

COUNCIL OF INSTITUTIONAL INVESTORS

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January 20, 2003

Kimberley Crook
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: ED 2 Share-Based Payment

Dear Kimberley:

The Council of Institutional Investors is pleased to comment on the International Accounting Standards Board's exposure draft regarding 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.

The Council supports the principles outlined in the exposure draft. 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 requiring all options to be expensed, along with meaningful disclosure of relevant assumptions, will result in high-quality, comparable financial statements. We believe your approach is the most appropriate one for all countries, and we are urging the U.S. Financial Accounting Standards Board to add this issue to its 2003 agenda and approve similar rules.

We have a few suggestions that we believe might improve the proposed rule and result in stronger protections for investors.

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First, the proposed disclosures could be improved with the addition of 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. The proposed 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 your proposed 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.

Third, we request that the IASB carefully consider the appropriate accounting treatment for tax effects of share-based payments. We are concerned that the proposed treatment, which would require income statement recognition of adjustments, might be confusing for investors.

Finally, we urge the IASB to stand firm in the face of terrific pressure from powerful interest groups interested in killing this proposal. 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.

The Council applauds the IASB's work toward developing first-rate global accounting standards. Your work will greatly help Council members better evaluate and compare investment alternatives throughout the world.

Please contact me with any questions.

Sincerely,

Sarah A.B. Teslik
Executive Director

cc: Robert Herz, FASB
David Tweedie, IASB