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Technical Director  
File Reference No. 1600-100  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 161

Reference: Disclosures about Certain Loss Contingencies - an amendment of FASB Statements No. 5 and 141(R)

Dear Sir,

Northrop Grumman Corporation (“NGC”) appreciates the opportunity to share our comments on the proposed Statement of Financial Accounting Standards – “Disclosures of Certain Loss Contingencies – an amendment of FASB Statements No. 5 and 141(R) (the “Exposure Draft”). We are concerned about the unintended negative consequences that would rise from issuing the Exposure Draft in its current form on our accounting for and disclosure of loss contingencies related to litigation.

While we appreciate the good intentions the FASB has in mind in drafting increased disclosure requirements, we submit that these good intentions will be undermined by the unintended yet very real economic consequences they will have by inadvertently advancing the interests of a broader constituency than the current shareholders to which management has a fiduciary duty to protect. The Exposure Draft reflects a profound break from the ABA-AICPA Treaty’s carefully considered balance between the need to protect the attorney-client privilege / attorney work product doctrine and the need for reliable and transparent financial reporting. Instead, the Exposure Draft emphasizes broad disclosure at the expense of the attorney-client privilege, unnecessarily and inappropriately putting shareholder interests at risk and providing a roadmap for the plaintiff’s attorneys to gain access to previously privileged information.

Litigation is an inherently arduous and lengthy technical process that cannot be adequately appreciated and interpreted by the average financial statement user without the benefit of years of legal training and experience. Assessments are carefully and meticulously evaluated by the company based on an intimate understanding of facts discovered in the confines of the case, along with the context of legal complexities such as legal precedence and judicial process (e.g. venue, jurisdiction, presiding judge, jury composition and appeal status). Providing insight into the details surrounding a company’s exposure to loss along with an assessment of its potential impacts and the critical assumptions made by the company in reaching its assessment assumes a

level of sophistication and understanding of complicated legal issues on the part of an investor that is unrealistic. What may seem significant when disclosed to an untrained reader may actually be a benign development or fact unworthy of note. For example, the Exposure Draft requires a corporation to disclose all amounts claimed (including punitive or treble damages), no matter how wildly inflated. This could include even remote loss contingencies expected to be resolved within a year (if the impact could be “severe”, such as a lawsuit seeking to bar the company from doing business) or any loss contingency for which the company does not yet have enough information to determine that the risk of loss is remote. Doing so cannot help but elevate their significance, regardless of any explanatory text that attempts to put them in context. Disclosing such artificial, arbitrary valuations would provide no meaningful insight into a corporation’s future cash flows and would likely have the ironic, unintended consequence of leaving the financial statement user with an overstated, inaccurate view of potential losses. Even more concerning is the possibility that disclosure of uncertain estimates and projections, based on early assessments or mere claims, could lead to additional litigation and claims if the information is later deemed inaccurate and a third party claimed reliance on such information.

Further, the Exposure Draft requires assessing and disclosing a “best estimate of maximum exposure to loss” amount where quantified damages have not even been claimed, a common occurrence in certain jurisdictions where such claims are not allowed by law or where the plaintiff has been unwilling or unable to provide an estimate. It also requires disclosure of the detailed assumptions used in establishing this estimate. We believe it is inappropriate for the defendant to be forced to use confidential and possibly privileged information to do the plaintiff’s work, creating potentially discoverable documentation, in what may be a case without basis. This documentation, along with the public disclosures, can and will be used by plaintiffs against the defendant, causing the disclosed estimates to become self-fulfilling. This also causes a quandary in that the defendant will seemingly have to calculate and disclose its potential losses while simultaneously asserting its innocence, essentially relieving what should be the plaintiff’s sole burden of proof.

As noted in the Exposure Draft, it appears the Board believes that its constituents may “prefer to have a highly uncertain estimate supplemented with a qualitative description than no quantification of a potential loss...” We respectfully disagree that such “highly uncertain” estimates can help a shareholder meaningfully assess future earnings and cash flows and reiterate our concern that such information could be used by the corporation’s litigation adversaries, for example, as admissions against interest or an invitation for copycat lawsuits. Large corporations are often the target of frivolous lawsuits with outrageous damage claims designed to extort settlement efforts because the corporations are viewed to have “deep pockets”. Typically, these claims are not disclosed, but if they were disclosed and misinterpreted, they could actually bring harm to shareholders through cash outflows from increased litigation losses that may lead to volatility in share prices.

We appreciate the FASB’s attempt to provide relief to companies through an “Exemption from Disclosing Prejudicial Information”: a two-step process that allows a company to aggregate loss contingencies at a higher level than by the nature of the contingency, and in those “rare” circumstances in which the disclosure of such an aggregate amount would still be prejudicial, to withhold “only the information that would be prejudicial.” This purported exemption, however, fails to adequately address the potential for harm, as it is limited (indeed, possibly even contradicted) by explicitly expecting the exemption to be “rare” and admonishing that under “no circumstances may an entity forgo disclosing ...the factors that are likely to affect the ultimate

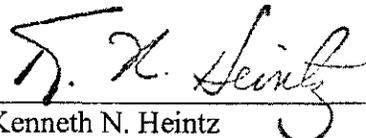
outcome of the contingency along with the potential impact on the outcome.” This broad exception is sufficiently vague and ambiguous as to swallow up the exemption itself, as a not unreasonable interpretation of this exemption would require the disclosure of those very types of sensitive, often privileged information that would cause harm if revealed. Further, for companies involved in sufficiently few significant litigation matters, it would be relatively simple for a reasonable reader of the financial statements to ascertain which litigation is being referred to in the aggregated disclosures. There well may be additional special challenges for regulated companies about disclosure of regulatory reports, investigations and other unasserted claims in light of the confidential nature of the customer and related products and services.

Finally, we note that the Exposure Draft is intended to be largely consistent with the requirements of IAS 37 “*Provisions, Contingent Liabilities and Contingent Assets*,” including proposed amendments to that standard. Although those similar disclosure requirements under IFRS may not be especially contentious in countries currently requiring IFRS, we believe the United States (U.S.) legal environment is significantly divergent from that of most countries for a number of reasons, not the least of which is the volume and nature of cases. Thus, disclosures in one environment could have different legal consequences in a different environment. As an example, in the U.S., advice of in-house counsel is “privileged”, whereas in many countries, only advice from external counsel receives that treatment. We believe the existing guidance under SFAS 5 as it currently stands is understood by the legal and financial community, including investors, and works reasonably well within the confines of the U.S. legal environment. Amending this guidance to enhance disclosures in the manner set forth in the Exposure Draft will be providing a solution to a problem that does not exist, or at least one that cannot be fixed with accounting disclosures.

In conclusion, we strongly urge the FASB to concentrate on what we believe to be its most important constituents, a company’s current shareholders, and weigh the benefits increased disclosures could have in their assessment of future cash flows against the real economic harm these disclosures are likely to cause. In that regard, we respectfully recommend that the guidance in FAS 5 be retained and that the Exposure Draft not be finalized..

We appreciate your consideration of our views and would be pleased to discuss them with you further. Should you have questions regarding our comments, please contact Ken Heintz, NGC’s Chief Accounting Officer, at (310) 201-3312 or via email at [Kenneth.Heintz@ngc.com](mailto:Kenneth.Heintz@ngc.com) at your convenience.

NORTHROP GRUMMAN CORPORATION

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