

THE JEFFREY COMPANY
88 EAST BROAD STREET
COLUMBUS, OHIO 43215-3508
614-221-0828

Letter of Comment No: 3185
File Reference: 1102-100

JAMES P. GARLAND
PRESIDENT

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Director of Major Projects
File Reference No. 1102-100
Financial Accounting Standards Board
Norwalk CT 06856-5116
(sent via FedEx)

Dear Sir or Madam:

We wholeheartedly support the FASB's proposals to modify Statements 123 and 95 to require that stock options be expensed on the P&L.

For the record, we agree with the Board on Issue #1, that the cost of options should be treated as compensation and recognized on the financial statements.

We also agree with the Board on Issue #2, that the pro forma disclosures permitted under Statement 123 are not an appropriate substitute for recognition of costs on the financial statements.

We'll defer comment on most other issues, because of their technical nature that's beyond our competence. But in regard to Issue #18, we think the Board has done a fine job explaining the issues and the positions that it is taking.

For the record, The Jeffrey Company is a family-owned company that invests exclusively in publicly traded stocks and bonds. We are a buy-and-hold investor; the average age of our equity holdings is approximately 15 years, and a few holdings are more than 50 years old. We call ourselves a "family endowment fund" because our primary objective has been to make distributions to family members that are stable, that keep pace with inflation, and that do not favor one generation over another. In making both investment decisions and distribution decisions, we rely on published financial statements from the corporations whose securities we own. From your perspective, we qualify as a user of financial data — and that's why we're intensely interested in good accounting.

In addition to the specific comments above on the issues in the current Exposure Draft, we have a few general comments below.

Executives with stock options have different interests than long-term investors like us. Executives with stock options have a financial incentive to starve dividends and to boost their stock price via share buybacks — no matter what the current price of the stock. Faced with the choice of using corporate cash to boost the dividend by a quarter or to

boost the stock price by a dime, options encourage executives to boost the stock price by a dime. The executives win; we long-term investors lose.

Options encourage short-term thinking. Individuals with currently exercisable options would have to be saints not to focus on boosting the short-term price of their stock. This diverts their attention from the issue that matters most to us, namely their company's long-term health and prosperity. Individuals with options waste too much precious time watching their stock's price.

Options magnify greed. The huge financial leverage of options — the fact that they're worthless at one price, and worth a fortune at another — encourages corporate executives to bend rules and change facts. Three professors at Texas A&M recently wrote a paper on their finding that option compensation was closely related to bad accounting. To quote from their abstract: "...we find that the Chief Executive Officer's stock option compensation...is the most influential factor affecting the likelihood of a[n earnings] misstatement."

Options don't necessarily reward good behavior or even good results — options are lottery tickets that reward good luck. Reginald Jones was chairman of General Electric from 1972 to 1981. During this period earnings and dividends more than doubled — but the price of GE stock fell. When Mr. Jones retired in 1981, his 1972 options were under water. So much for good behavior and good results!

The fact that options cannot be valued precisely does not mean they shouldn't be expensed at all. By that same logic, bricks-and-mortar assets shouldn't be depreciated, either. Who really knows the correct depreciation rate for (say) Intel's headquarters building? No one. Should that stop Intel from depreciating its headquarters building? No.

The expensing of options needs to be mandatory. We own shares of several large pharmaceutical companies, none of which expense options. I had a phone conversation recently with one company CEO who told me that he couldn't expense options until his competitors did, too. Presumably if his company were to voluntarily expense options today, its reported earnings would decline, thereby lessening the value of his and his colleagues' current options. Furthermore, his company would be likely to issue fewer options in the future, which would put it at a disadvantage (compared to other pharma companies) in recruiting new senior employees.

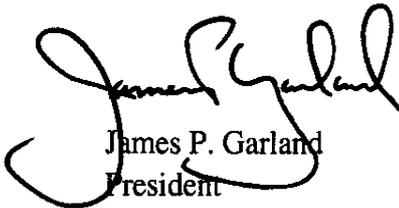
Options have value. Options are compensation. Not to record them as an expense is wrong. The reluctance to expense options comes from a fear that reduced reported earnings might depress stock prices. A compensation tool that encourages poor accounting is a tool whose use should be discouraged.

Expensing options puts the best possible brake on their use — i.e., one that's flexible and market based. Because stock options currently appear to be "free," companies issue too many of them. Under the proposed standards, companies will remain free to issue options, but the options themselves will no longer be free — and when options cost money, companies will issue fewer of them. In spite of the above comments, we certainly don't want to forbid the use of options. Options make perfect sense in many situations. We just want the use of options to be moderated by natural market forces — i.e., by having them treated on financial statements on an equal basis with all other types of compensation.

If your agency thinks it useful, I would be willing to come to Norwalk to participate in the public roundtable session on June 29.

In closing, we appreciate the FASB's efforts to improve accounting standards in this very significant area.

Sincerely,



James P. Garland
President

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