounting should assume cash settlement and then adjust if actual exercise results in stock.

II. Accounting framework

We do not agree that "the concept of value in a current exchange embodied in it [the definition of fair value] in FASB Concepts Statement No. 7 entitled Using Cash Flow Information and Present Value Accounting Measurement] applies **equally** [emphasis added] to equity instruments subject to this statement"(7). "The Concepts Statement No. 7 definition refers explicitly only to assets and liabilities" (7). Presumably, Concepts Statement No. 7 deliberately did not include equity and, with a desire to avoid unintended consequences, we are concerned about an opportune amendment to a Concepts Statement without the extensive deliberation. Further, we observe that the ED bases its views of fair value on "the amount at which an asset or liability could be bought (or incurred) or sold (or settled) on a current transaction between willing parties that is in other than a forced or liquidation sale." We do not believe the concept of value in a current exchange applies to employee stock options because they are simply not exchangeable - - at any price.

III. Valuation

A. Model use

We do not see the distinction between a so-called "closed form" and a so-called "lattice" model in the Glossary and suggest it be reworked. For example, a simple lattice model can produce the same results as a Black-Scholes Merton model with the same assumptions; a closed form model depends on its assumptions which may vary to include a lattice model. We think they are both equations.

B. Discounts for restrictions on trading

The ED suggests that to take into account the nontransferability of employee share options, this proposed statement would require that fair value be estimated using the expected term rather than its contractual term (Issue 4d). This only applies to a Black-Scholes-Merton model or to a simple lattice model. We are concerned that this approach doesn't result in a discount that is sufficient to reflect the trading restrictions. We don't know what that discount is-- but we're sure that it isn't zero!

Lastly, we are uncertain how expected post-vesting employment behavior affects (19 b) grant date value under the FASB model that asks one to exclude forfeitures from the valuation of the grant (10). We have heard a member of the FASB OVG group identify that provision as post-vesting forfeiture behavior. This suggests that there has been no meeting of the minds among the experts.

C. Volatilty

The Glossary suggests calculation of volatility exclude dividends, whereas in SFAS 123 the calculation of volatility includes dividends (406).

D. Risk free rate

We are uncertain about the use of other-than-risk-free rate (B13). We are well aware that a contingent claims framework, that is based on the construction of hypothetical risk free balanced long and short position, perforce requires the use of a risk free rate. Yet, we have heard a member of the FASB OVG group suggest that a company cost of capital rate can be used. This suggests that there has been no meeting of the minds among the experts.

E. Other assumptions

What are some examples of "the other pertinent factors" (19 and B2) that are included in an option price? We continue to be concerned about vagueness in model inputs that contribute to a non-level playing field; we have heard Board members express similar concerns. We suggest that all model inputs be defined now and the FSP process be used should a new model emerge that requires different thinking. Our concern comes from the fact that unlike foreign exchange, interest rate and commodity derivatives that are often exchanged for cash, there is no such market for employee stock options to validate the financial instrument model assumptions.

Also, the remark that 'way in-the-money options have no significant time value' (20b) and, therefore, 'the fair value for the option is the fair value of the stock' is inconsistent with the FASB view that volatility is a key element of option value. Admittedly in the circumstance described it is unlikely that the volatility value, which is a subset of what people commonly think of as time value, is very high. Our concern is valuing way in- or way out- of-the-money options is where the academic finance literature is split on the reliability of the value. We observe in the past that accounting standard setters confronted with way out- or in- the-money option value have sidestepped the issue by focusing on at-the-money options only. We are concerned about this significant gap in guidance, particularly for companies in acquisition mode.

We are uncertain why valuation can now be based on industry averages and other pertinent evidence such as published research (B23), when the valuation is supposed to be company specific. Would you please clarify the basis for this conclusion?

IV. Taxes

We are uncertain why a temporary tax asset should not be adjusted for changes in the fair value of the underlying stock (44), but rather wait for a triggering event to record a valuation allowance or the actual exercise of the stock. Shouldn't financial statement users expect that a company's tax asset reflects the company's best estimate at the financial statement date? This inquiry is consistent with our earlier recommendation that changes in tax effects related to options run to net income through the exercise date of the option. We believe that it makes sense to true up a tax estimate in the income statement consistently for both down (currently in ED) and up movements, especially when the tax effect is an objective measurement.

V. Dividend equivalents

We think the wording on the classification of dividend equivalents on unvested restricted stock is still unclear and will perpetuate the diversity in practice. The ED suggests that dividend equivalents on unvested restricted stock where the dividends are not repaid on forfeiture of the restricted stock be classified as compensation cost, but is silent on what happens if repaid. Identifying the accounting for unvested options would resolve this void.

VI. EPS

We are uncertain of the meaning of "the required pro forma per share amounts shall reflect the change in the denominator of the diluted earnings per share calculated as if the assumed proceeds under the treasury stock method, including measured but unrecognized compensation costs and any excess tax benefits credited to additional paid in capital were determined under the fair value based method (24)." Does this mean that at the EPS reporting date one is to exclude from vested and unvested options an estimate of the "to be forfeited" unvested options determined at the grant date?

We also are uncertain of the meaning of issuable in the phrase "if other options or other equity instruments are granted or forfeited during the period, the shares issuable shall be weighted..." If this applies to options, it negates the idea that options are considered at the reporting date; if it applies to (say) time restricted stock, such stock may be issued, not issuable.

VII. Sales of securities to employees

Sales of securities to employees via stock options or otherwise should enjoy a discount because they:

- Avoid fees to underwriters,
- Often are not transferable,
- They encourage purchases of employees who may not be so inclined because of their concerns about diversifying risk in their portfolio of assets that often is already weighted toward their company. (Issue C6).

We understand that the FASB may discount the second and third view as irrelevant, believing that only a company view and not an employee view should dictate value. We note that fair value is that value that a willing seller (the company) and buyer (employee) would agree to, and, therefore, both views impact value.

VIII. Disclosures

The requirement to disclose the transfer of value from existing shareholders to option holders upon exercise amounts seems redundant (46a), e.g., disclosing intrinsic value at exercise. If as the ED suggests, the expense shows that transfer, then it is already disclosed.

The significant increase in disclosure requirements seems to (rightly) suggest a concern about the quality and subjectivity of the fair valuation exercise. Given that, we believe that some readers may question whether a measurement of such uncertainty should be recognized in the basic financial statements.

IX. Cost benefit

We have priced the services of lattice model valuation experts and find them expensive... while being admittedly concerned about the requisite benefit.

X. Transition

We think that upon adoption of the new standard, companies should be able to revalue outstanding unvested stock options using a new methodology. We believe the ED (and, we suspect revisions to the ED), have changed (will change) the measurements of fair value. For example, consideration of the lattice model is now required, except under very limited conditions. Indeed, a lattice model is stated as "preferred," though it is clear that the Board has very mixed feelings on this issue on reaching this consensus. It is also clear from casual observation that practice is changing for early adopters, as more information becomes known about FASB's views on acceptable valuation considerations.

XII. Minor items

To be fair, please note that the U.S tax code also uses intrinsic value to value employee stock options, and the "safe harbor" fair value is a SFAS 123 valuation with significant adjustments for objective measures rather than strict adherence to SFAS 123 (B10). Also, from what we have heard the latter safe harbor value is rarely used.

We are uncertain of the meaning of the phrase "for purposes of financial statement disclosures" (B20) when the section refers to valuations in the income statement.

Are market prices for employee stock options available outside the U.S? (C60)

The probability of a performance conditions can exist between zero and one [hundred percent] (C102).

We are uncertain what reasons the FASB is citing as the basis for the departure from basic tax accounting (C136).

The E Glossary definition of "employee" neither requires the use of the term "consistently" nor should it reference its status under U.S payroll tax law because neither are definitive requirements. Further, section a and b as to "leased employees" are redundant.

Should the E Glossary definition of "grant date" regarding pending shareholder approval unless perfunctory also include employees who vote on getting their own stock options?