

Michael J. Wood Vice President, Chief Accounting Officer 781.522.5833 781.522.6411 fax 1820-100 Comment Letter No. 132

> Raytheon Company 870 Winter Street Waltham, Massachusetts 02451-1449 USA

October 19, 2010

Leslie F. Seidman, Acting Chairman Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Subject: File Reference No. 1820-100

Dear Ms. Seidman:

Raytheon Company appreciates the opportunity to review and comment upon the proposed Exposure Draft entitled, *Revenue Recognition (Topic 605), Revenue from Contracts with Customers* ("the Exposure Draft" or "ED"), issued by the Financial Accounting Standards Board ("FASB" or "the Board"). Raytheon Company, with 2009 sales of \$25 billion, is a technology and innovation leader specializing in defense, homeland security and other government markets throughout the world. With a history of innovation spanning 88 years, Raytheon provides state-of-the-art electronics, mission systems integration, and other capabilities in the areas of sensing; effects; and command, control, communications and intelligence systems, as well as a broad range of mission support services. With headquarters in Waltham, Mass., Raytheon employs 75,000 people worldwide.

We are a major supplier to the U.S. Government and are committed to strong corporate governance, including accountability to our stockholders and transparent disclosure. We seek to provide the highest levels of financial reporting for the benefit of our investors in the U.S. market and across the globe. Accordingly, we continue to have a significant interest in the Board's project underlying the Exposure Draft.

In our industry, we enter into arrangements with customers to provide highly customized, complex engineering, design and manufacturing services over extended periods. These arrangements are usually with an individual customer (principally the U.S. Government) and are generally priced based upon estimated costs plus a reasonable margin for the risks we assume in the contract. We believe that our industry is specialized and our contracts embody many different complexities that simply do not exist in many other industries, such as incentive / award fees; change orders; options / additions; combining and segmenting; claims; and penalties. In addition to arrangements with our U.S. Government customers, we also enter into direct foreign sales arrangements with international governments that involve similar economic and regulatory considerations. The revenue recognition model currently promulgated under Accounting Standards Codification (ASC) 605-35, *Revenue Recognition, Construction-Type and Production-Type Contracts* (ASC 605-35), is well established and understood by investors in our industry, as it is aligned with how our contracts are bid, negotiated and managed.

We thank the Board for considering many of the previous concerns we expressed in our comment letter on the Discussion Paper entitled, *Preliminary Views on Revenue Recognition in Contracts with Customers*. We also thank the Board for its efforts and the efforts of the FASB Project Staff to discuss and understand our issues and suggestions for modifying / clarifying the proposed standard to provide a useful replacement for ASC 605-35 in our industry. We believe the Board has made significant progress in making the model useful for long-term contractors and their investors. Many of our current requests for clarification included in this comment letter are intended to ensure that future interpretations of the model are consistent with what we believe the Board's views are regarding accounting for long-term construction / production-type contracts and

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that a fundamental tenet of the model is that its application results in decision-useful information for investors. In order to provide decision-useful information to investors, we believe our financial reporting should align with how our contracts are bid, negotiated and managed. If the model is not successful in achieving this result, or if the Board's intent for application of the proposed model to long-term construction / production-type contracts is misinterpreted, we are concerned that companies would be required to provide "non-GAAP" measures in order for investors to understand results of operations in our industry. We believe this would be a flawed outcome. To avoid this, we recommend that the Board consider the following changes:

Contract segmentation and identification of performance obligations - We believe the Board has appropriately recognized that, in many instances, it is impractical to separate long-term contracts into multiple performance obligations due to the significant over-arching contract management services and pervasive prime contracting risks related to the complex and interrelated nature of the underlying tasks in most of our contracts. This is highlighted in the application guidance in paragraphs BC56 – BC59 of the ED; however, we believe this concept should have more prominence in the proposed standard, as interpretations of "distinct profit margin" could vary widely and the guidance therein related to contract management services and risks is helpful in making appropriate interpretations in our industry. Further, we believe that this guidance should apply to all of the segmentation and performance obligation requirements to ensure that contracts for highly complex deliverables with integrated contract management services and risks are accounted for appropriately and the resulting accounting provides decisionuseful information to investors. In this respect, we also believe the Board's guidance with respect to the level at which onerous performance obligations is determined does not align with the economics of our contracts. We believe that recording an onerous liability for a performance obligation (at inception or some other point in time) on what is a profitable contract overall and where total future contract revenue exceeds total future contract cost does not provide decision-useful information to financial statement users.

We also believe the Board should consider whether providing both segmentation and performance obligation guidance is necessary. We found this portion of the proposed standard to be complex and potentially confusing. We believe this was added to address the Board's concern that if a contract has a variable transaction price, an entity may allocate a change in the transaction price to all performance obligations in a contract rather than to the applicable individual performance obligation (of the contract) to which the change relates. We believe this issue may be better addressed in the guidance on allocating transaction price and propose that the Board clarify that if variable consideration relates to a single performance obligation or just a portion of the performance obligations underlying a contract, an entity should allocate the variable consideration only to the performance obligation or obligations to which it relates.

In addition to these considerations, we recommend that the Board consider the potential value of a "top-down" approach for identifying performance obligations. The Exposure Draft currently requires the identification of tasks and aggregation of those tasks into performance obligations (a "bottom-up" approach). We find this to be more confusing and complex than the current approach in ASC 605-35. We currently have approximately 15,000 contracts with a low volume of comparable contracts and believe a "top-down" approach is more operable and would ensure a more consistent application of the performance obligation principle. A "top-down" approach focused on the contract and when you can segment below the contract level (which is optional today under ASC 605-35) may be more operable when implementing the standard across many varied industries and would ensure that financial reporting is aligned with how companies bid, negotiate and manage their contracts. We believe the principles in ASC 605-35 that provide criteria for when segmenting a contract may be appropriate and the option to segment or not (with consistency in application to similar circumstances) afford

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companies the ability to apply professional judgment in determining what level below the contract level represents both a practical and meaningful presentation of financial results. We believe that if given the option in this manner, companies will naturally segment contracts into their logical components in order to relay to investors and management their economic performance and that if companies' policies for segmentation are disclosed and applied consistently, decision-useful information will result.

Considering the above, we recognize it is inherently difficult to promulgate guidance that would allow the economic substance of multitudes of existing and future revenue arrangements to be properly reported in all cases. For example, we acknowledge that the software industry believes that segmentation of the software and electronic (or computer-based) components of an off-the-shelf mobile phone provides the most decision-useful information to its investors. Conversely, we believe treating integrated long-term construction / production-type contracts as a single effort or performance obligation provides, in many cases, the most decision-useful information to our investors. As a result, we believe promulgating prescriptive combining / segmenting guidance to reflect the economic substance of arrangements is inherently difficult using a "bottom-up" approach. Balancing the desire to have a single standard for revenue recognition in varied industries and the need for individual companies and industries to report financial results consistent with how their contracts are bid, negotiated and managed, we believe the Board should consider aligning the identification of performance obligation principles with the current guidance in ASC 605-35 that allows for a "top-down" approach and provides appropriate flexibility to allow for practicality and the application of reasonable judgment to ensure financial results reflect the underlying economics of the related contracts.

**Disclosure** – In our view, the effort to provide the significant additional quantitative disclosures and tabular reconciliations of balance sheet amounts described in the Exposure Draft would significantly outweigh the benefits provided to investors. As the proposed model will apply across all industries, we do not believe prescriptive disclosures are beneficial given the substantial differences across business models. We suggest requiring disclosure at a principles-based level, as opposed to prescriptive disclosures that may not be meaningful to financial statement users. A principles-based approach would allow different industries to provide relevant information to their respective financial statement user groups. We believe the disclosure principle in the proposed standard needs to weigh three key elements: 1) the benefits investors will receive versus the cost to provide the disclosures; 2) the level of disaggregation of quantitative disclosure information and principles to determine that level; and 3) when non-financial or forecast data should be included in the required disclosures and the related impact on audit firms and the safe harbor protections afforded under the Private Securities Litigation Reform Act of 1995 (PSLRA) and related U.S. Securities and Exchange Commission (SEC) regulations.

The Exposure Draft does not provide a principle regarding the expected level of disaggregated quantitative disclosure information. This could lead to information that is not comparable across similar companies and leave an entity open to questions as to why it did not disclose a greater level of detail. Conversely, an entity may disclose so much detail that useful information is obscured by a large amount of insignificant items. We suggest a principle requiring the level of disaggregated disclosure in the proposed standard be consistent with how a chief operating decision maker views his/her company, similar to current segment reporting disclosure requirements.

Further, we believe the suggested disclosures regarding contracts with original expected durations beyond one year (paragraph 78 of the ED) would result in the inclusion of information based on projections in audited footnotes. This would result in public audit

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firms needing to audit long-range planning information that is subject to many changes and variables. In many cases, this information would not be relevant to our investors since the underlying assumptions would likely be stale by the time we file our required reports with the SEC. Inclusion of this information in the footnotes versus Management's Discussion and Analysis of Results and Operations would also exclude it from the safe harbor protections regarding forward-looking statements afforded by the PSLRA and related SEC regulations. Therefore, we suggest that if the Board retains this disclosure requirement, it requires only a percentage estimate of what portion of a company's backlog will be satisfied over one year given the inherent lack of precision in determining when a performance obligation may be satisfied.

- Transition— We believe retrospective application of the proposed guidance, which would require restatement of our prior results, is impractical and cost-prohibitive. To resolve this issue, we believe the proposed standard should provide application guidance that considers when retrospective treatment may be impractical, such as that in ASC 250, Accounting Changes and Error Corrections (ASC 250), as follows:
  - An entity is unable to apply the requirement after making every reasonable effort to do so;
  - An entity is required to make assumptions about management's intent in a prior period that cannot be substantiated; and/or
  - An entity is required to make estimates of amounts for which it is impossible to distinguish objective information about those estimates at the time they were made.

As an alternative, we suggest that the proposed guidance be applied prospectively for contracts with customers entered into after the effective date of the standard. Other major revenue recognition standards have been applied on a prospective basis, including most recently Accounting Standards Update No. 2009-13, *Revenue Recognition* (Topic 605): *Multiple-Deliverable Revenue Arrangements*, and Update No. 2009-14, *Software* (Topic 985): *Certain Revenue Arrangements that Include Software Elements*. To address the Board's concern regarding the preservation of trend information about revenue, we suggest that entities be required to disclose information that enables financial statement users to understand the effects of the change in accounting principle (resulting from adopting the new standard) in the spirit of ASC 250.

If the Board requires full retrospective reporting, we request a sufficiently long lead-time to assess potential system, process and policy implementation challenges, which we believe will be substantial. It will take a tremendous amount of resources to implement this standard on a retrospective basis given the long-term nature of our contracts and robustness required in our policies and processes surrounding contract estimates, particularly given the complexity of our products and frequent use of variable fee contract structures by our customers. We recommend that if retrospective application is required, the adoption date be at least four years from the date of final standard issuance.

 Contract Costs – We appreciate that the Board has included guidance in the proposed standard regarding contract costs that may be recognized in fulfilling performance obligations. We believe retaining this guidance is critical because the proposed standard will supersede existing U.S. GAAP that specifically supports deferral of certain costs related to work-in-process on long-term construction / production-type contracts that is not contained in other standards that will remain in effect after the adoption of the new standard. File Reference No. 1820-100 October 19, 2010 Page 5 of 6

## Other issues –

Continuous transfer of control – We generally agree with the proposed guidance for determining when control of a promised good or service has been transferred to a customer based on the rights underlying the contract. We also agree conceptually that when they can be established and monitored objectively and reliably, output measures are the most direct measure of progress toward completion. However, input measures, particularly costs incurred, are the practical, predominant measure of progress used by us today, as they faithfully reflect the underlying economics of a continuous transfer of control model. This view aligns with paragraph BC74 of the ED, which specifies that an entity should select a revenue recognition method that best depicts the entity's performance under the contract. We believe this concept should be given more prominence in the proposed standard and suggest that the Board adopt language similar to that in ASC 605-35, paragraph 25-71, which explains the drawbacks and advantages of both output and input measures (as follows):

Both input and output measures have drawbacks in some circumstances. Input is used to measure progress toward completion indirectly, based on an established or assumed relationship between a unit of input and productivity. A significant drawback of input measures is that the relationship of the measures to productivity may not hold, because of inefficiencies or other factors. Output is used to measure results directly and is generally the best measure of progress toward completion in circumstances in which a reliable measure of output can be established. However, output measures often cannot be established, and input measures must then be used. The use of either type of measure requires the exercise of judgment and the careful tailoring of the measure to the circumstances.

- Time value of money We conceptually agree with the application of a "time value of money" principle if a contract includes a material financing component. However, we suggest the Board clarify that the time value of money principle should contemplate the economic intent of the parties to a particular contract and exclude transactions whose customary payment terms are intended not as a financing mechanism, but to provide a protective contractual right (e.g., sound business practice to get an upfront advance as a security deposit; for customers to not have to pay a portion of the contract until it is closed).
- Variable consideration We generally agree with the concepts in paragraph 38 of the ED regarding an entity's ability to reasonably estimate transaction price. However, we believe that paragraph 38 should be clarified that if variable consideration in total is less than likely of being recognized, it should not be deemed to meet the threshold of being reasonably estimable. This is because we inherently believe that the fair value of an item that is not likely to be realized is significantly below its estimated probability-weighted outcomes and likely has a fair value closer to zero unless part of a large statistical population. We also think this will result in an estimate closer to "most likely" probable outcome, while retaining a probability-weighted approach for those items that are "likely."

For the convenience of the reader, we have included selected original Exposure Draft questions in Attachment I preceding our response to each question. We did not respond to questions that were not applicable based on our current business or industry practices or to those with which we principally agree. We appreciate the continued opportunity to present our views on this subject and welcome the opportunity to review them with you either in person or by telephone.

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Thank you for your attention and consideration of our comments. If you should have any questions, please feel free to contact me at 781-522-5833.

Respectfully,

Michael J. Wood

Vice President and Chief Accounting Officer

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## ATTACHMENT I

- Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:
  - a. combine two or more contracts and account for them as a single contract;
  - b. segment a single contract and account for it as two or more contracts; and
  - c. account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

We generally agree with the proposed principle for combining two or more contracts, however, we believe the combining evaluation should not be limited to "price;" rather, it should focus on economic interdependence. The combining indicators in paragraph 13(a), "contracts are entered into at or near the same time," and paragraph 13(c), "the contracts are performed either concurrently or consecutively," are predicated conceptually on economic interdependence. We believe this is consistent with current guidance in determining when to combine contracts, as reflected in ASC 605-35, and ASC 985-605, *Software, Revenue Recognition*, and thus recommend modifying the proposed combining guidance to better align with the approach under those standards.

We also believe the Board should consider whether providing both segmentation and performance obligation guidance is necessary. We found this portion of the proposed standard to be complex and potentially confusing. We believe this was added to address the Board's concern that if a contract has a variable transaction price, an entity may allocate a change in the transaction price to all performance obligations in a contract rather than to the applicable individual performance obligation (of the contract) to which the change relates. We believe this issue may be better addressed in the guidance on allocating transaction price and propose that the Board clarify that if variable consideration relates to a single performance obligation or just a portion of the performance obligations underlying a contract, an entity should allocate the variable consideration only to the performance obligation or obligations to which it relates. Please see our response to question #2 below, which further details our concerns related to identification of performance obligations.

We agree with the application of the same price interdependence / independence criteria to contract modifications. However, as noted above, we believe the combining evaluation should not focus solely on pricing. Our customer contracts are arrangements to provide highly customized, complex engineering, design and manufacturing services delivered over extended periods and our customers participate significantly in the design, development and production of the underlying products / solutions. Due to the significant involvement of our customers during contract performance, modifications to scope and/or specification are commonplace. The current combination criteria outlined in paragraph 13 of the Exposure Draft do not fully contemplate the economic interdependence between contract modifications and overall effort. Similarly, the scope of work for unpriced change orders is often interdependent with the base contract effort and we can often reasonably estimate the transaction price prior to the final pricing negotiations. We

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thus recommend the Boards consider an additional combination criterion, "the contracts include elements that are closely interrelated or interdependent in terms of design, technology or function." Aligning the combining principles with economic indicators would generally enable combination of contract modifications and unpriced change orders with our underlying (base) contracts, better reflecting the economic substance of our arrangements and how we bid, negotiate and manage our contracts.

2. The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

We believe the Board has appropriately recognized that, in many instances, it is impractical to separate long-term contracts into multiple performance obligations due to the significant over-arching contract management services and pervasive prime contracting risks related to the complex and interrelated nature of the underlying tasks in most of our contracts. This is highlighted in the application guidance in paragraphs BC56 BC59 of the Exposure Draft; however, we believe this concept should have more prominence in the proposed standard, as interpretations of "distinct profit margin" could vary widely and the guidance therein related to contract management services and risks is helpful in making appropriate interpretations in our industry. Further, we believe that this guidance should apply to all of the segmentation and performance obligation requirements to ensure that contracts for highly complex deliverables with integrated contract management services and risks are accounted for appropriately and the resulting accounting provides decision-useful information to investors. For example, as part of a contract that involves the highly complex detailed design and integration of mission system equipment, we may do simple tasks that could be done by many parties, such as procure laptops to use in conjunction with the mission system. However, we would not view our procurement of the laptops as a separate performance obligation, as the contract management services and the risks are so interrelated that they cannot be separated since the utility to the customer is the overall integrated solution. More specifically, the customer is looking to us to manage its entire project and deliver a fully integrated system that works effectively and the procurement of laptops, itself, has no stand-alone value to the customer.

As we described above in our response to question #1, we also believe the Boards should consider whether providing both segmentation and performance obligation guidance is useful.

In addition to these considerations, we recommend that the Board consider the potential value of a "top-down" approach for identifying performance obligations. The Exposure Draft currently requires the identification of tasks and aggregation of those tasks into performance obligations (a "bottom-up" approach). We find this to be more confusing and complex than the current approach in ASC 605-35. We currently have approximately 15,000 contracts with a low volume of comparable contracts and believe a "top-down" approach is more operable and would ensure a more consistent application of the performance obligation principle. A "top-down" approach focused on the contract and when you can segment below the contract level (which is optional today under ASC 605-35) may be more operable when implementing the standard across many varied industries and would ensure that financial reporting is aligned with how companies bid, negotiate and manage their contracts. We believe the principles in ASC 605-35 that provide criteria for when segmenting a contract may be appropriate and the option to segment or not (with consistency in application to similar circumstances) afford

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companies the ability to apply professional judgment in determining what level below the contract level represents both a practical and meaningful presentation of financial results. We believe that if given the option in this manner, companies will naturally segment contracts into their logical components in order to relay to investors and management their economic performance and that if companies' policies for segmentation are disclosed and applied consistently, decision-useful information will result.

Considering the above, we recognize it is inherently difficult to promulgate guidance that would allow the economic substance of multitudes of existing and future revenue arrangements to be properly reported in all cases. For example, we acknowledge that the software industry believes that segmentation of the software and electronic (or computer-based) components of an off-the-shelf mobile phone provides the most decision-useful information to its investors. Conversely, we believe treating integrated long-term construction / production-type contracts as a single effort or performance obligation provides, in many cases, the most decision-useful information to our investors. As a result, we believe promulgating prescriptive combining / segmenting guidance to reflect the economic substance of arrangements is inherently difficult using a "bottom-up" approach. Balancing the desire to have a single standard for revenue recognition in varied industries and the need for individual companies and industries to report financial results consistent with how their contracts are bid, negotiated and managed, we believe the Board should consider aligning the identification of performance obligation principles with the current guidance in ASC 605-35 that allows for a "top-down" approach and provides appropriate flexibility to allow for practicality and the application of reasonable judgment to ensure financial results reflect the underlying economics of the related contracts.

3. Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

We generally agree with the proposed guidance for determining when control of a promised good or service has been transferred to a customer based on the rights underlying the contract. However, we believe that the Board should provide indicators specific to meeting criteria for continuous transfer of control. The Exposure Draft currently provides guidance on how to recognize revenue in a continuous transfer of control model, but it is unclear what level of customization is necessary for an entity to apply the continuous control model to a performance obligation. We believe the intent of the Board is for contracts with similar underlying economics to be accounted for consistently, therefore, additional guidance is necessary to clarify when a continuous transfer of control model is appropriate. We believe the customer specific nature of the good or service is a good indicator, but, by itself, may not provide enough guidance. We suggest the Board include additional indicators of continuous transfer of control, such as, an on-going customer relationship, the specialized nature and/or complexity of the deliverable, long-term nature of the contract, and customer requirement to make progress payments throughout the period of performance.

We also agree conceptually that when they can be established and monitored objectively and reliably, output measures are the most direct measure of progress toward completion. However, input measures, particularly costs incurred, are the practical, predominant measure of progress used by us today, as they faithfully reflect the underlying economics of a continuous transfer of control model. This view aligns with paragraph BC74 of the ED, which specifies that an entity should select a revenue recognition method that best depicts the entity's performance under the contract. We

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believe this concept should be given more prominence in the proposed standard and suggest that the Board adopt language similar to that in ASC 605-35, paragraph 25-71, which explains the drawbacks and advantages of both output and input measures (as follows):

Both input and output measures have drawbacks in some circumstances. Input is used to measure progress toward completion indirectly, based on an established or assumed relationship between a unit of input and productivity. A significant drawback of input measures is that the relationship of the measures to productivity may not hold, because of inefficiencies or other factors. Output is used to measure results directly and is generally the best measure of progress toward completion in circumstances in which a reliable measure of output can be established. However, output measures often cannot be established, and input measures must then be used. The use of either type of measure requires the exercise of judgment and the careful tailoring of the measure to the circumstances.

4. The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price. Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

We generally agree with the concepts in paragraph 38 of the Exposure Draft regarding an entity's ability to reasonably estimate transaction price. However, we believe that paragraph 38 should be clarified that if variable consideration in total is less than likely of being recognized, it should not be deemed to meet the threshold of being reasonably estimable. This is because we inherently believe that the fair value of an item that is not likely to be realized is significantly below its estimated probability-weighted outcomes and likely has a fair value closer to zero unless part of a large statistical population. We also think this will result in an estimate closer to "most likely" probable outcome, while retaining a probability-weighted approach for those items that are "likely." For example, consider a contract that embodies a binary (i.e., event-based) incentive fee (i.e., an incentive fee attainable according to whether our designed product exceeds a given performance level on final test); under this example contract, a successful pass on final test results in a \$10 million fee and a failure results in \$0 fee. Assuming the probability of failure is 80% and the probability of success is 20%, we believe it is fundamentally wrong to value the contingent revenue in this example at \$2 million when most third parties would likely discount it significantly more than that unless it was part of a large statistical population given the substantial uncertainty of achievement.

5. Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect *how much* revenue an entity recognizes when it satisfies a performance obligation rather than *whether* the entity recognizes revenue? If not, why?

We agree that a customer's credit risk should affect *how much* revenue an entity recognizes when it satisfies a performance obligation. However, we request that the Board provide interpretive guidance regarding the application of paragraph 43 of the Exposure Draft under a continuous transfer of control model when an entity has not fully satisfied a single performance obligation. Specifically, it is unclear whether paragraph 43

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requires an entity to treat the impairment of an unbilled receivable (contract asset) due to an unfavorable change in a customer's credit risk as a reduction of revenue while likewise treating the impairment of the billed receivable (for the same performance obligation) as expense. We recommend the Board allow entities to account for changes in customer credit risk that occur while a portion of a performance obligation is unsatisfied as a reduction in revenue. For example, consider a contract with a single performance obligation where control is transferred continuously; the contract is only 75% complete and there are both an unbilled receivable (contract asset) and a billed receivable when a downgrade in the customer's credit risk occurs. Based on the proposed model, one could interpret that a portion of the required impairment resulting from the change in the customer's credit risk should be recorded to revenue and a portion to expense despite the performance obligation being only partially satisfied. We believe that the accounting treatment for both billed and unbilled receivables should be consistent prior to the complete satisfaction of a performance obligation, as we do not believe the timing of billing terms should result in divergent accounting treatment.

6. Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

We conceptually agree with the application of a "time value of money" principle if a contract includes a material financing component. However, we suggest the Board clarify that the time value of money principle should contemplate the economic intent of the parties to a particular contract and exclude transactions whose customary payment terms are intended not as a financing mechanism, but to provide a protective contractual right (e.g., sound business practice to get an upfront advance as a security deposit; for customers to not have to pay a portion of the contract until it is closed). Our contracts with the U.S. Government are subject to the Truth in Negotiations Act (TINA) and Federal Acquisition Regulations (FAR), which specifically prohibit financing arrangements. However, the timing of our payments from the U.S. Government does not always align with performance under our contracts because the FAR Part 32 payment rules and terms in some instances do not allow the U.S. Government to pay above certain caps until final delivery.

Specifically, the most common payment terms under FAR Part 32 are performancebased payments (i.e., milestone or event-based) and progress-based payments (i.e., based on cost). Both of these payment types are structured to compensate the contractor regularly throughout the period of performance, but also include retained amounts that are not paid until delivery or final performance of a contract Performancebased payments per FAR 32.1005 may "not exceed 90 percent of the contract price if on a whole contract basis, or 90 percent of the delivery item price if on a delivery item basis." and "are not expected to result in an unreasonably low or negative level of contractor investment in the contract." Progress-based payments per FAR Part 32.501-1 provide that "the customary progress payment rate is 80 percent, applicable to the total costs of performing the contract." FAR Part 32.103 also requires "upon completion of all contract requirements, retained amounts shall be paid promptly." Alternatively, per FAR Part 32.102, "advance payments may be made to prime contractors for the purpose of making advances to subcontractors," based on specific contract negotiations. Given these terms, there may be differences in timing of revenue recognition versus payment (both positive and negative), however, these requirements are meant to compensate the contractor as work is performed (and revenue is earned) while affording the U.S. Government the protective right of retaining a portion of the fee. Across thousands of contracts, the timing difference between revenue recognition and payment may be a material amount, but the economics of the underlying transactions are meant to compensate the contractor as

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work is performed and not intended as a financing mechanism. We believe that reflecting the time value of money in these situations would not provide decision-useful information to investors, as doing so would not reflect the underlying intent of the parties and the economic substance of our transactions.

8. Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, Intangible Assets), an entity should recognize an asset only if those costs meet specified criteria. Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?

Please refer below to our combined response to questions 8 and 9.

9. Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation. Do you agree with the costs specified? If not, what costs would you include or exclude and why?

We appreciate that the Board has included guidance in the proposed standard regarding contract costs that may be recognized in fulfilling performance obligations. We believe retaining this guidance is critical because the proposed standard will supersede existing accounting principles generally accepted in the U.S. (U.S. GAAP) that specifically supports deferral of certain costs related to work-in-process on long-term construction / production-type contracts that is not contained in other standards that will remain in effect after the adoption of the new standard. In these instances, reliance on another standard may not provide sufficient guidance to determine what contract costs are deferrable and result in inconsistent application.

In addition, we believe that the term "abnormal costs" as used in both paragraph 33 (b) and paragraph 59 (c) of the Exposure Draft needs further definition. In our industry, contractors are required to anticipate and define their best estimate of all of the costs required to complete a contract at the outset of the performance of a contract and to monitor such cost estimates over the contract performance period. It is not uncommon for cost estimates to vary over the performance period as actual costs become known, and for new costs to develop that are specifically related to the performance of a given contract. In this context, it is very difficult to identify whether such changes in cost estimates result in "abnormal" costs, as there is no clear distinction as to what constitutes abnormal costs, particularly if such costs are required and relate directly to the requirements of a specific contract. We acknowledge however, that costs related to excess / idle capacity or similar costs that provide no utility to contract performance, or are material and infrequent / non-recurring costs such as those related to work stoppages, natural disasters, or other force majeure incidents not anticipated in the normal course of business are "abnormal" in nature and should be expensed as incurred.

If, however, costs resulting from the realization of risks that were possible (but not considered highly likely) at the inception of a contract, which we currently include in contract cost estimates and impact the overall profitability of the contract (e.g., rework, work-arounds, unplanned scrap, re-design costs and similar items), are intended to be "abnormal costs," we are concerned such interpretation does not accurately represent the economics of our contracts. We often bid an estimate of rework (trial and error) into our contracts and view rework as a normal cost of providing highly complex, specialized and cutting-edge deliverables; therefore, we would not view changes in estimate related to

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varying degrees of trial and error efforts (which are a normal course of business in performing our contracts) as "abnormal."

We are also concerned that separate designation of such costs as period costs could produce results that are not decision-useful to investors. For example, under existing U.S. GAAP, if actual rework costs exceeded the initial estimated amount for a contract with an expected margin rate of 10%, we would include these incremental costs in our estimate-to-complete and reduce the contract margin rate. However, if a contractor were permitted to treat these rework costs as "abnormal" costs, the proposed standard implies the contractor would expense the rework costs and still report a 10% gross margin on the overall contract going forward. This appears to skew reported results in a manner that does not reflect the economic substance of contracts with customers and renders any assessment of future performance less predictive. In addition, this approach presents application challenges, as increased cost estimates are often identified after the initially incurred effort (i.e., initial performance of effort in one quarter is later determined in another quarter to be deficient; and many of these increases historically relate to estimated future profit and related costs). Excluding these costs from contract margin rates as "abnormal" would result in variability in reporting practices and reduce the comparability of information between similar companies in our industry. For example, consider a contract with a 10% margin at bid that, in a subsequent period, experiences a 2% increase in costs related to expected rework; the Exposure Draft model appears to require us to expense the rework costs separately and not adjust our bid margin of 10% to reflect actual performance of 8%. The same scenario under current guidance would result in an 8% margin on the entire contract, as we would record the adjustment via the cumulative catch-up method in the period of the change in estimate. We believe that current practice provides a more timely and accurate depiction to investors of the current economic performance on the contract, as well as a better projection of future performance.

We conceptually agree that when the cost of providing a good or service is expected to be greater than the consideration received from the customer for a good or service, the related performance obligation should be deemed onerous and remeasured at the entity's expected cost of providing that good or service. However, we believe the Board's guidance with respect to the level at which onerous obligations is determined does not align with the economics of our contracts. We believe that recording an onerous liability for a performance obligation (at inception or some other point in time) on what is a profitable contract overall and where total future contract revenue exceeds total future contract cost does not provide decision-useful information to financial statement users. For example, the costs to fulfill the initial performance obligation may be greater than that of subsequent performance obligations due to expected learning curve cost that is bid into a contract. This could result in an interpretation that the initial performance obligation is onerous and require immediate loss recognition, thereby producing results that do not align with the overall economics of the transaction or how we bid, negotiate and manage our contracts. This would not only diminish the predictability of our future results, but also fail to provide our investors with decision-useful information. We suggest that in instances of multiple performance obligations, costs to produce early units that benefit the entire contract should be eligible for capitalization and that the onerous test should be performed at the contract level to ensure the accounting provides decision-useful information to investors about an entity's performance.

10. The objective of the Boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

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- 11. The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?
- 12. Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

We offer our responses to questions 10-12 on disclosure (Exposure Draft paragraphs 69-83) collectively, as follows.

In our view, the effort to provide the significant additional quantitative disclosures and tabular reconciliations of balance sheet amounts described in the Exposure Draft would significantly outweigh the benefits provided to investors. As the proposed model will apply across all industries, we do not believe prescriptive disclosures are beneficial given the substantial differences across business models. We suggest requiring disclosure at a principles-based level, as opposed to prescriptive disclosures that may not be meaningful to financial statement users. A principles-based approach would allow different industries to provide relevant information to their respective financial statement user groups. We believe the disclosure principle in the proposed standard needs to weigh three key elements: 1) the benefits investors will receive versus the cost to provide the disclosures; 2) the level of disaggregation of quantitative disclosure information and principles to determine that level; and 3) when non-financial or forecast data should be included in the required disclosures and the related impact on audit firms and the safe harbor protections afforded under the Private Securities Litigation Reform Act of 1995 (PSLRA) and related U.S. Securities and Exchange Commission (SEC) regulations.

The Exposure Draft does not provide a principle regarding the expected level of disaggregated quantitative disclosure information. This could lead to information that is not comparable across similar companies and leave an entity open to questions as to why it did not disclose a greater level of detail. Conversely, an entity may disclose so much detail that useful information is obscured by a large amount of insignificant items. We suggest a principle requiring the level of disaggregated disclosure in the proposed standard be consistent with how a chief operating decision maker views his/her company, similar to current segment reporting disclosure requirements. We believe an approach similar to current segment reporting disclosure will provide the most decision-useful information, as companies already track information at that level and use it to manage their businesses. Adoption of this principles-based approach will also better align cost and benefit, as in many instances this approach will limit the need for significant system and process changes to collect and track information at a level that may not provide decision-useful information across all industries.

The suggested disclosures regarding contracts with original expected durations beyond one year (paragraph 78 of the Exposure Draft) would result in the inclusion of information based on projections in audited footnotes. This would result in public audit firms needing to audit long-range planning information that is subject to many changes and variables. In many cases, this information would not be relevant to our investors since the underlying assumptions would likely be stale by the time we filed our required reports with the SEC. Inclusion of this information in the footnotes versus Management's Discussion and Analysis of Results and Operations would also exclude it from the safe harbor protections regarding forward-looking statements afforded under the PSLRA and

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related SEC regulations. Therefore, we suggest that if the Board retains this disclosure requirement, it requires only a percentage estimate of what portion of a company's backlog will be satisfied over one year given the inherent lack of precision in determining when a performance obligation may be satisfied.

Overall, we support the Board's efforts to enhance the disclosure requirements and believe a principles-based approach will allow prepares to provide relevant information to their respective financial statement user groups. However, we believe that the Board should complete the overall disclosure framework project prior to adopting new disclosure requirements in individual standards to ensure consistency in application of the overall disclosure framework across all accounting standards.

In addition to the above, we do not believe that the model should prescribe presentation of contract assets separately from receivables. We currently present both billed and unbilled receivables together on the face of the financial statements as "contracts in process" and provide a reconciliation of the "contracts in process" line item in the footnotes to our financial statements. We believe this is the most meaningful presentation, as the vast majority of our contracts are under a continuous transfer of control model and the only difference between billed and unbilled receivables is the timing of the payments. We recognize in other industries the differences between billed and unbilled receivables primarily relates to complete satisfaction of a performance obligation and agree that separate presentation may be most meaningful in those instances, As such, we request that entities be allowed to present contract assets and receivables in a way that provides the most decision-useful information to their investors and other financial statement users, as long as they provide related disclosures to reconcile those amounts and explain the presentation.

13. Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

We believe retrospective application of the proposed guidance, which would require restatement of our prior results, is impractical and cost-prohibitive. To resolve this issue, we believe the proposed standard should provide application guidance that considers when retrospective treatment may be impractical, such as that in ASC 250, as follows:

- An entity is unable to apply the requirement after making every reasonable effort to do so;
- An entity is required to make assumptions about management's intent in a prior period that cannot be substantiated; and/or
- An entity is required to make estimates of amounts for which it is impossible to distinguish objective information about those estimates at the time they were made.

As an alternative, we suggest that the proposed guidance be applied prospectively for contracts with customers entered into after the effective date of the standard. Other major revenue recognition standards have been applied on a prospective basis, including most recently Accounting Standards Update No. 2009-13, *Revenue Recognition* (Topic

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605): Multiple-Deliverable Revenue Arrangements, and Update No. 2009-14, Software (Topic 985): Certain Revenue Arrangements that Include Software Elements. To address the Board's concern regarding the preservation of trend information about revenue, we suggest that entities be required to disclose information that enables financial statement users to understand the effects of the change in accounting principle (resulting from adopting the new standard) in the spirit of ASC 250.

If the Board requires full retrospective reporting, we request a sufficiently long lead-time to assess potential system, process and policy implementation challenges, which we believe will be substantial. It will take a tremendous amount of resources to implement this standard on a retrospective basis given the long-term nature of our contracts and robustness required in our policies and processes surrounding contract estimates, particularly given the complexity of our products and frequent use of variable fee contract structures by our customers. We recommend that if retrospective application is required, the adoption date be at least four years from the date of final standard issuance.

14. The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

We have aligned our requests for additional clarification and/or implementation guidance with our responses to the foregoing Exposure Draft questions and have included examples that we believe relevant to our interpretation of the Exposure Draft. Overall, we feel that the implementation guidance is not as useful as it could be in many instances due to the fact patterns being overly simplistic and extremely skewed toward one view or the other. It would be more useful to have examples that clarify grey areas. We recommend that these examples focused on grey areas not be prescriptive, but instead help users understand how to consistently apply the underlying principles.

In addition to the above, we respectfully request clarification or implementation guidance regarding paragraph 47 of the Exposure Draft. Our primary customer, the U.S. Government, often provides "Government-furnished equipment" ("GFE") for use at its direction in our fulfillment of various contractual requirements. However, standard contract terms under FAR Part 52.245 provide that the U.S. Government "shall retain title to all Government-furnished property" and that "generally, contractors are not held liable for loss, damage, destruction, or theft of Government property." As a result, we believe GFE is not a form of consideration, as the U.S. Government "controls" GFE, as indicated by these standard contract terms. We believe this is consistent with the current guidance in ASC 605-35-25, paragraphs 22-24, which is predicated on a risk model that is materially consistent with the control model outlined in the ED. We thus request the Board clarify the requirement to assess whether "control" is obtained via alignment to the indicators in paragraph 30 of the ED.

We believe a risk of ownership model is most appropriate in determining whether control of non-cash consideration has passed to an entity, as many of the control criteria in the Exposure Draft are not applicable to situations involving GFE in our industry (i.e., unconditional obligation to pay; customer specific design). For example, the U.S. Government may award a contract that requires the design, build and delivery of five radars and provide to us special test equipment to use in radar testing. Per the contract terms, legal title of this special test equipment remains with the U.S. Government. The U.S. Government may provide this special test equipment for our use in the performance of other contacts; however, the U.S. Government may at any time also restrict our use of the equipment or re-purpose the equipment at its sole discretion, including providing it to

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another contractor. Therefore, the risk and rewards of ownership and control are not transferred and value would not be included as non-cash consideration.

- 15. The Boards propose that an entity should distinguish between the following types of product warranties:
  - a. a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.
  - b. a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

We do not agree with the Board that an entity should distinguish between warranties for latent defects and those that cover defects that arise after a product is transferred to customers. We do not believe this principle is operable because a standard warranty may provide some level of assurance that a product will perform without defect for a period of time without distinction to whether the defect existed at the date of transfer or developed thereafter. In these instances, we believe it will be very difficult to allocate transaction price related to the warranty for latent defects and the warranty for faults arising after the product is transferred due to the aforementioned general assurances of many warranties. Therefore, we believe all standard warranties are economically similar and should be accounted for consistently.

We suggest that the Board only distinguish between standard warranties and separately priced or extended warranties, which may be purchased at the discretion of the customer. We believe that a separately priced or extended warranty does give rise to a separate performance obligation and revenue should be recognized as the related services are delivered. We believe this treatment is consistent with the economics underlying the transaction, as a separately priced or extended warranty provides the customer with additional assurance and gives rise to an obligation to the entity separate from the delivery of the product.