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VIA E:MAIL: director@fasb.org

Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116

Re: <u>File Reference No. 1810-100</u> - Exposure Draft – Proposed Accounting Standards Update – Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Dear Mr. Golden:

Honeywell International is a diversified technology and manufacturing leader, serving customers worldwide with aerospace products and services; control technologies for buildings, homes and industry; automotive products; turbochargers; and specialty materials. Based in Morris Township, N.J., Honeywell's shares are traded on the New York, London and Chicago Stock Exchanges.

We appreciate the opportunity to offer comments on the Proposed Accounting Standards Update - Accounting for Financial Instruments and Revisions to Accounting for Derivative Instruments and Hedging Activities ("the proposed update"). While we appreciate the FASB's ("the Board") efforts to reduce complexity, simplify accounting and improve financial reporting for financial instruments, derivatives and hedging activities, we have significant concerns with the current proposed changes. Our concerns are driven by anticipated issues associated with the adoption of certain proposed changes and the interaction of such adoption with interpretation from both an audit and regulatory perspective. Additionally, certain proposed changes represent an increase in complexity and rules based accounting which is contrary to the Board's objectives to improve the accounting standards and strive for convergence with IFRS. Lastly, there are certain proposed changes which would result in accounting that misrepresents transaction economics and limits our ability to appropriately mitigate risk thereby negatively impacting our investors and shareholders. We are concerned that the significance of these changes and their impacts may not be fully contemplated by the Board. Below we provide detail regarding these concerns and our proposed alternatives.

In the May 2008 draft, changes to foreign currency hedging of forecasted intercompany transactions were proposed. In subsequent discussions and publications it was noted that the proposed changes would require linkage between intercompany exposures and the third party transaction that results in an earnings exposure living through in consolidation. The May 2008 exposure draft lacked detail regarding such linkage and how it should be practically implemented. We noted that such changes are not mentioned or expanded upon in the current proposed update.

We are concerned that this concept has not been fully exposed to the preparer community and any changes to this area in the finalization of the proposed update would have substantial implementation issues. We strongly urge the Board to either clarify that there will be no changes to the existing guidance and current practice around these transactions or to further research the current use of foreign currency hedging of forecasted intercompany transaction to understand the existing strategies and practices that companies use to manage these foreign currency exposures. We would recommend that the Board then re-expose any proposed changes including additional guidance and practical examples on the concept of linking intercompany transactions to third party exposures for portfolios with significant forecasted intercompany transaction hedging activities. By doing so the Board will ensure any potential changes to the existing guidance are done so with thorough feedback from the preparer community, which will result in a more feasible, operational and successful implementation.

The following provides responses to several of the specific questions raised by the Board in the proposed update. We have limited our responses to those questions that most significantly impact our processes, operations and risk mitigation strategy.

Question 1: Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments do you believe should be excluded or which financial instruments should be included that are proposed to be excluded? Why?

We believe clarification of the scope is necessary as it relates to securitized or factored trade receivables that have not met the true sale criteria detailed in ASC 860, *Transfers and Servicing* or a trust which holds the receivables and is required to be consolidated under ASC 810, *Consolidation*. The current proposed update is unclear as to whether these types of trade receivables would be treated in the same manner as the short-term receivables and payables discussed in paragraph 33 of the proposed update. We believe instruments of this nature should be carried at amortized cost in order to maintain consistency across receivables of similar nature.

Question 4: The proposed guidance would require an entity to not only determine if they have significant influence over the investee as described currently in Topic 323 on accounting for equity method investments and joint ventures but also to determine if the operations of the investee are related to the entity's consolidated business to qualify for the equity method of accounting. Do you agree with this proposed change to the criteria for equity method of accounting? If not, why?

We do not agree with the proposed change to the criteria for equity method accounting. The accounting for equity method investments including conclusions regarding significant influence, participating versus protective rights, and majority versus minority ownership already contains significant complexities. Incorporating additional considerations of whether the operations of the investee are considered related to the investor's consolidated operations serves only to increase the difficulty of practically completing these assessments, expands the potential for inconsistent accounting conclusions across companies and industries, and expands the current rules based accounting. Also, the Board's proposal does not address strategic equity method investments which may not meet the criteria to be considered related to the investor's consolidated operations but are

necessary in order to begin operating in certain markets in the future. This is most common in emerging regions, where often without strategic equity method investments Company's cannot begin expanding operations to such markets.

Additionally, many of our equity method investments are in small non-public investees for which performing or obtaining a quarterly valuation of fair value would be extremely difficult, costly, and would result in a potentially inaccurate illustration of the earnings cycle of these investments. This would not prove beneficial to our investors' and financial statement users' understanding of these investments and their performance. The majority of our equity method investments are made based on a business strategy to invest long term and recognize earnings on these ownership interests as the companies grow and expand their operations (which may be considered related to our current operations or may represent operations for which we plan to expand our market involvement in the future). A quarterly fair value measurement would not result in an accurate reflection of this business strategy or the corresponding earnings cycle.

Lastly, the changes to the criteria for equity method accounting would also cause a significant difference between US GAAP and IFRS which is contradictory to the FASB's joint convergence efforts. We believe the additional criteria, of related operations, for equity method accounting should not be incorporated into the proposed update. This change will be challenging to implement, will not prove useful for the majority of financial statement users and may in fact be a detriment to their understanding of the nature of our equity method investments and represents a significant divergence from the IFRS treatment of equity method investments. We recommend the Board, in joint deliberation with the IASB, perform a more in-depth study of the perceived issues associated with the application of the current model for equity method investments prior to finalizing any proposed changes.

Question 8: Do you agree with the initial measurement principles for financial instruments? If not, why?

We do not agree with the initial measurement principles for financial instruments. Generally, we feel that a more principles based model that focuses on management's long term strategic plan with respect to the financial instrument is a more appropriate measurement approach. Based upon management's long term strategic plan the accounting treatment of amortized cost, fair value with changes through earnings, or fair value with changes through other comprehensive income would be determined. Specifically, we do not agree with the initial measurement principles as they relate to equity investments and contracts with embedded derivatives.

Measuring all equity investments at fair value with changes recognized in earnings will result an accounting treatment that does not necessarily reflect a company's long term strategic plan with respect to such investments. If a company's management has the long term strategic plan in place to hold an equity investment as a long term investment, collect dividends and distributions on the investment, and function as a long term strategic financial partner with the business, measuring the investment at fair value through earnings each period would misrepresent the nature of the investment. Additionally, measuring equity investments at fair value through earnings under the proposed update would result in significant earnings volatility that is not directly associated with a company's normal

business operations and would potentially mislead investors and financial statement users and be difficult to implement. We propose the treatment of equity investments converge with the current approach under IFRS and allow for treatment of equity investments at fair value through other comprehensive income if supported by management's long term strategic plan and irrevocable election at acquisition of the investment. Any concerns regarding investor and financial statement user access or visibility to information regarding changes in fair value of such an equity investment would be addressed through the required accounting of fair value changes in other comprehensive income and disclosure requirements of such activity. Such a change would represent a step towards convergence while also providing useful and pertinent financial statement information for investors and users.

We also do not agree with the initial measurement principles for financial instruments as they relate to contracts with embedded derivatives. Requiring measurement of contracts with embedded derivatives that are not clearly and closely related at fair value with changes recognized in earnings will result in treatment of the host contract that is inconsistent with its characteristics and management's long term strategic plan. By definition, contracts that contain an embedded derivative that is not clearly and closely related would typically not be measured at fair value with changes recognized in earnings without the existence of the derivative. Such derivatives are often insignificant or non-substantive in relation to the underlying host contracts such as inflation indices embedded within a receivable. Preventing bifurcation of these contracts results in the application of fair value accounting treatment to the contract while the nature and characteristics of the host contract (which typically represents the majority of the value of the instrument) are essentially ignored. Additionally, we believe this treatment does not simplify the accounting for these types of instruments as a company would still be required to identify, understand and value the hybrid instruments under the proposed model. This will be operationally difficult to implement and result in treatment that overrides the primary business strategy associated with the instrument. We propose the Board maintain the existing embedded derivative bifurcation accounting which would allow for unrelated embedded derivatives to be bifurcated thus treating them in the most appropriate manner while treating the host contract in a manner that is consistent with its nature and management's long term strategic plans.

Question 16: The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications should be prohibited? If not, in which circumstances do you believe that reclassifications should be permitted or required? Why?

We do not agree that reclassifications of initial measurement elections be prohibited. Instances of changing initial measurement elections should be limited, however if the nature in which management intends to utilize a financial instrument changes the measurement election should be adjusted to coincide with such change. We propose the Board incorporate requirements similar to the existing guidance in ASC 320, *Investments – Debt and Equity Securities* (specifically, changes to initial elections would potentially call into question managements intent and ability to make the same assertions for other similar investments), to ensure that changes to initial measurement elections are limited to isolated, nonrecurring, unusual events that could not have been reasonably anticipated. In

the event there is a reclassification of initial measurement elections significant disclosure of any such events would be required.

Question 56: Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

We believe the modification to the effectiveness threshold from highly effective to reasonable effective is appropriate. The elimination of bright line guidance regarding quantitative hedge effectiveness assessments is an improvement to the accounting for hedging activities. We feel it will result in more consistent application of hedge accounting and will improve companies ability to manage risk. However we have concerns regarding the definition of reasonably effective and implications of the change from an audit and regulatory perspective. We propose the Board incorporate additional guidance or examples illustrating criteria to consider when assessing if a relationship is reasonably effective. This clarification will improve the implementation of the modification to the effectiveness threshold and reduce costly and time consuming reviews both from the perspective of the auditor community and regulatory bodies.

Question 57: Should no effectiveness evaluation be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term? Why or why not?

We agree additional effectiveness evaluations should not be required after inception of the hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonable effective over the expected hedge term. We utilize hedge accounting, specifically critical match terms relationships, to manage our risks and our designations are based upon strong economic relationships. Thus we believe given the nature of our hedge relationships, if at inception it was determined to be reasonably effective, there is no need for additional effectiveness assessments, barring any significant changes to the underlying risk, hedging instrument or market environment that are expected to exist for more than a temporary period of time.

Alternatively, we believe it is unclear in the proposed update if quarterly measurements of ineffectiveness would be required if all of the critical terms of the hedged item and hedging instrument match other than insignificant timing mismatches (such mismatches are within a "reasonable" time period). In such instances we strongly believe that ongoing measurements of ineffectiveness on a quarterly basis should not be required. We believe paragraph 126 of the proposed update may indicate the Board's acceptance of the "minimal" or insignificant ineffectiveness associated with these types of relationships and that no ineffectiveness measurements would need to be performed on an ongoing basis. By requiring ineffectiveness calculations on each relationship with no exception if critical terms match and the relationship is expected to have insignificant ineffectiveness at inception over the expected hedge term, the Board is potentially creating significant additional quarterly requirements while providing no benefit to investors or users of the financial statements. Such requirements will have significant system, cost, and timing implications (from the perspective of our quarterly and annual filing deadlines). See our response below regarding the operational concerns of completing

ineffectiveness calculations for every cash flow hedging relationships regardless of expected ineffectiveness.

In addition to the significant operational constraints in calculating ineffectiveness for all cash flow hedging relationships on a quarterly basis (even those where the critical terms match) we have significant concerns regarding the Board's proposed change to the recognition of ineffectiveness associated with cash flow underhedges. The current proposed change would require ineffectiveness to be recognized in earnings for gains and losses on the hypothetical derivative instrument. There are fundamental differences between the ineffectiveness associated with overhedging (which represents an economic gain or loss that will and should impact earnings, consistent with current requirements) and underhedging. Gains and losses on underhedging are noneconomic and nonrecurring; they are caused by noncash timing differences and will never be truly realized or incurred. Therefore, by forcing companies to recognize these gains and losses in earnings each period it will cause increased volatility, complexity and confusion for investors and financial statement users regarding the effectiveness of hedging relationships. We propose the Board remove the requirement to record in earnings the ineffectiveness related to underhedges in cash flow hedging relationships.

Question 61: Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for cash flow hedging relationships? If yes, what constraints do you foresee and how would you alleviate them?

We have significant concerns around the operational constraints in calculating ineffectiveness for all cash flow hedging relationships. We maintain a portfolio of nearly 10,000 hedging relationships over the course of a fiscal year, used strictly to mitigate our exposure to foreign currency risk. These relationships are currently designated under ASC 815 as critical matched terms relationships where all of the critical terms of the hedging instrument match the hedged transactions. Therefore, outside of certain annual procedures to indicate there is no or insignificant ineffectiveness associated with these relationships and monitoring that critical matched terms continue to exist we do not complete ongoing calculations of ineffectiveness. Requiring this calculation for every hedging relationships regardless of whether critical terms match will have significant operational implications to our current processes, systems and organization and will be operationally difficult to implement.

Our current system does not contain the functionality to create an additional 10,000 hypothetical derivatives and calculate ineffectiveness between the actual derivative instrument and hypothetical derivative. Additionally, given the size of our portfolio and our quarterly filing requirements it would be impossible to manually calculate ineffectiveness within our current treasury operations on a timely basis. Therefore if this requirement were to be finalized we would be forced to either extensively expand our treasury staffing or make significant IT investments for a new treasury system with the capability to perform the proposed calculations. Both options would require extensive lead time, potentially create significant organizational disruptions and result in additional significant capital costs. This change would provide no value to our investors and financial statement users. In order to alleviate these operational constraints we encourage the Board to provide additional guidance in the proposed update that would clarify the requirements for ineffectiveness calculations for cash flow hedging relationships and allow for an exemption to the calculation requirements for those relationships in which all of the critical terms match.

Question 63: Do you foresee any significant operational concerns or constraints arising from the inability to discontinue fair value hedge accounting or cash flow hedge accounting by simply dedesignating the hedging relationship? If yes, what constraints do you foresee and how would you alleviate them?

We foresee operational impacts arising from the inability to discontinue hedge accounting by simply dedesignating a relationship. We currently utilize this approach in our commodity hedging program to address basis risk which is not the primary hedged risk in these relationships and is not a component of the derivative instrument used as the hedging instrument. When the basis risk changes, we incorporate such change into the assessment and measurement procedures and recognize the necessary portion of ineffectiveness in earnings. Assuming the basis risk change has not resulted in our hedge relationship no longer meeting the effectiveness evaluation requirements; we then dedesignate the hedge relationship and redesignate a new hedge relationship with the adjusted basis risk. This approach is a critical component of our risk management strategy.

We manage our commodity hedging in this manner under the existing ASC 815 guidance which prohibits commodity component hedging. In these scenarios our commodity exposures are perfectly hedged and it is only the basis risk (which cannot be bifurcated from the relationship under existing hedge accounting requirements, for example transportation costs, value add costs, other material costs) that causes ineffectiveness. By removing the ability to dedesignate hedging relationships based on an entities risk management policy the Board is limiting the ability of companies to adequately mitigate complex risks. We propose the Board either maintain the existing guidance regarding dedesignation and redesignation or allow for hedging of component risks (outside of interest rate risk) such as commodity exposures and other non-financial risks. We would support a change that would allow for hedging of non-financial component risks and feel this change would lend itself to the convergence efforts as the IASB seems to be amenable to providing flexibility in this area.

Question 65: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement do you believe should not be required and why?

We feel the proposed disclosure requirements, specifically with regards to hedge accounting are unnecessary and would not provide incremental useful information to financial statement users. The current disclosure requirements governing hedge accounting, including existing ASC 815, Derivatives and Hedging (as well as the requirements of the guidance previously known as FAS 161, Disclosures about Derivative Instruments and Hedging Activities) ASC 820, Fair Value Measurements and Disclosures, and proposed ASU 820, Amendments for Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRS provide sufficient disclosures surrounding a company's use and accounting for derivatives and hedge relationships.

Question 70: How much time do you believe is needed to implement the proposed guidance?

The proposed update in its current form would require significant implementation time. The time necessary to address the system implications alone would be substantial. Many of the other proposed changes represent significant adjustments to the current accounting model for financial

instruments, derivative instruments and hedging accounting activities. Additionally, with the significant number of standards planned to be finalized over the next year and the Board's joint convergence project timeline, we do not believe an effective date of earlier than 2014 would be operational. Furthermore, we recommend the Board consider the costs and benefits of adopting the proposed update with such significant variations from IFRS. Mandating implementation of the proposed updates, only to make additional changes in the efforts to converge with IFRS would be inefficient and could confuse investors, financial statement users, auditors and preparers.

Question 71: Do you believe the proposed transition provision is operational? If not, why?

We do not believe the proposed transition provision is operational. The proposed update is a significant change to the current accounting for financial instruments, derivative instruments, and hedge accounting. A blanket transition provision for such diverse changes does not adequately ensure the financial statements are presented in a complete and clear manner. For example, the change to the accounting for equity investments, the proposed change is requiring these investments be re-measured at fair value with changes recognized through earnings, however under the proposed transition provision gains and losses in other comprehensive income on equity investments that have been classified as available for sale would be released through the cumulative-effect adjustment. Any future gains and losses are of the same nature as the existing gains and losses within other comprehensive income, therefore different treatments of the two from the perspective of the proposed transition provision is inconsistent and results in unclear financial statement information regarding these investments. Additionally, the transition guidance regarding existing hedge relationships is unclear. We believe that all of the hedge accounting changes should be made on a prospective basis for newly executed derivatives and hedging relationships.

For the reasons stated above, we do not support implementation of the noted proposed changes in the Exposure Draft in their current form. If FASB elects to proceed with an update to Topic 815, Financial Instruments and Topic 825, Derivatives and Hedging, we respectfully submit that, at a minimum, the update:

- Maintains the current criteria of when to apply equity method accounting which is consistent
 with the current IFRS treatment of such investments and do not incorporate any additional
 rules based guidance regarding the relation of investee and investor operations;
- Does not make adjustments to the existing requirements for foreign currency hedging of forecasted intercompany transactions without further public exposure and research; and
- Stipulates in the proposed update there is no requirement for ongoing measurements of ineffectiveness on a quarterly basis if at inception of the hedging relationship the critical terms of the relationship match and it is expected to have insignificant ineffectiveness.

Further, the effective date of the proposed update should be carefully considered in conjunction with the Board's joint convergence project with the IASB. Requiring adoption of substantial changes to US GAAP which cause additional differences from the IASB's proposed accounting will prove costly and inefficient for companies and negatively impact investors and financial statement users

understanding of the accounting for these instruments. Any changes to the accounting for financial instruments, derivative instruments and hedging activities should be issued once the respective convergence project is finalized for this subject matter. Doing so will ensure significant overhaul and changes to accounting documentation, processes, and systems will only occur once versus multiple times over a short period of time.

Thank you for your consideration of the comments raised in this letter.

Sincerely,

Kathleen A. Winters

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Vice President and Corporate Controller

Honeywell International