STANLEY



August 14, 2008

LETTER OF COMMENT NO. 42

Technical Director – File Reference No. 1590-100 Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5166

RE: File Reference No. 1590-100: Accounting for Hedging Activities, an amendment of FASB Statement No. 133

The Stanley Works ("Stanley") appreciates the opportunity to respond to the proposed Statement of Financial Accounting Standard identified above. Stanley, an S&P 500 company, is a diversified worldwide supplier of tools and engineered solutions for professional, industrial, construction and do-it-yourself use, and security solutions for commercial applications.

Stanley supports the FASB's effort to revisit hedge accounting and we understand that the Board's primary objectives are to: 1) simplify the accounting for hedging activities; 2) improve the financial reporting of hedging activities to make the accounting model and associated disclosures more useful and easier to understand for financial statement users; 3) resolve major practice issues related to hedge accounting under FAS 133; and 4) address recognition and measurement differences between derivative instruments and the related hedged items. Stanley agrees with these objectives and applauds the Board's efforts in trying to improve hedge accounting and transparency, both of which are very complex tasks. However, Stanley believes certain aspects of the current exposure draft do not align with and will impede the obtainment of such objectives.

Stanley's comments on the proposed Statement are as follows:

Issue 1: Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the ability of an entity to designate individual risks and requiring the reporting of the risks inherent in the hedged item or transaction?

Stanley strongly disagrees with the FASB's view on Issue 1. To begin, accounting standards should not impact or limit established financial markets and strategies. Rather, accounting standards should be developed to respond to the business environment to help markets act efficiently by providing reliable and relevant financial information that enables users to assess amounts and timing of an enterprise's cash flows and overall financial position.

Enterprises face a number of business risks which continue to grow as global competition intensifies. Such risks include, but are not limited to, credit, geo-political, commodity, interest rate and currency. These risks vary between entities in both type and amounts as well as in risk tolerances and strategies utilized to mitigate them. It is the job of corporate finance organizations to develop a risk management strategy to establish and manage its risk appetite which includes plans to mitigate unwanted risks or take advantage of risk opportunities, since it is through the taking of risk that profit is made and avoidance of unnecessary risk profit is protected. By creating an unlevel playing field between companies that actively manage their risk taking by forcing market to market earnings fluctuation for those that manage their financial risks and no mark to market impact for those who do not, the Board is encouraging the non-management or, even more concerning, the mismanagement of financial risks. Accounting should be agnostic as to active or passive risk taking, risk management and risk ignorance and should not discriminate against one in favor of the other. It is clear from the proposed Statement that the Board is showing a preference for risk ignorance by creating earnings volatility for those companies that favor financial risk management and risk selection. The capital markets continue to provide new and innovative products for the management of financial operational risks emanating from foreign exchange, interest rates, credit and commodities. When used judiciously, as most companies do, derivative financial instruments to improve the financial performance and reduce the cost of capital of the company employing these technologies. Ensuring that derivative financial instruments are in fact effective hedges of underlying risks such as interest rates, currency, credit and commodities is a worthy focus of the Board. Creating a discriminatory financial reporting environment for those who employ effective hedges of these financial costs is not. The entity's risk management decision should drive the accounting model. However, the proposed Statement would in essence drive the risk management operational model which is not a Board objective.

Also, the current exposure draft grants a specific hedge exception to foreign exchange risk. One significant component of foreign exchange rate differences is the interest rate differential between two countries. As such, it is not appropriate to grant one risk type an exception and disallow another risk type, when the disallowed risk has a significant impact on the allowed risk type. Additionally, what is wrong with managing interest rate risk and right with managing foreign exchange risk. Reporting entities should have a choice of what they pay for money (interest) and the costs or proceeds of products purchase or sell to other counties (foreign exchange). The proposed approach to hedge accounting reduces comparability between companies in two ways. 1) Companies with a greater exposure to interest rates will have less flexibility to hedge those costs than companies with greater exposure to foreign exchange. 2) Companies who do not manage financial risk will have less earnings volatility than those that do not, but in most cases will have more financial risk and higher financial costs.

As far as reporting on the risks inherent in the hedged item, the added disclosure requirements that are required on a quarterly basis by FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133 provide sufficient information as to the amount, type and success of risk mitigation associated with the hedged item.

In summary, "disallowing" an enterprise to actively manage certain risk components through the "elimination" of effective hedge accounting treatment on most transactions does not improve financial reporting on the hedged item, it interferes with the selection of risks that get managed and encourages risk ignorance.

Issue 2: Do you believe the Board should continue to permit an entity to designate those individual risks as a hedged risk?

Per our response to Issue 1, the proposed Statement should allow an entity to designate individual risks as the hedged risk as currently allowed under FAS 133.

Issue 3: Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for fair value hedging relationships and cash flow hedging relationships?

Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the shortcut method and critical terms matching, which would eliminate the ability of an entity to assume a hedging relationship is highly effective and to recognize no ineffectiveness in earnings?

There will be operational difficulties in calculating ineffectiveness as some actual derivatives may not have a derivative with the exact terms that match the hedged underlying at that particular point in time. If not, how would this entity proceed to measure ineffectiveness? The method used by an entity could change on the same instrument over its maturity if a "matching" derivative is initially available but subsequently not available in a later period. If multiple methods existed to measure ineffectiveness, comparability issues will arise as divergence in practice will take place. Board should consider if the hierarchy in FAS 157 should be referenced or another hierarchy created for measuring hedge ineffectiveness?

The shortcut method should not be eliminated as it serves as a very effective and efficient means of assessing hedge effectiveness in certain cases. The problem does not lie in the method, rather in the way preparers utilize such method. In our view, there is not a generic method that should be prescribed to assess hedge effectiveness and judgment should be left to preparers and auditors to select a method that is best suited for the particular circumstances that can be supported. Since derivatives possess many different attributes and continue to evolve, a generic test is not warranted. This need for flexibility under a principles based approach is very similar to the fair value concept as preparers need to determine which evidence of fair value is more suitable under particular facts and circumstances: an income approach, a cost approach or a market approach. Stanley utilizes the short cut method effectively and believes that in many cases it is a good methodology in ascertaining the hedge effectiveness. The differences between it and the long haul method in most cases are immaterial and as consequence not worth human capital required for the long haul method.

However, we agree with the Board's concern that an entity should not be able to designate the hedge to be perfectly effective under the shortcut method and never review the relationship again to ensure actual execution of the terms of the derivative and underlying were achieved. As such.

the issue is with the application of the shortcut method by certain registrants, not the method itself.

Issue 4: Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

For situations in which interest rate risk is currently designated as the hedged risk for financial instruments but would no longer be permitted under this proposed Statement (except for any entity's own issued debt at inception), do you believe you would continue to qualify for hedge accounting utilizing your current hedging strategy? If not, would you (a) modify your hedging strategy to incorporate other derivative instruments, (b) stop applying hedge accounting, (c) elect the fair value option for those financial instruments, or (d) adopt some other strategy for managing risk?

The change in the effectiveness threshold to reasonably effective is appropriate and consistent with a principles based accounting model. We believe the prior model was not adequately defined, rigid and costly to administer.

Stanley has actively monitored and managed its risk profile. As part of such profile, Stanley believes it is appropriate for any organization to have a view of the optimum mix of fixed and floating rate debt from a risk and return perspective and have a targeted blend of floating and fixed rate debt. Based on this risk management strategy, Stanley has entered into interest rate swaps after debt inception to achieve that optimum mix. The purpose of these interest rate derivatives is to manage our fixed to floating profile to maintain an optimal balance of fixed and floating rates at any one time. Based on the proposed Statement, Stanley will not be able to effectively hedge such risk and obtain the cheapest cost of debt capital and our business and therefore our shareowners will be negatively economically impacted by an accounting standard. Example: Stanley maintains a policy guideline of 30% - 40% floating rate exposure in our debt portfolio because overtime that has proven to be the lowest cost and lowest volatility portfolio. If our short term floating rate debt component of our debt portfolio is liquidated over time, we would be unable to maintain our policy guideline without increasing our portfolio mix of floating rate debt through the use of a swap to floating after the issuance.

Issue 5: Do you foresee any significant operational concerns in creating processes that will determine when circumstances suggest that a hedging relationship may no longer by reasonably effective without requiring reassessment of the hedge effectiveness each reporting period?

Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? If so, why?

There should not be any significant operational concerns as processes required under the proposed Statement would be very similar to the type of processes that companies utilize to comply with FAS 144 impairment indicators. The indicators would be very different and

performed by different finance resources in most entities; however, the overall process could be easily defined and leveraged from what entities currently utilize in impairment tests.

There should not be any correlation between the discontinuance of hedging relationships and how a hedge is assessed. Either the hedge is effective or not. If the answer to hedge effectiveness is different between a model that requires hedge effectiveness to be tested every period compared to one that requires it when certain indicators are met, then the difference is not due to the hedge relationship, rather it is due to either improper internal controls or non-adherence to the accounting standard by the financial statement preparer.

Issue 6: Do you agree with the Board's decision to continue to require that hedge accounting be discontinued if a hedge becomes ineffective? Alternatively, should an effectiveness evaluation not 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 hedger term?

Hedge accounting should not be discontinued if a hedge becomes ineffective as such ineffectiveness is required to be reported in earnings immediately. If a portion is still effective, Stanley believes that the actual effective amount should not be "deemed" to be ineffective because a subset of the initial hedge is not. Rather, the ineffectiveness portion should be reported in earnings immediately. Based on the disclosure requirements in FASB Statement No. 161, any ineffectiveness will be reported (as is required today) and users of financial statements can determine the success (or lack thereof) of the overall risk management strategy taken on the specific hedged items.

To illustrate, assume a fair value hedge was entered into on a \$10 million notional debt instrument. If the fair market value change in the debt instrument amounted to \$2 million during the current hedge period and the change in the derivative instrument amounted to only \$500k, we believe \$1.5 million should be reported in earnings immediately as hedge ineffectiveness, but the remaining \$500k should continue to be allowed hedge accounting treatment, since it was truly economically hedged. Under FAS 161, the ineffectiveness of this particular risk type will be disclosed and readers of the financial statements will see that the hedge and risk management strategy executed on the debt instrument are not perfectly effective.

Stanley believes that some form of annual assessment needs to be performed on hedge effectiveness to ensure the hedge is reasonably effective. An annual review of hedge effectiveness, similar to the goodwill impairment model as specified in FAS 142, would be sufficient. Such review could consist of qualitative and/or quantitative analysis depending on the individual facts and circumstances. This annual approach could be expanded and required on an ad hoc basis if risk indicators would cause a market participant to question if the hedging relationship is expected to be reasonably effective.

Issue 7: Do you believe that Statement 133 should be amended to prescribe the presentation of these amounts?

Under a principles based accounting model, Statement 133 should not be amended. Rather, the presentation should be decided by the professional judgment of preparers and auditors and should not propose a significant issue. For example, most preparers would present the offset to a commodity hedge used in production in cost of sales or an interest rate hedge on a debt instrument in interest expense. Also, the current disclosure requirements that exist in relation to accounting policies and the newly required disclosures in FASB Statement No. 161 will help address this Issue.

Issue 8: Do you believe that the proposed effective date would provide enough time for entities to adopt the proposed Statement? Why or why not?

The proposed effective date provides enough time for entities to implement this proposed Statement. However, Stanley does not believe that this timing provides the Board adequate time to generate a comprehensive Statement that actually improves financial reporting and will not have significant implementation issues. As such, Stanley strongly recommends the Board ensure enough time has been allocated in reaching its conclusion, rather than issuing this proposed Statement followed by numerous DIGs, FSPs or EITFs that have followed past derivative FASB Statements. This is a very complex topic and Stanley would rather see a quality standard that takes more time and consensus to develop instead of one that is "pushed" aggressively and will be amended by future accounting guidance. Stanley strongly believes such an outcome will just add to the current derivative complexity.

Issue 9: Do you believe that there are specific disclosures that should be required during transition? If so, what?

The adjustment recorded to accumulated other comprehensive income that will be required upon initial application of this proposed Statement should be reported as well as an explanation of the material drivers behind such adjustment (i.e., certain derivative instruments not dedesignated).

Issue 10: Do you agree with the Board's decision to allow a one-time fair value option at the initial adoption of this proposed Statement? Do you agree with the Board's decision to limit the option to assets and liabilities that are currently designated as hedged items under Statement 133?

Stanley does not agree with the Board's decision due to consistency and comparability issues. Individual asset and liability measurements should be based on their individual merits and classification as an asset or a liability, not based on implementing a new hedge accounting standard. By allowing certain companies to report assets and liabilities at fair value due to that entity having risks that qualify for hedge treatment, while entities with no exposure or different risk management objectives account for the same type of underlying asset or liability at book value creates significant comparability issues between entities.

The proposed Statement should not disqualify certain intercompany transactions from hedge accounting. Even though transactions may be intercompany in nature, consolidated cash flows and earnings are impacted due to foreign exchange risk. Also, the variability in cash flows due to foreign exchange could impact sales or purchase prices in different geographic regions and

would eventually impact external sales or purchases. Since the consolidated financial statements are impacted directly and actual external transactions are indirectly impacted either through cost or pricing actions, intercompany transactions should not be disqualified from hedge accounting as economic consequences relate to such risks and are not eliminated in consolidation. The fact of the matter is companies can lose money doing business with themselves in different currencies and should be allowed to protect itself from adverse economic consequences of currency fluctuations.

Stanley also is concerned that the proposed Statement does not converge with International Accounting Standards and such approach is disconnected from the Board's convergence goals. Due to the complexity of derivative instruments and their significance to the global capital markets, Stanley believes this accounting topic is one where the obtainment of international views and convergence is logical and beneficial.

Overall, Stanley agrees that hedge accounting needs to be re-examined and appreciates the Board's attempt to address this complex and significant issue. However, hedge accounting needs to be further researched as the Statement's implications on financial markets and how an entity manages real business risks is very severe. In Stanley's opinion, all financial business risks should be allowed hedge accounting treatment if the proper relationship and documentation is in existence at hedge inception.

Also, some of the confusion that has been experienced relating to the accounting model and disclosures of derivatives relates to the abundance of authoritative guidance that has been developed and not codified. It is often difficult, costly and timely for preparers and auditors to perform the necessary research when encountered with a derivative question. We strongly advise the Board to increase the speed of its codification project, or at least in relation to derivative instruments, as one comprehensive derivative accounting standard would dramatically improve accounting consistency and accuracy.

We appreciate the Board's consideration of our comments. Should you wish to discuss any of these views, please contact Don Allan at (860) 827-3858.

Sincerely,

Donald Allan

Vice President and Corporate Controller

Craig Douglas

Vice President and Treasurer