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JAMES P. GARLAND
PRESIDENT

February 24, 2003

Kimberley Crook
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UMTED KINGDOM

Dear Ms. Crook:

I am writing in regard to ED2: Share-Based Payment.

The Jeffrey Company is a family holding company, a corporation that's owned by one family and that invests its capital in shares of other publicly traded companies. Thus I'm writing on behalf of The Jeffrey Company's shareholders who indirectly own shares of publicly traded corporations such as General Electric, Unilever, and Microsoft.

The Jeffrey Company strongly supports the IASB's efforts to expense employee stock options.

Long-term investors who buy shares, and employees who receive options, have opposing interests. Long term investors are interested in the earnings, cash flows, and dividends from their investments, with prices being only a secondary consideration. Option holders are interested in the prices of their investments, and nothing else. Long term investors like cash dividends, because dividends are real money that's not subject to market fluctuations, and dividends are a more secure form of return. Option holders dislike dividends, because dividends diminish the value of their options. Long term investors focus on the long term. Option holders focus on the short term.

The current American accounting standard that discourages the expensing of options in turn encourages their issuance. And the issuance of options encourages executives and directors of corporations to focus on their own interests rather than the interests of their shareholders. This so-called agency problem — i.e., the conflict between agents and owners — did not originate with stock options, but it has been exacerbated by their indiscriminate use. If options were expensed — as they should be to meet accounting goals of transparency and accuracy — then corporations would issue fewer options, and the interests of agents and owners would be more closely aligned.

Options are compensation and should be expensed. The common arguments for *not* expensing options don't make sense.

The claim that options should not be expensed because they have no value is laughable in the same league as the claim that currency has no value because it's just pieces of paper.

- The claim that options should not be expensed because they're hard to value is defensible only if the accounting and investment communities find it desirable not to expense other hard-to-value costs such as depreciation.

- The claim that options should not be expensed because they're essential to entrepreneurial capitalism is specious. For one thing, the expensing of options would not prohibit their issuance. For another, entrepreneurial capitalism has flourished in this and other countries for a long time without the extensive use — or even the presence of options. A slightly different claim that options should not be expensed because their use encourages the formation of stock market bubbles would carry more weight. But encouraging bubbles should not be a goal of the accounting profession.

- The claim that options do not need to be expensed on the statement of profit and loss (P&L), because they're already accounted for in a footnote, ignores the importance of the P&L and overstates the financial literacy of both analysts and investors. While the details of option schemes should be explained in a footnote, both the presence of options and their cost should be revealed in the most important statement of all i.e., the P&L.

Jeffrey shareholders and I both thank the IASB for its efforts to make employee stock options a front-page expense rather than just a back-of-the-report footnote. We disagree with the Exposure Draft on only one point. Paragraph 21 of the Draft recommends that option expense be calculated based on the expected life of an option rather than on its contractual life. Question 12 asks if we agree with this idea. We do not. The value of an option should be calculated based on its contractual life. But our disagreement with paragraph 21 is a relatively minor one, and we'd be delighted if the Draft in its current form were to be approved by the IASB.

Sincerely,

James P. Garland
President