COUNCIL OF INSTITUTIONAL

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

May 28, 2004

P.O. Box 5116

File Reference: 1102-100

Director of Major Projects—File Reference 1102-100

Financial Accounting Standards Board

401 Merritt 7

Letter of Comment No: 3172

Re: File No. 1102-100

Norwalk, CT 06856-5116

Dear Director:

The Council of Institutional Investors, an organization of more than 140 public, corporate and union pension funds with more than \$3 trillion in investments, is pleased to comment on the Financial Accounting Standards Board's exposure draft regarding share-based payments, which calls for the expensing of all share-based payments, including stock options, awarded to employees.

The Council supports the proposed rules detailed in the exposure draft and applauds the FASB's courage in championing this controversial and much-needed reform. We urge the FASB to stand firm in the face of terrific pressure from powerful interest groups interested in killing this proposal. Council members and other investors have collectively lost billions from recent U.S. corporate scandals, including ones resulting from fraudulent and misleading financial statements. The Council firmly believes that 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 FASB proposal is in line with 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. The 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.

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Audited financial statements are the primary source 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. We believe your approach is the most appropriate one for companies operating in the United States and will result in a reliable estimate of the cost of stock-based compensation arrangements.

We are pleased that the proposed disclosures provide financial statement users meaningful information about the number and value of share-based payments and the methodology used to value the awards. Taken together, the information should improve investors' ability to evaluate the cost and potential dilution of shareholder value represented by these awards.

While the proposed disclosures of the variables used to estimate fair value are helpful, we recommend that the FASB consider expanding the disclosure of volatility to include three years of data on actual volatility, as determined by some consistent standard. While past volatility may not be representative of future volatility, such disclosure, which should be easy to calculate, would greatly enhance investors' ability to check on misuse and gauge the reasonableness of the volatility assumption.

The Council applauds the FASB's work toward developing first-rate accounting standards. Your work will greatly help Council members better evaluate and compare investment alternatives and improve the functioning of U.S. financial markets.

Please contact me with any questions.

Sarah A.B. Teslik
Executive Director

Sincerely

c: Robert H. Herz, Chair, FASB

Senator Richard C. Shelby

Senator Paul S. Sarbanes

Congressman Michael G. Oxley

Congressman Richard H. Baker

Bryan Corbett, Counsel, Senate Committee on Banking, Housing and Urban Affairs Jeffrey P. Mahoney, FASB