

***NORTHROP GRUMMAN***



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Elizabeth M. Murphy, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

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Securities and Exchange Commission Staff Paper: May 26, 2011, *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers-Exploring a Possible Method of Incorporation*

Dear Ms. Murphy:

We appreciate the opportunity to provide our comments on the “Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers” (the “Work Plan”), issued by the Securities and Exchange Commission (the “Commission”). The intent of this letter is to articulate our position on the Work Plan, from our perspective as a leading provider of systems, products, and solutions to U.S. Government and commercial customers.

In our letter dated April 7, 2009 to the Commission regarding the International Financial Reporting Standards (“IFRS”) Roadmap, we expressed support for the use of a set of high-quality globally accepted accounting standards by preparers of financial information. We also supported the continued convergence of existing Financial Accounting Standards Board (“FASB”) and International Accounting Standards Board (“IASB”) (collectively the “Boards”) standards that is currently underway with key projects targeted for substantial completion during the coming year. We reaffirmed this support in our letter dated October 18, 2010, addressing the Commission’s solicitation of public comment regarding integration of IFRS into the U.S. financial reporting system. However, we reiterated that we still had concerns regarding the timing and manner of the transition.

The Work Plan identifies “Condorsement” as a possible approach to transition to IFRS, which we feel may be the most viable approach for incorporating IFRS into the U.S. financial reporting system. While evaluating the practicalities of the Work Plan, we identified the following areas of concern which we believe should be considered in order to make “Condorsement” a feasible methodology:

- U.S. Involvement in Global Standard Setting
- U.S. Adoption of IFRS Becoming Another “Jurisdictional” Deviation
- Accountability for Consistency in Application and Interpretation of IFRS
- IFRS Adoption by U.S. Regulatory Agencies

### **U.S. Involvement in Global Standard Setting**

The Commission has expressed its belief that it will be important for the United States to “continue to have an active role in the international accounting arena to assist in the development and promotion of high-quality, globally accepted accounting standards; to be proactive in identifying new and emerging financial reporting issues; and to ensure that U.S. interests are suitably addressed in the development of those standards.” We fully support and agree with this belief but maintain that the Work Plan is currently not specific enough in how it plans to achieve this. We feel the role that the U.S. will play in future international standard setting is a key issue to be addressed, and should be done in a very specific way, especially in light of the Boards recent divergence in key areas. We believe there are three key players needed to execute the U.S. role in standard setting, and we have the following observations regarding the roles that these parties should play.

#### *Role of the FASB*

The Commission has expressed the belief that the FASB could participate in the IASB’s standard setting process in several ways. We feel that a valuable role for the FASB still exists, but not as currently stated in the Work Plan. We believe that the most appropriate role of the FASB is in a solely interpretative setting whereby they provide structure around what types of practices would be considered acceptable alternatives beneath a wide range of alternatives allowed for under the IFRSs. We envision the FASB providing interpretations, illustrative white papers, practice aids and similar tools to aid U.S. constituents both as they perform the initial transition from U.S. GAAP to IFRS, and as new IFRSs are endorsed by the Commission. In order to avoid the creation of a new set of “rules-based” standards these illustrative tools should serve as a form of non-authoritative GAAP.

By perpetuating a significant role for the FASB as a key regulatory authority as currently contemplated in the Work Plan, the Commission would be undermining the authority of the IASB and creating confusion as to which body has the responsibility for establishing globally accepted accounting standards. We believe that as part of the process for implementing IFRS in the United States, the Commission will need to formally acknowledge that the IASB has sole responsibility for establishing accounting standards on a global basis, and that the FASB’s role as a standard setting organization has ended. Rather than having a role to incorporate the IFRSs into U.S. GAAP, we believe the FASB’s role in the “Condorsement” process ought to be characterized as modifying U.S. GAAP to conform to IFRS. This may be a subtle difference, but we believe it better describes the fact that the FASB’s role has changed, and that U.S. GAAP will change to be substantially the same as IFRS.

As a means to further reflect the change in the FASB's role, we believe that the staff of the FASB should be substantially reduced to eliminate those elements that today are focused on the development of new standards. We believe that the responsibilities assigned to the FASB, as listed on page nine of the Work Plan, could be performed by a much smaller FASB organization, and once the "Condonement" phase is substantially complete, the staff could be reduced even further to a level sufficient to support the ongoing mission of the FASB to transition new standards as they are developed. These reductions would have the added benefit of substantially reducing the FASB's operating budget and associated accounting support fees currently assessed against U.S. issuers of securities.

### *Role of the Commission*

We believe that the role of the Commission, as set forth in the Work Plan and excluding the first paragraph that describes the Commission's role with the FASB, adequately describes the role that the Commission should continue to pursue once U.S. registrants have fully converted to IFRS reporting.

We also understand that there may be circumstances where the Commission concludes that it does not wish to accept certain provisions of one or another of the IASB standards, or that it may not approve of a standard altogether. In such circumstances, we believe that it will be necessary for the Commission to issue its own rules or guidelines for U.S. registrants to follow and that such requirements might represent departures from strict compliance with IFRS reporting. To best fulfill that role, the Commission may want to consider incorporating various elements of the current FASB organization into its ranks to provide sufficient manpower and bandwidth to continue its role in the future. We believe the acquisition by the Commission of critical resources that are elements of the FASB's staff today would be preferable to the notion of perpetuating the existence of the overall FASB organization.

We believe that the circumstances under which the Commission would issue its own rules would be rare, and that where this situation were to occur, U.S. registrants would simply have to identify that their reporting has deviated from IFRS requirements in light of their need to conform to the rules or reporting requirements imposed by the Commission. Users of the financial statements would thus be sufficiently informed regarding the departures from IFRS reporting, and could make their own judgments regarding the particular matter. This form of reporting would be much more transparent and useful to investors and other users of the financial statements than would be the situation where a U.S. company applied "U.S. GAAP" which is somewhat similar to IFRS, but not quite the same, thus leaving it up to a user of the financial statements to determine where the differences might exist.

Furthermore, the Work Plan indicates that U.S. constituents should endorse category 2 and 3 standards without substantial revision. If that is the case, the Commission will need to have a clear plan in place on what its standard setting involvement will be and establish a set of principles to be applied to keep the changes within the "rare" designation. Otherwise the end result of this convergence project will end up looking much the same as the current structure in that there will be IFRSs and U.S. GAAP with significant differences between the two.

## *Role of U.S. Constituents*

The Commission asserts that the FASB could play a key role in ensuring that U.S. constituents have the ability to influence the IASB's standard-setting process and have their interests be considered in the development of new standards. While we wholeheartedly agree that the U.S. constituents' views need to be heard by the IASB, we believe that it is the responsibility of the constituents themselves to make their voices heard, and not to rely on another quasi-regulatory body to take up the duty of representing them. If such a role were needed because these views were not receiving adequate attention, we believe that the Commission would be the appropriate body to represent the U.S. perspectives on key issues that the IASB should be considering. For the use of a single set of high-quality global accounting standards to work, there needs to be only one duly appointed body that is charged with developing and promulgating such standards to avoid the obvious confusion that could ultimately result. By definition, the goal of having a "single set of high-quality, globally accepted accounting standards" implies that there should be a "single" standard setting body.

## **U.S. Adoption of IFRS Becoming Another "Jurisdictional" Deviation**

The Work Plan identifies shortcomings in the way that IASB standards have been adopted globally, and thus casts doubt upon whether there truly is a single set of high-quality globally accepted accounting standards in use around the world. "Condorsement" as described in the Work Plan, would effectively attempt to morph existing U.S. GAAP into a new "U.S. GAAP" model that approximates IFRS but with a U.S. "flavor" to the standards. The "U.S. GAAP" terminology would continue to exist, thus U.S. companies would continue to report under a set of standards that are labeled as U.S. GAAP and which are intended to approximate IFRS reporting. One advantage of retaining the U.S. GAAP nomenclature, is that the complexities associated with changing references within U.S. laws, contractual documents, regulatory requirements/guidelines, and other similar documents would be mitigated.

We also feel that the Commission should allow U.S. filers the option to early adopt an "as-is" version of IFRS. If U.S. GAAP is ultimately intended to be modified by the FASB to become substantially equivalent to IFRS, as contemplated by the "Condorsement" approach, and if foreign filers in the U.S. are permitted to file IFRS compliant financial statements, we believe that U.S. filers should be afforded the same opportunity if they would prefer that option. This would benefit among others, companies with large international operations with access to domestic and foreign markets.

## **Accountability for Consistency in Application and Interpretation of IFRS**

To ensure that global standards (i.e. IFRS) continue to be of the highest quality we feel that the IASB, or an appointed body with global representation that reports to the IASB, should formally be established that would be accountable for the consistency, application, interpretation, regulation, and enforcement of IFRS, in all jurisdictional areas. Currently, enforcement activity varies considerably among jurisdictions and interpretations of what is appropriate vary worldwide. This body could evaluate how IFRS is being applied in each jurisdiction, and reach a conclusion regarding whether such applications are deemed to be substantially compliant with IFRS and to provide that information to users of the financial statements. We believe that, were this body to judge a jurisdictional application as not being faithfully compliant with IFRS, that determination would be important information for users of financial statements.

These differences will become more pronounced when there are published U.S. GAAP versions of category 1 and subsequently category 2 and 3 standards. In light of the FASB/ IASB progress thus far, it appears that most if not all of the MoU projects will be substantially converged when the final standards are issued. Given that many countries already use a jurisdictional approach to adopting IFRS, a problem with consistency could develop if, for example, a country were to adopt a U.S. GAAP converged standard rather than the IFRS standard. Without some sort of overall global oversight body, this may result in increased confusion for users of financial statements. While the Boards believe the differences will be minimal, one of the primary goals of a single set of global accounting standards is comparability, which could be significantly reduced if the jurisdictional applications of IFRS were not independently evaluated to determine their degree of compliance with IFRS.

### **IFRS Adoption by U.S. Regulatory Agencies**

As a U.S. government contractor, we operate in a unique industry subject to many statutory and regulatory requirements not shared by our commercial counterparts. The pricing and costing of federal government contracts are governed by cost principles contained in the Cost Accounting Standards (“CAS”) which govern the accounting for defense contracts and subcontracts and are applied through the Federal Acquisition Regulation (“FAR”) which provide specific rules for the measurement, accounting period assignment, and allocation of contract costs.

As these rules are not comprehensive sets of accounting rules, U.S. GAAP is applied to certain costs for cost accounting purposes as well as for financial accounting purposes. Thus, changing U.S. GAAP to make it substantially compliant with IFRS will likely increase the number and complexity of the adjustments between IFRS and cost accounting regulations, requiring increased maintenance and separate accounting records. This will also result in numerous accounting practice changes, which must be documented and approved by the U.S. government customer.

To date, few details have been provided by the Commission regarding communications and field work with regulatory bodies such as the Internal Revenue Service (“IRS”), Department of Defense (“DoD”) and U.S. General Services Administration (“GSA”). We recommend that the Commission work with these bodies to identify and resolve unintended regulatory consequences resulting from changes in accounting rules and to develop a plan to mitigate those impacts if the “Condorsement” approach were to be adopted.

It will be important to align the accounting requirements with IFRS to minimize differences between financial accounting, and tax/cost accounting. One approach may be to coordinate roundtable discussions between issuers and rule-makers. We also recommend that the Commission work with these regulatory bodies to implement a concurrent effective date with a transition methodology that mirrors the decision of the Commission. We also continue to believe that prospective application is the most cost effective transition methodology.

## Conclusion

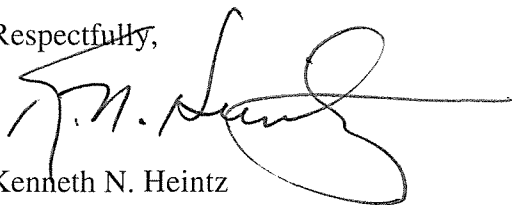
We appreciate the Commission's outreach in trying to determine the least burdensome and most cost effective approach to incorporating IFRS into the U.S. financial reporting system.

We believe the Commission should establish an appropriate timetable for the "Condorsement" approach. The five to seven year period provided for in the Work Plan may be too aggressive given that constituents will be in the process of implementing the category 1 standards during that time (i.e. revenue recognition, leasing, and financial instruments). Accordingly, we recommend that the next necessary step would be for the Commission to draft a detailed transition plan that states how each standard will be classified (i.e. which category), and when each category or standard will be effective, and to expose this plan for public comment, prior to finalization.

Overall, notwithstanding the concerns expressed above, we feel that the Work Plan has outlined a viable approach to incorporating IFRS which will result in achieving the overall goal of adopting a single set of high-quality, globally accepted accounting standards.

We appreciate the opportunity to comment on the Work Plan, and would be pleased to discuss further our company's perspective.

Respectfully,

A handwritten signature in black ink, appearing to read "K. N. Heintz", with a large, stylized flourish extending to the right.

Kenneth N. Heintz  
Corporate Vice President  
Controller and Chief Accounting Officer