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GERALD I. WHITE, CFA
PRESIDENT

June 30, 2004

Letter of Comment No: 6411
File Reference: 1102-100

Director of Major Products
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference 1102-100, Share-Based Payment

Dear Sir:

General Comments

I am writing this letter as someone who has been a financial analyst and investment advisor for more than thirty-five years. I have represented the analyst community in the financial reporting process, served on FASAC and several FASB task forces, and taught financial statement analysis at the graduate level. While many Board members and staff are familiar with my background, I have attached some biographical information to this letter.

The exposure draft represents an important positive development in financial reporting, as it remedies a glaring deficiency in current GAAP. Despite all of the posturing of those who oppose the expensing of share-based compensation, there are two principles that remain unassailable:

1. Options and other share-based compensation instruments have real economic value.
2. Financial statements that fail to record these economic values omit corporate expenses that are often material and almost always relevant to the evaluation of corporate performance.

These principles require that all share-based payments be recorded in financial statements, with appropriate recognition as expenses.

Some opponents of expensing have argued that fair value measurement is not sufficiently precise to be accorded accounting recognition. This argument ignores two critical points:

- (1) Virtually all measurements now incorporated into financial statements are imprecise. Revenue recognition is often based on estimates. Depreciation and amortization, the allowance for bad debts, retirement benefit cost, insurance reserves, and impairment are examples of income statement constituents based on estimates that often turn out to be inaccurate.
- (2) Companies that grant options to their employees must have some quantifiable understanding of the value of those grants. Grants to senior management often result from complex negotiations that may involve the board of directors (or at least its compensation committee) and outside consultants. These circumstances strongly suggest that companies explicitly measure the value of options granted.

Measuring stock options at a value of zero is clearly erroneous. Given the disclosure requirements of Statement 123, most preparers and their auditors have extensive experience with the measurement issues peculiar to stock options. Therefore I expect that implementation of the new standard will be far easier than for prior standards (derivatives, for example) where that experience was lacking.

Responses to Specific Issues

Recognition of Compensation Cost

Issue 1

Share-based payments are a form of compensation that should be recognized in the employer's financial statements. There is no rational argument against the Board's conclusion.

Issue 2

While the pro forma disclosures are extremely useful to financial analysts, they are not a substitute for financial statement recognition. The integrity of financial statements requires that all expenses be recorded in the income statement rather than relegated to footnote disclosure.

Measurement Attribute and Measurement Date

Issue 3

I agree with the Board's conclusion that grant-date fair value is the best measurement of the value of share-based instruments.

Fair Value Measurement

Issue 4(a)

I believe that the ED provides sufficient guidance for financial statement preparers to measure the value of employee share options. As companies have been granting options for more than two decades and making pro forma disclosures of the fair value of options granted for nearly ten years, they should have little difficulty implementing the new standard.

Issue 4(b)

As stated earlier in this letter, I believe that the measurement problems peculiar to stock option expensing are no more onerous than in other areas of financial reporting. Given the high relevance of stock option cost for many companies, the reliability of measurements proposed in the ED is sufficiently high.

The Black-Scholes model has the advantages of familiarity and transparency; financial statement users can critique the assumptions used and make their own estimates if they wish. I am not sufficiently knowledgeable about lattice models to state whether they are preferable. If the Board holds this belief, it should allow companies to use such models, accumulating experience and educating the financial community until such time as the Board chooses to revisit this issue.

Issue 6

I agree; all shareholders can enroll in dividend reinvestment and other plans that permit them to purchase shares at the current market price.

Issue 7

I agree.

Issue 14(a)

In principle, I believe that all entities applying GAAP should use the same accounting methods. The line between public and nonpublic entities is increasingly gray as many “nonpublic” companies have numerous shareholders (some are investment funds with many shareholders). When a “nonpublic” company issues stock options, it is often in anticipation of going public. For all of these reasons I oppose allowing “nonpublic” entities to prepare financial statements without properly accounting for their options.

Issue 15

The arguments made in response to issue 14(a) are even more applicable here. As an investor in smaller companies, I strongly oppose allowing any public firms to issue financial statements that use inferior GAAP.

Issue 16

I agree. Such cash flows are neither operating nor investing in nature.

Issue 18

Yes; the proposed standard is far less hard to understand than many existing standards and should be comprehensible to anyone with a reasonable understanding of financial matters.

Conclusion

I urge the Board to adopt the exposure draft as a final statement. This subject has already consumed far too much of the Board's efforts and it is time to put a standard in place.

If there are any questions, I would be pleased to respond.

Sincerely,

A handwritten signature in cursive script, appearing to read "Gerald J. Roberts".

GERALD I. WHITE, CFA

President, Grace & White, Inc. Investment Counsel

Brown University, AB 1966

New York University, MBA 1971

Chartered Financial Analyst

CFA Institute (formerly AIMR):

Member, Financial Accounting Policy Committee, 1970 - 2000

(Chairman 1976 - 1987)

Distinguished Service Award (1987)

C. Stewart Sheppard Award (1995)

Adjunct Professor of Accounting, New York University

Stern School of Business (1978 - 1995)

Co-Author, *The Analysis and Use of Financial Statements*, Third Edition

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