



June 29, 2004

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

By email to: director@fasb.org

Re: File Reference No. 1102-100

Dear Ms. Bielstein:

First Horizon National Corporation appreciates the opportunity to comment on the Exposure Draft, *Share-Based Payment, an amendment of FASB Statements No. 123 and 95* (the "Exposure Draft"). We acknowledge the extensive process undertaken by the FASB in its reconsideration of the conclusions previously reached in Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"). However, we believe that certain provisions of the Exposure Draft should be revisited by the FASB during its consideration of respondents' comments. Additionally, we believe that enhancements can be made in specific areas of the Exposure Draft to improve the quality of information provided to investors and to provide additional guidance for entities upon adoption of the new standard. Our concerns are summarized in the following categories.

- Income Taxes
- Cash Flows
- Graded Vesting
- Measurement Methodology
- Assumption Estimates
- Restatement Prohibition
- Transition Guidance
- Disclosures
- Requisite Service Period

Income Taxes

Under the guidance provided in the Exposure Draft, a tax "shortfall" at exercise would be recognized as income tax expense while a tax "windfall" would be recognized as additional paid-in capital. We believe that a more appropriate model is provided in paragraph 36 of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, which requires adjustments be made to paid-in capital for deductible items resulting from the

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issuance of stock. This treatment is consistent with the view presented in the Exposure Draft that, at exercise, an equity transaction (as opposed to a compensation event) has occurred. Therefore, since an equity-issuance transaction has occurred, we believe that tax "shortfalls" should be recognized as a reduction of paid-in capital regardless of whether prior increases to paid-in capital have been recognized for share-based awards.

We believe this position is further supported by the expense measurement provisions of the Exposure Draft. Since the fair value, as measured at grant date, of a share-based payment will not change (assuming no modifications), the amount ultimately expensed will be based on this initially determined fair value. However, requiring additional income tax expense to be recognized on a "shortfall" essentially results in a remeasurement of fair value at exercise date for recognition of income tax expense, without any corresponding change to reported pre-tax earnings.

If the FASB determines that tax "shortfalls" should be recognized in the income statement, then we believe that this is a *de facto* recognition of the entire share-based award process (including exercise) as a compensation event. Under this scenario, any "windfalls" created at exercise should also be recognized in the income statement.

The Exposure Draft also requires that an entity's deferred tax assets be true-up for the deduction received upon each individual employee exercise. We believe that this provision is inconsistent with the requirements of the Exposure Draft to base the estimated value of share-based awards at the grant level, not the individual level. Embedded within each grant's fair value are assumptions developed from a history of several grants, with modification for current expectations. Therefore, it seems that tax true-ups should occur, at a minimum, at the grant level, if not a portfolio level.

Cash Flows

We understand the motivation for the classification of cash flows to be consistent with the basis of accounting for share-based awards. However, we believe that the payment of taxes is a distinctly different event from the actual issuance of a share-based award. We believe, as discussed above, that the issuance of shares is an equity event. The payment of taxes by an entity is an operating event. Therefore, events affecting the amount of taxes paid (e.g., excess tax benefits resulting from the exercise of a share-based award) should be considered within operating cash flows. This treatment is consistent with that afforded to interest costs related to (and tax benefits derived from) financing activities performed through the issuance of debt as well as the tax implications of investment sales.

Graded Vesting

The Exposure Draft requires that grants with graded vesting be split into separate awards for determination of fair values and the applicable service periods based on vesting date. Since the agreement between the entity and the employee is for the life of the grant, we believe that grants with graded vesting have the same requisite service period (and period of employee service benefits received) as grants with cliff vesting. We also believe that the fair value of an award with graded vesting can be determined with the same degree of accuracy as cliff vested awards. This fair value should then be allocated over the life of the grant (i.e., term of the agreement) using the straight-line objective applied to other share-based awards (as currently required by SFAS 123).

Measurement Methodology

We agree that the use of a lattice (binomial) model is theoretically preferable to a closed-form model (Black-Scholes-Merton). However, while the Exposure Draft states that use of a lattice model is preferable, there are several points in the Exposure Draft where it could be inferred that a lattice model is required unless it is completely impracticable for an entity to develop a reasonable basis for the associated assumptions. We believe that the inputs into a model have a greater likelihood of affecting the fair value of share-based awards than the actual model used. It is conceivable that an entity using Black-Scholes-Merton could have a more accurate measurement of a grant's ultimate fair value than an entity using a binomial model based purely upon the inputs (and underlying assumptions) used in each model. Since, regardless of the model used, the true fair value for an award (with a future vesting period) will never be known at the date of grant, we believe that the FASB should not formally endorse any valuation model as more preferable in the final statement.

Assumption Estimates

The Exposure Draft requires that in situations where a range of possibilities has been developed for an assumption and no single option is more or less likely, an entity should use an average of the range (the expected value). We believe, as indicated in SFAS 123, that the provisions of FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss (an Interpretation of FASB Statement No. 5)*, present a more appropriate estimation methodology. By definition, when a range is established and it is probable that a loss has been incurred, if no point in the range is considered more probable than any other, the entity should accrue the low end of the range immediately through expense. Therefore, we believe that, when no single point in the range is considered most preferable, the estimates used in determining the fair value of a share-based award should use the end of the range resulting in the lowest amount of expense recognition.

Restatement Prohibition

We believe that the Exposure Draft's prohibition on restatement of prior financial statements will result in a significant decrease in comparability of information for users of financial statements. Given the significant changes between the Exposure Draft and SFAS 123, financial statement users cannot simply compare the pro forma disclosures, for entities electing to use Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), from the footnotes and arrive at an amount truly comparable to the expense to be recognized under the new statement. We believe that the Exposure Draft is correct in not requiring a re-determination of fair value for previously issued awards. However, the inability to restate prior periods creates significant unnecessary disclosures for entities that continue to report those prior periods in subsequent years (e.g., SEC registrants). Therefore, we believe that restatement of prior periods should be permitted with the previously determined fair values being acceptable for valuation purposes. This is essentially the "Retroactive Restatement Method" previously addressed by the FASB in Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure - An Amendment of FASB Statement No. 123*.

We also believe that a full restatement in accordance with the provisions of the new statement should also be permitted in situations where it is practicable to do so. This would include a retroactive application of a new model for valuing options so that all share-based awards would be consistently valued for all periods presented should an entity elect to change its valuation methodology upon adoption of the new statement. We acknowledge the

FASB's concern regarding the "hindsight" effect on valuation of prior awards, but we believe that, given the potential magnitude of the financial statement impact, a desire for comparability consistent with Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*, takes precedence over possible mis-valuation of historical share-based compensation awards.

Transition Guidance

As stated above, the significance of differences between SFAS 123 and the Exposure Draft would result in a lack of comparability between reporting periods presented in future financial statements. Compounding this difference could be an entity's election to adopt a binomial model, given the FASB's stated preference, after previously applying Black-Scholes-Merton. Any differences resulting from adoption of the new standard would lead to financial statement comparability issues until the period during which awards outstanding at the initial adoption of the new statement vested were no longer included in subsequent financial statements. For a public registrant, this condition would likely exist for at least five years after adoption due to the Securities and Exchange Commission's three year income statement presentation requirement (i.e., two years or more until vesting and three years of income statements presented in filings). We believe that this provides additional support for the position that restatement of prior period financial statements be permitted by the new statement.

Disclosures

As presented in our comments on restatement, we believe that if it is practicable for an entity to restate prior financial statements, we believe this should be permitted. This would result in an elimination of some of the transitional disclosures required by the Exposure Draft, including the continued presentation of prior pro forma SFAS 123 disclosures for entities that opted to use APB 25 to value options.

Additionally, we believe that the continued use of intrinsic value within disclosures for share-based awards would only create confusion for the users of financial statements. If a transition to the fair value measurement of share-based awards is necessary, then terms such as intrinsic value should be put aside as much as possible. Additionally, once an entity commences recognizing compensation expense in its income statement for share-based awards, the transfer of value from existing shareholders to holders of share-based awards is measured in the income statement and the potential dilution of shares is included in the present calculation of weighted average shares. Thus, we believe that disclosure of intrinsic values and the transfer of value from existing shareholders would not have any relevance once share-based awards are recognized in the income statement using fair value measurements.

Service Inception Date

The Exposure Draft indicates that, in certain circumstances, the service inception date (i.e., the first date compensation cost should be recognized) can occur before the grant date. This results in the possibility that compensation expense would be recognized prior to the formal approval of the grant by the appropriate authority. While we agree that it is possible for employees to provide service based on an informal understanding of an anticipated share-based award, we believe that if the remaining events until grant are more than perfunctory (e.g., approval by the Compensation Committee), then expense should not be recognized until the grant has been approved. We believe this is consistent with the approval/commitment provisions of Statement of Financial Accounting Standards No. 144, *Accounting*

for the Impairment or Disposal of Long-Lived Assets, and Statement of Financial Accounting Standards No. 146, *Accounting for the Costs Associated with Exit or Disposal Activities*. We believe that it would be undesirable to establish a precedent, however narrow, that approval is not required before transaction recognition.

If you have any questions or comments regarding the positions presented in this letter, please contact me at (901) 537-1937.

Sincerely,

/s/ Shawn P. Luke

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