COUNCIL OF INSTITUTIONAL INVESTORS

Suite 512 • 1730 Rhode Island Avenue, N.W. • Washington, D.C. 20036 • (202) 822-0800 • Fax (202) 822-0801

Letter of Comment No: 4D
File Reference: 1102-001
Date Received: 1-21-03

January 21, 2003

MP&T Director—File Reference 1102-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1102-001

Dear MP&T Director:

The Council of Institutional Investors is pleased to respond to the Financial Accounting Standards Board's invitation for comments on similarities and differences between FASB Statement No. 123 and IASB's proposed IFRS on share-based payments.

Members of the Council, an association of more than 130 corporate, public and union pension funds with more than $3 trillion in pension assets, have a significant financial stake in the global capital markets. Audited financial statements are one of the primary sources of information available to guide and monitor Council members' investment decisions. The integrity of these statements is critical to Council members and their millions of pension system participants and beneficiaries.

<u>The Council supports the principles outlined in the IASB's exposure draft, and we urge the Financial Accounting Standards Board to propose and approve similar rules.</u> The IASB proposal is in line with the Council policy on the issue, which states that since stock options granted to employees, directors and non-employees are compensation and have a cost, companies should include these costs as an expense on their reported income statements and disclose their valuation assumptions.

Council members adopted this policy in March 2002, following a careful, two-year analysis and discussion of the issue. Their decision was based partially on the belief that disclosure-based solutions are no longer adequate given the explosion of stock-based compensation arrangements.

We believe the IASB's recommendation requiring all options to be expensed, along with meaningful disclosure of relevant assumptions, will result in high-quality, comparable financial statements.

We appreciate that many powerful interest groups are opposed to rules requiring all share-based payments to be expensed. However, we encourage FASB to stand firm in the face of the opposition. Council members have collectively lost billions of dollars in pension assets from the recent U.S. corporate scandals and market collapse. Financial reporting standards should be shaped solely by what provides the most relevant, comprehensive information about a company's financial condition, not by what results in the most attractive reported numbers.

Industry recommendations for enhanced disclosure of share-based payments should be considered. However, we do not believe that expanded disclosure should serve as a substitute for expensing.

We agree that modifications to current disclosure requirements would result in stronger protections for investors.

First, required disclosures should include details about the number of shares available for future award under all plans as of the beginning of the reporting period and the end of the reporting period. Potential dilution is a complex issue, and many investors evaluate option "overhang" as part of their investment assessments. Current disclosures address only one half of the "overhang" calculation—the number of outstanding options. The other, equally important half is the number of shares available for future award. That important number is missing from current disclosures.

Second, disclosure would be significantly enhanced if companies were required to provide descriptions of any material modifications, including repricings and replacements, to existing awards. Such modifications can serve as meaningful signals to investors, and, as a result, investors use those signals to make economic decisions.

These additional disclosures should be provided in annual and quarterly filings.

The Council applauds the FASB's work setting first-rate accounting standards and bringing greater transparency to financial reporting.

Please contact me with any questions.

Sincerely,

Sarah A.B. Teslik
Executive Director

cc: Robert Herz, FASB
David Tweedie, IASB