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Martin T. Stanislav
Vice President & Controller

June 19, 2009

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Subject: File Reference No. 1660-100

Dear Mr. Golden:

Thank you for the opportunity to review and comment upon the Discussion Paper entitled *Preliminary Views on Revenue Recognition in Contracts with Customers* ("the Discussion Paper") issued by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). Lockheed Martin Corporation is a global security company that employs about 146,000 people worldwide and is principally engaged in the research, design, development, manufacture, integration and sustainment of advanced technology systems and products. We also provide a broad range of management, engineering, technical, scientific, logistic and information services. We serve both domestic and international customers with products and services that have defense, civil and commercial applications, with our principal customers being agencies of the U.S. Government. We reported 2008 sales of \$42.7 billion.

As a major aerospace and defense (A&D) contractor and supplier to the U.S. Government through long-term construction and production-type contracts, we are concerned that the limitations in the proposed revenue recognition model would result in less decision-useful information to investors and other users of financial statements.

We appreciate the joint efforts of the FASB and IASB to create a single revenue recognition standard for all industries and transactions that could be used to improve consistency under U.S. GAAP as well as serve as a model for International Financial Reporting Standards (IFRS). We also believe the revenue recognition model under U.S. GAAP has become overly complex. Our greatest concern is that the revenue recognition model presented in the Discussion Paper does not adequately address the underlying economics, performance and contractual terms of the long-term contracts that constitute the majority of our business. The existing revenue model under U.S. GAAP for our contracts, based on the American Institute of Certified Public Accountants' Statement of Position 81-1, *Accounting for Construction-type and Certain*

Mr. Russell G. Golden
June 19, 2009
Page 2

Production-type Contracts (SOP 81-1), addresses the nature of our contracts in a manner that faithfully represents the underlying economics of transactions with our customers and has proven to be well understood by both financial statement preparers and the investor community. It should also be noted that IFRS also has a well established revenue recognition model for long-term contracts, namely International Accounting Standard (IAS) 11, *Construction Contracts*. We believe the underlying provisions of SOP 81-1 and IAS 11 are very similar. Based on a proven track record in both the A&D industry and other industries that engage in contracts with similar characteristics, we advocate a revenue recognition principle that applies the tenets of SOP 81-1 and IAS 11 that would address long-term construction and production-type contracts.

If the FASB and IASB decide to continue to move forward with the single revenue recognition model proposed in the Discussion Paper, we ask that clarifying provisions be added that give consideration to long-term construction and production-type contracts. Without clarification, we believe the results of the proposed standard will yield significantly different accounting results from those generated by the standards currently in effect. In the remainder of our comment letter, we have summarized those areas of the proposed revenue recognition model that we believe require clarification or modification. Our answers to the specific questions posed in the Discussion Paper are included in an attachment to this letter.

Performance Obligations under Long-term Construction and Certain Production Type Contracts (Unit of Account)

We believe the performance obligations should be aligned with the underlying economics of the contract. However, we do not believe that the revenue recognition model set forth in the Discussion Paper appropriately addresses the following factors that are prevalent in our customer contracts:

- Highly customized to a customer's specifications and cannot be easily transferred to another party in the event of default by the original customer;
- Extended period of time required to design, develop and manufacture products, often resulting in the delivery of only a few items;
- Customer oversight is significant during the contract period, including the sharing of technical, schedule and cost data. This activity represents, in an economic sense, a continuous sale that occurs as the work progresses; and
- The contractual relationship is extremely detailed between the customer and ourselves, and for our U.S. Government customer, prescribed by federal regulations.

Our contracts are bid, negotiated with our customers, and managed as single projects with an overall expected profit margin. Each contract may include many specific contract line items, some of which are individually priced, that define tasks to be completed and criteria for customer payments, or are used by our customer to designate their sources of funding. While certain of these contract items may represent separate deliverables under that contract, they are not marketed and sold as separate components. All of the contract line items are intertwined in order to meet the overall requirements of our customer. We believe the performance obligations should be measured consistent with the underlying economics of our contracts and in most cases that will be the overall contract.

Mr. Russell G. Golden
June 19, 2009
Page 3

The Discussion Paper also needs to address the accounting for long-term service contracts that include multiple deliverables over the contract performance period. The Discussion Paper definition of performance obligations would imply the need to allocate revenue to every revenue event that may occur during the contract performance period. However, our customers typically contract with us for a “total solution” and not individual events. Therefore, we would view the entire contract, rather than each event, as the unit of account.

The Discussion Paper aligns the recognition of revenue with the completion of performance obligations based on when control passes to the customer, whether a good or service. Depending upon the terms and conditions in a contract, we may recognize revenue differently under the model proposed in the Discussion Paper for producing identical products for our customers: for one customer it may be as the work under the contract progresses following the services model and, for another, when the final product is delivered following the goods or completed contract approach. We believe that economically similar contracts should follow the same revenue recognition model and that revenue recognition should not hinge on certain non-substantial contractual terms.

Satisfaction of Performance Obligations and Transfer of Control is a Continuum

As discussed elsewhere in our comment letter, most of our contracts are for an extended performance period, resulting in the delivery of a few products, following a lengthy design and development phase. The transfer of control for the “goods” model as set forth in the Discussion Paper would result in the contract value being allocated to each delivered product and only recognized as control of each product is passed to the customer. Recognition of revenue under this approach would not provide decision-useful information; the results would be inconsistent with the underlying economics of the contract and would not accurately reflect the performance achieved during the contract performance period.

We believe the Boards should consider a principles-based approach for transfer of control for goods provided under long-term construction and production-type contracts by giving recognition to our customer’s continuous involvement throughout the performance period as an element of control. Control effectively passes during the contract performance period. Our customers actively participate in design reviews, testing and other activities, and receive periodic reports that show progress towards completion. Also, customers frequently request changes be made to the design or requirements of products during the contract performance period through the change order process.

Measurement of Progress on Contracts

Since we believe that control passes to the customer on a continuous basis, as discussed above, it is important that measurement of progress towards completion of the contract is given due consideration by the Boards. We recognize the measurement of progress is judgmental and that output measures are an appropriate measure, particularly where items are produced in significant quantities. However, as discussed elsewhere in this comment letter, many of our contracts only provide for the delivery of a few products, following an extensive design and development phase.

Mr. Russell G. Golden
June 19, 2009
Page 4

In cases such as these, we believe it is appropriate to consider other measures of progress towards completion of the contract. In contrast with Example 5 in the Discussion Paper, we believe costs incurred, as a percentage of the estimated total contract cost, is an appropriate measure of progress towards completion of a contract. This has proven to be a sound measure of progress for many of the contracts in our business and is a concept that is well understood by our investors and users of our financial statements. The Boards should consider guidance similar to that set forth in SOP 81-1, where certain costs at the outset of a contract are disregarded if they do not represent measures of progress on the contract. Examples of this include significant up-front payments to subcontractors, purchase of a significant quantity of materials at the outset of a contract or other significant one-time payments, all of which are excluded from the measurement of progress until utilized in the performance of the contract.

Measurement of Contingent Revenue as a Performance Obligation

We believe that the recognition of award fees or incentives (contingent fees) should be considered in the estimate of the total contract consideration using management's best estimate, rather the probability-weighted approach that is set forth in the Discussion Paper. In addition, the initial measurement of contingent fees and other variable pricing provisions as well as when such items should be re-measured deserves further clarification in the Discussion Paper.

A significant number of our contracts contain contingent fees which represent a significant component of the overall contract revenue and profits. The contingent fees are embedded in the underlying economics of our contracts, and our pricing decisions reflect our best estimate of the amount to be realized during the contract performance period. We believe the best-estimate approach is more precise and consistent with performance on contracts and our industry's current practice, as it is predicated on the single "most-likely" probability outcome; a probability-weighted average of estimates can be skewed by the range of "unlikely" (low-probability or high-probability) outcomes considered, and may even yield a result that is not actually possible to achieve.

Recognition of contingent fees only upon award does not take into account the underlying economics of the contracts and the performance period during which the contingent fees are earned. Such an approach would increase volatility in our financial results and would necessitate further disclosures (potentially including non-GAAP disclosures) to assist our investors understanding of the performance on our contracts. Our contracting environment also includes variable pricing provisions including change orders, claims, and penalties, which should be treated similarly.

Performance on long-term contracts generally covers many reporting periods, and our management's best estimate of the contingent fees expected to be realized is updated periodically to reflect contract performance and other developments. Accordingly, we believe contingent fees and other variable pricing provisions should be re-measured with each reporting period.

Onerous Contracts

The Discussion Paper, as currently drafted, may require the recognition of a loss on certain performance obligations within a contract that is otherwise profitable in its entirety. Such a

Mr. Russell G. Golden
June 19, 2009
Page 5

measurement process could affect even our cost-reimbursable contracts whereby the customer reimburses us for our allowable costs plus a reasonable profit. Our investors understand the underlying economics of our long-term contracts, and the recognition of losses on otherwise profitable contracts would not only confuse users of our financial statements, but also would be inconsistent with the overall profitability of the contract. We believe loss contracts should continue to be measured at the overall contract level, rather than at the individual performance obligation level.

Cost Accumulation and Recovery on Contracts

Paragraph 6.43 of the Discussion Paper states that “[t]he Boards do not intend a new revenue recognition standard to include guidance on accounting for the costs associated with contracts with customers. Consequently, costs would be recognized as expenses when incurred unless they were eligible for capitalization in accordance with other standards.” However, many contracts in our industry, governed by the Federal Acquisition Regulation (FAR) and standards of the Cost Accounting Standards Board, provide for the recovery of certain costs through revenue which do not fit the proposed model of contract costs being solely attributable to the discharge of contractual obligations. Such costs include allocated amounts of bid and proposal expenses, independent research and development costs, and other indirect costs, as well as certain contract-specific direct charges such as those pertaining to proposal preparation for additional follow-on work. Accordingly, we believe that a comprehensive revenue recognition standard must explicitly address these costs in its model.

In addition, some costs incurred in the early stages of production contracts are related not only to the discharge of obligations at those early stages, but arguably through the entire production run or life of the contract. Examples of such costs include learning curve costs, production costs currently allocable to multiple units under a production lot or program accounting methodology, and set-up costs for the delivery of services. We are concerned that, without providing additional guidance on accounting for these costs, the proposed new standard could result in the recognition of losses on the first units delivered and profits on the units delivered later under the same contract, which would not be representationally faithful to the transaction as contracted nor provide decision-useful information concerning future cash flows. Both SOP 81-1 and IAS 11 provide guidance as to the capitalization of certain costs that are recoverable under long-term contracts. We believe adding this additional scope to the Boards’ project would not detract from the “one model” objective; it would merely expand the model to address another category of costs, where present, that are contractually recoverable from the customer.

Summary

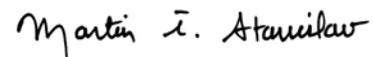
We believe that the proposed single revenue recognition model advocated in the Discussion Paper would drastically alter the current revenue recognition methods used in our industry and would provide less useful information to our investors and other users of our financial statements. We would suggest that the Boards strongly consider a separate revenue recognition model for long-term contracts that embraces the tenets of SOP 81-1 and IAS 11, which are similar and have demonstrated soundness with both the preparers of financial statements and those in the investor community.

Mr. Russell G. Golden
June 19, 2009
Page 6

If the Boards continue with the revenue recognition model set forth in the Discussion Paper, it is important that the concerns raised in our letter be considered. We believe our suggested clarifications for long-term contracts would facilitate our ability to report what we believe to be the underlying economics and performance of our contracts.

Please feel free to contact me if you or your staff would like to discuss any of the points made in our comment letter or if there is a desire to more fully understand the long-term contract aspect of our industry.

Sincerely,



Martin T. Stanislav
Vice President and Controller

Attachment

Preliminary Views Document on Revenue Recognition Lockheed Martin Responses to Questions

Question 1:

Do you agree with the Boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition methods?

While we do not object to the creation of a single standard, we do not agree that the principle be based solely on changes to contract assets and liabilities. We believe that the characteristics of long-term construction and certain production-type contracts (hereafter referred to as "certain long-term contracts") are inconsistent with the measurement methods upon which the contract asset/liability approach is dependent. These characteristics include the length of the contract performance period, the interrelation of many elements within a single integrated customized product or service, and others as further explained in response to the questions that follow. Furthermore, our contracts with the U.S. Government contain additional provisions (contractual coverage of certain period costs, contingent fees, reimbursement of contract costs, among others) that the Boards' model either fails to adequately address, or under which an accounting result inconsistent with the economics of the contract would be generated.

These characteristics and their unique implications have been long recognized and acknowledged by both standard setters in the U.S (various pronouncements culminating in AICPA Statement of Position (SOP) 81-1) and internationally (the IASB's IAS 11, which is generally consistent with SOP 81-1). SOP 81-1 contains a discussion of the characteristics unique to certain long-term contracts and explains why its accounting model best addresses those characteristics, and does so in a compelling fashion. Under SOP 81-1, revenue recognition is based on the percentage of completion of the contract, viewing the entire contract as a single unit of accounting.

We believe that a robust single revenue recognition standard can provide different guidance for different circumstances, and would advocate that the Boards' model be expanded to allow for SOP 81-1-like treatment under the appropriate circumstances. If a single revenue recognition principle cannot be developed, we believe the use of two revenue recognition principles, one that addresses certain long-term contracts and one that applies to all other types of transactions, would be appropriate. This latter approach is similar to that taken by the IASB with IAS 11 and IAS 18.

Question 2:

Are there types of contracts for which the Boards' proposed principle would prove not to provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in these examples?

Accounting for certain long-term contracts under the Boards' proposed revenue recognition principle would not provide decision-useful information, in our view. As we understand the Boards' model, revenue would not be recognized in accordance with the progress made under the contract if the customer did not assume control of the product until the completion of the contract performance period. Generally, certain long-term contracts provide for the transfer of title to the end product upon contract completion, often following a development and production process that may take a number of years. Not recognizing revenue until the customer has taken control of the completed product essentially follows the completed contract method of revenue recognition (found lacking as discussed in SOP 81-1 and considered a method of last resort when reliable estimates of contract progress cannot be made). Reporting revenue in this manner would be distortive to and inconsistent with the progress actually achieved during the period of performance on the contract. Investors in our industry understand the long-term nature and underlying economics of our contracts.

In our industry, contract terms, estimating techniques, and performance milestones are used to validate progress achieved during the performance of certain long-term contracts. These tools, and the accounting that results by applying the provisions of SOP 81-1, provide a meaningful representation of the progress performed and the economic substance of the activities taking place, and are well accepted and understood by our management, customers, and investors. To the extent that the Boards' proposed model differs, its application would result in accounting results that differed in the level of acceptance and understanding currently achieved. In addition, as further described in the answers to the questions below, to the extent that the results of the model differed from the economic substance of the contracted transaction (if, for example, an accounting loss would be recognized in the first year of a multi-year, profitable-in-its-entirety contract), the Boards' model could actually impede rational decision making.

Accordingly, we recommend that the Boards' proposed model incorporate revenue recognition principles currently found in SOP 81-1, IAS 11, and IAS 18, which would better reflect the contractual terms and the economics of our transactions under certain long-term contracts, and provide more useful and relevant financial reporting information to decision-makers concerning these contracts and our performance of them.

Question 3:

Do you agree with the Boards definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition?

Conceptually, we agree with the broad definition of a contact as being an agreement that exists between two or more parties. However, in our view, the main issue of contention is less whether a contract exists, but rather how the terms of the contract are to be reflected in the accounting for revenue and cost recognition. The terms of contracts in the aerospace and defense industry, often calling for the development and manufacture of limited quantities of highly specialized, technologically groundbreaking products, are complex and very different than those, for example, encountered in consumer goods manufacturing, retailing, or wholesaling of large quantities of a standardized good or service. Further, contracts with the U.S. Government incorporate the additional requirements of the Federal Acquisition Regulation and Cost Accounting Standards.

Question 4:

Do you think the Boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables (or components) of a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

While potentially helpful in addressing short-term contracts or contracts calling for discrete deliverable components, we do not believe the proposed definition would be helpful in consistently identifying deliverables or components of certain long-term contracts, particularly in our industry.

Aerospace and defense industry contracts are generally very complex and prescriptive in their specifications and statements of work. Requirements under such contracts often do not correspond to deliverables in the conventional sense, nor do they have separate values assigned to them by either the customer or manufacturer. Rather, the contract is negotiated, managed, and evaluated economically as a single, complex project. In many cases, a contract requirement has no standalone value absent its role in contributing to the completed end product. In these circumstances, the identification of a performance obligation for the purpose of achieving a measurable revenue recognition amount would likely yield an arbitrary result.

The application of the Boards' definition of a performance obligation could result in either the subjective segmenting of contracts in a manner unlikely to provide comparable results, or the use of the completed contract method of accounting (as discussed above). Existing standards, providing for the percentage-of-completion

model of revenue recognition, based on costs expended as a percentage of estimated total costs or other criteria as appropriate, provide less arbitrary, more comparable results. We think the Boards' model should do the same.

Question 5:

Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

As stated in our answer to question 4, the completion of a performance obligation on certain long-term contracts often does not correlate to the transfer of a promised asset or service to the customer in our industry. Often, the product is a complex system of systems, and the transfer is made when the system is complete in its entirety, not as components are built. Likewise, the contract itself is negotiated as a single whole. Under these circumstances, we believe that the best measurement of the retirement of performance obligations is the estimated percentage of completion of the contract as a whole.

While control may not pass to the customer until the system is complete, the nature of certain long-term contracts would suggest that the customer has elements of control during the contract performance period. For example, the customers are intimately involved with oversight activities, including various design and program reviews. Customers also receive periodic progress reports as to the technical, schedule and cost status of the respective contracts. If the Boards ultimately conclude that one revenue recognition model is appropriate, we believe it should appropriately provide clarification as it relates to certain long-term contracts.

Question 6:

Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

The concept of a returned good and refund of the customer's consideration is not applicable to our contracts.

Question 7:

Do you think that sales incentives (for example, discounts on furniture sales, customer loyalty points, and "free" goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

Sales incentives as described in the question are not applicable to our contracts.

Question 8:

Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised asset or when the customer receives the promised services? Why or why not? If not please, suggest an alternative when a promised good or service is transferred.

If control is defined as ownership, title, or possession, we do not believe that control is the only criterion upon which to base the recognition of a transfer (and, by extension, the recognition of revenue). Certain long-term contracts may call for title to the product to transfer upon completion of the contract rather than continuously throughout the construction process. However, performance obligations may be assigned and discharged, and value-generating activity performed, at different stages of the contract without the actual transfer of title of the promised asset to the customer.

In the case of U.S. Government contractors such as Lockheed Martin, the transfer of ownership of an asset or completion of an element of a contract is usually not conveyed until the customer issues an acceptance certificate, but there may be a continuous transfer of ownership through the construction or production oversight process with or without acceptance certificates being generated. This transfer of ownership can differ for identical items based on the nature of the customer. For example, foreign military sales through the U.S. Government and contracts with commercial customers can differ concerning when the actual passage of title to the customer has occurred. Similar issues exist when the customer receives promised services throughout a process but it is not possible to identify separate steps as satisfaction of discrete performance obligations. For example, customers often contract for a “total solution”, and not for the multitude of individual activities that it takes to perform the requirements of long-term service contracts.

We believe that a revenue recognition model incorporating the percentage-of-completion method, which may include the use of a cost-to-estimated total cost methodology, is a better answer. As an alternative, we believe that the Boards’ proposed definition of control be expanded to allow for a continuous transfer of control to the customer over the contract performance period when customer oversight and review of contract progress is sufficient to support this position. Such contract oversight occurs with regularity under contracts with the U.S. Government.

Question 9:

The Boards propose that an entity should recognize revenue only when a performance obligation is satisfied. Are there contracts for which the proposal would not provide decision-useful information? If so, please provide examples.

The Boards’ model would not provide decision-useful information for a number of long-term contract scenarios in our industry. Some contracts with the U.S. Government are

of the cost reimbursement variety, under which all allowable costs (as defined) incurred under the contract are billable to the customer. Under the proposed model, certain cost reimbursement-type contracts would yield losses in the portion of the contract performance period if defined performance obligations were not discharged and costs were incurred, despite the fact that contractually all such costs were recoverable under the contract (said differently, a loss would be recognized in certain reporting periods for a contract that, by its nature, is profitable). Reporting a loss during any period on a contract that provides for all costs to be reimbursed does not provide decision-useful information.

Certain long-term contracts involve significant design and development efforts, prior to the production of a limited quantity of products, which may not represent discrete performance obligations, yet those costs related to the development efforts are explicitly recoverable under the contract. In addition, and as further described in our answer to question 11, some costs that would otherwise be period costs are reimbursable costs under U.S. Government contracts but may not pertain to a performance obligation under a contract. Reporting losses for costs incurred that are contractually covered and will generate revenue on a contract that is profitable in its entirety does not provide decision-useful information. Such costs are specifically recognized in SOP 81-1 as being unique to our industry and realizable, due to the linkage of Federal contracting regulations to the accounting for our long-term contracts.

Question 10:

In the Boards' proposed model, performance obligations are measured initially at the transaction prices. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

- (a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?**

We agree conceptually that performance obligations should be measured initially at the transaction price. However, contracts in the our industry are often amended to add scope, revise the schedule, exercise options, or make other changes, with corresponding changes to the transaction price.

Certain types of contracts such as cost-plus fixed fee or award fee do not allow for performance obligations to be measured initially at the transaction price. Contingent fees such as award fees or incentive fees often represent a significant portion of our revenues and earnings under these contracts. We believe that these contingent fees should be measured using management's best estimate of the amount to be realized during the contract performance period. This approach provides the "most-likely" result and is consistent with the underlying economics of the contract and the manner in which the contract is bid

and negotiated. Results under a probability-weighted estimate could be skewed by considering “unlikely” (low-probability) outcomes that vary significantly in magnitude from the more likely values. We also believe, due to the long-term nature of our contracts, that management’s best estimate of contingent fees expected to be realized should be, and in practice is, updated periodically to reflect contract performance and other developments affecting the expected outcome. Accordingly, contractors should re-measure performance obligations under contracts with contingent fees at each reporting period.

- (b) Do you agree that a performance obligation should be deemed onerous and re-measured at the entity’s expected cost of satisfying the performance obligation if the cost exceeds the carrying amount of the performance obligation? Why or why not?**

As described in our answer to (a) above, we encounter many changes to our contracts and the performance obligations therein that we do not consider onerous, but which should be reflected in the accounting for the contract.

In contrast, we believe the definition of onerous should be applied when viewing the contract as a whole, rather than to an individual performance obligation. There are numerous instances where the early phases of certain long-term contracts (for instance the design and development phases of a design, development, and production contract), would be indicative of a loss (onerous), but the overall contract would be considered profitable. As mentioned in our earlier answers, the nature of our contracts and the manner in which they are negotiated and managed all support the use of a single unit of accounting for the contract as a whole.

- (c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations make the approach unsuitable? Please provide examples.**

As previously stated, many examples of certain long-term contracts cannot be reliably segmented into a series of discrete performance obligations such that decision-useful information could be provided at each financial statement date. Such contracts do not readily lend themselves to the identification of separately valued performance obligations or the assignment of revenue to individual elements of their multiple tasks and contractual requirements.

- (d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.**

As previously stated, certain long-term contracts should be subject to a measurement approach consistent with the overall progress on completion of the contracted asset or project using a percentage of completion methodology (including methods predicated on a cost-to-cost analysis). The progress-based measurement approaches under SOP 81-1 represent a tried and tested methodology that has been successfully applied to these types of contracts in the nearly thirty years since that standard was issued, and for years prior to that under certain predecessor standards.

U.S. GAAP and the IASB have independently arrived at similar answers to account for revenue under these circumstances unique to certain long-term construction contracts. We find this compelling, and believe the Boards should consider our suggestions to address revenue recognition associated with certain long-term contracts either separately from the model set forth in the Discussion Paper or, if within, then with the clarifications that have been recommended in our comment letter.

Question 11:

The Boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges a customer to recover any costs of obtaining the contract (for example, selling costs) are included in an initial measurement of the performance obligations. The Boards propose that an entity should recognize these costs as expenses unless they qualify for recognition as an asset in accordance with other standards.

- (a) Do you agree that amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations. Why or why not?**

Many contracts in our industry, governed by the Federal Acquisition Regulation and standards of the Cost Accounting Standards Board, provide for the recovery of certain costs through revenue which do not fit the proposed model of contract costs being solely attributable to the discharge of contractual obligations. Such costs include allocated amounts of bid and proposal expenses (costs of obtaining contracts), independent research and development costs, and other indirect

costs, as well as certain contract-specific direct charges such as those pertaining to proposal preparation for additional follow-on work. Accordingly, we believe that these costs associated with the obtaining of a contract should be included in the initial measurement of an entity's performance obligations rather than immediately expensed in the period incurred. It should be noted, however, that many of these costs are required to be allocated to all existing contracts, rather than assigned to the specific contract (if any) to which they may be identified.

Some costs incurred in the early stages of certain long-term contracts are related not only to the discharge of obligations at those early stages, but arguably through the entire production run or life of the contract. Examples of such costs include learning curve costs, production costs currently allocable to multiple units under a production lot or program accounting methodology, and set-up costs for the delivery of services.

(b) In what cases would recognizing the contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.

As explained above, bid and proposal costs are recovered by companies in our industry through indirect cost pools which are not contract-specific. Such expenses are recovered across our business as general and administrative costs which are recorded as an indirect contract cost, but not associated with an entity's specific financial performance on a contract

Question 12:

Do you agree that the transaction prices should be allocated to the performance obligations on the basis of the entity's standalone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

As previously described, many of our products and services provided under certain long-term contracts consist of numerous components and systems. Many of these components, not to mention many subsidiary performance obligations which may be contractually stipulated, have no standalone selling price. These items are unique, custom products often designed for a single customer. The customer purchases the completed system, not a collection of components.

Without a standalone selling price, we would be required to use some estimating process to assign values to these performance obligations. As noted previously, these estimates would, by their very nature, be highly judgmental, potentially arbitrary, lack comparability, and be of questionable use.

We believe a better answer is to base the recognition of revenue on a measurement of contract progress in accordance with a percentage-of-completion method, applied to the selling price of the entire contract. This method is objective, verifiable, easily understood, comparable, and best reflects the economics of the contracted transaction in a decision-useful manner.

Question 13:

Do you agree that if an entity does not sell a good or service separately, it should estimate the standalone selling price of that good or service for purposes of allocating the service price? Why or why not? When, if ever, should the use of estimates be constrained?

As answered in question 12 above, we do not believe that estimates of standalone selling prices, where no actual standalone prices exist, should be used for purposes of allocating the revenue of an entire contract to its components. Under such circumstances, where no market exists for the individual contract components, we believe estimates of revenue are more objectively determined through the use of the percentage-of-completion methods currently prescribed by SOP 81-1.

If the Boards determined that some other method of estimation was necessary, we would ask that a method based on criteria other than the fair value model called for in EITF 00-21 be considered. We have found the 00-21 model unworkable when applied to the types of contracts we encounter.