

NORTHROP GRUMMAN CORP /DE/

Form 11-K

June 29, 2006

Table of Contents

---

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

### FORM 11-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2005

OR

TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_ .

Commission file number: 1-12385

A. Full title of the plan and address of the plan, if different from that of the issuer named below:

**NORTHROP GRUMMAN PEI**

**RETIREMENT SAVINGS PLAN**

B. Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:

**NORTHROP GRUMMAN CORPORATION**

**1840 Century Park East**

**Los Angeles, California 90067**

---

**Table of Contents**

***Northrop Grumman PEI  
Retirement Savings Plan***

*Financial Statements as of December 31, 2005 and 2004,  
and for the Year Ended December 31, 2005, and  
Supplemental Schedule as of December 31, 2005 and  
Report of Independent Registered Public Accounting Firm*

Table of Contents

**NORTHROP GRUMMAN PEI RETIREMENT SAVINGS PLAN**

**TABLE OF CONTENTS**

---

	<b>Page(s)</b>
<b><u>REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u></b>	1
<b>FINANCIAL STATEMENTS:</b>	
<u>Statements of Net Assets Available for Benefits as of December 31, 2005 and 2004</u>	2
<u>Statement of Changes in Net Assets Available for Benefits for the Year Ended December 31, 2005</u>	3
<u>Notes to Financial Statements as of December 31, 2005 and 2004, and for the year ended December 31, 2005</u>	4-12
<b>SUPPLEMENTAL SCHEDULE:</b>	
<u>Form 5500, Schedule H, Part IV, Line 4i, Schedule of Assets (Held at End of Year) as of December 31, 2005</u>	13

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Benefit Plan Administrative Committee of the

Northrop Grumman PEI Retirement Savings Plan

We have audited the accompanying statements of net assets available for benefits of the Northrop Grumman PEI Retirement Savings Plan (the Plan ) as of December 31, 2005 and 2004, and the related statement of changes in net assets available for benefits for the year ended December 31, 2005. These financial statements are the responsibility of the Plan s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Plan is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2005 and 2004, and the changes in net assets available for benefits for the year ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule of assets (held at end of year) as of December 31, 2005 is presented for the purpose of additional analysis and is not a required part of the basic financial statements, but is supplementary information required by the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. This schedule is the responsibility of the Plan s management. Such schedule has been subjected to the auditing procedures applied in our audit of the basic 2005 financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

/s/ DELOITTE & TOUCHE LLP

Los Angeles, California

June 27, 2006



Table of Contents

**NORTHROP GRUMMAN PEI RETIREMENT SAVINGS PLAN**

**STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS**

**AS OF DECEMBER 31, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<b>ASSETS:</b>		
Investment in Northrop Grumman Corporation PEI Pension and 401(k) Plans Master Trust at fair value	\$ 1,841,847	\$ 1,616,814
Participant contributions receivable	22,268	20,905
Employer contributions receivable	9,738	9,259
	<u>          </u>	<u>          </u>
<b>NET ASSETS AVAILABLE FOR BENEFITS</b>	<b>\$ 1,873,853</b>	<b>\$ 1,646,978</b>
	<u>          </u>	<u>          </u>

See notes to financial statements.

Table of Contents**NORTHROP GRUMMAN PEI RETIREMENT SAVINGS PLAN****STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS****FOR THE YEAR ENDED DECEMBER 31, 2005****INVESTMENT INCOME:**

Plan interest in Northrop Grumman Corporation PEI Pension and 401(k) Plans Master Trust	\$ 109,530
---	------------

Total investment income	109,530
-------------------------	---------

**CONTRIBUTIONS:**

Employer	78,949
----------	--------

Participant	181,428
-------------	---------

Total contributions	260,377
---------------------	---------

Total additions	369,907
-----------------	---------

<b>BENEFITS PAID TO PARTICIPANTS</b>	<b>(143,032)</b>
--------------------------------------	------------------

<b>INCREASE IN NET ASSETS</b>	<b>226,875</b>
-------------------------------	----------------

**NET ASSETS AVAILABLE FOR BENEFITS:**

Beginning of year	1,646,978
-------------------	-----------

End of year	\$ 1,873,853
-------------	--------------

See notes to financial statements.



Table of Contents

## NORTHROP GRUMMAN PEI RETIREMENT SAVINGS PLAN

### NOTES TO FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2005 AND 2004, AND FOR THE YEAR ENDED DECEMBER 31, 2005

---

#### 1. DESCRIPTION OF THE PLAN

The following description of the Northrop Grumman PEI Retirement Savings Plan (the Plan) provides only general information. Participants should refer to the Plan document for a more complete description of the Plan's provisions.

**General** The Plan is a qualified profit-sharing plan sponsored by the Productos Electronicos Industriales division of Northrop Grumman Electronicos, Inc. (the Company). The Plan includes a 401(k) feature and employer matching contributions. Both the savings and employee stock ownership features are reported within the Plan's 2005 financial statements.

The Plan was established by the Company on March 1, 1996, as a successor to the Westinghouse de Puerto Rico Retirement Savings Plan (the Predecessor Plan), maintained by Westinghouse de Puerto Rico, Inc. for the benefit of Puerto Rican employees of certain Westinghouse Electric Corporation affiliated companies who became employees of the Company, and any other subsequent eligible employees of the Company. The Benefit Plan Administrative Committee of Northrop Grumman Corporation (NGC) controls and manages the operation and administration of the Plan. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

Plan assets are invested 100 percent in the Northrop Grumman Corporation PEI Pension and 401(k) Plans Master Trust (the PEI Master Trust), which is administered by Banco Popular de Puerto Rico (the PEI Trustee). The PEI Master Trust, in turn, has invested 100 percent of the Plan's assets in the Northrop Grumman Defined Contribution Plans Master Trust (the DC Master Trust) which is administered by State Street Bank and Trust Company (State Street). As an agent to the PEI Trustee, State Street is responsible for tracking the individual assets and reporting month-end plan accounting to the PEI Trustee.

**Contributions** Plan participants may contribute between 1 percent and 8 percent of total compensation, in increments of 1 percent on a pre-tax basis through payroll withholdings. Basic contributions may be made in amounts of 1 percent to 4 percent of total compensation. Eligible employees who have authorized the maximum basic contribution may make Supplementary contributions in amounts between 1 percent and 4 percent of total compensation. Contributions are subject to certain limitations imposed by the Internal Revenue Code of 1986, as amended (the Code).

The Company contributes a match of 50 percent of the amount of a participant's Basic contribution. The maximum matching contribution will not exceed 2 percent of the total compensation of the participant.

An eligible employee may rollover any amount from another qualified plan or from an Individual Retirement Account into the Plan, provided that such rollover amount is paid to the PEI Trustee within 60 days of the date the employee received the qualifying rollover distribution.

***Participant Accounts*** A separate account is maintained for each participant, each of which has two subaccounts. Basic and Supplementary contributions are allocated to the participant s

## **Table of Contents**

contribution account. Company matching contributions are allocated to the participant's Company matching contribution account. Assets of the DC Master Trust are valued at the end of each month, and on a daily basis, and take into account earnings and losses of the Plan along with appreciation or depreciation, expenses and distributions. The benefit to which a participant is entitled is the benefit that can be provided from the participant's vested account.

***Vesting*** Plan participants are vested immediately in, and have a nonforfeitable right to, the balance of their Basic and Supplementary contributions at all times. Plan participants become 100 percent vested in Company contributions after three years of service and have no vesting prior to that time. Company contributions become 100 percent vested upon the attainment of age 65 or the death of a participant. Rollovers are 100 percent vested at all times and are not subject to forfeiture.

***Investment Options*** Upon enrollment in the Plan, each participant directs his or her contributions, including employer matching contributions, to be invested in any of the following investment funds within the DC Master Trust:

***Northrop Grumman Fund*** The Northrop Grumman Fund ( NG Stock Fund ) invests primarily in Northrop Grumman Corporation common stock.

***U.S. Equity Fund*** The U.S. Equity Fund consists predominantly of holdings in large and medium sized U.S. company stocks. The fund's objectives are capital appreciation over the long term, along with current income (dividends). The fund's stock investments are selected by independent professional investment managers appointed by the Plan's Investment Committee.

***Money Market Fund*** The Money Market Fund invests in the Northrop Grumman Stable Value Fund (the Stable Value Fund , see Notes 5 and 6). Investments of the Stable Value Fund are diversified among U.S. Government securities and obligations of government agencies, bonds, short-term investments, cash and investment contracts issued by insurance companies and banks. The Stable Value Fund is managed by an independent professional investment manager appointed by the Plan's Investment Committee.

***U.S. Bond Fund*** The U.S. Bond Fund consists of holdings in marketable, fixed income securities rated within the three highest investment grades assigned by Moody's Investor Services or Standard & Poor's Corporation, U.S. Treasury or federal agency obligations, or cash equivalent instruments. The fund is broadly diversified and maintains an average maturity of 10 years. The securities are selected by independent professional investment managers appointed by the Plan's Investment Committee.

***Payment of Benefits*** All withdrawals from the Plan during employment shall be paid in cash. All distributions from the Plan upon retirement, termination or death shall be paid in cash and/or shares of Northrop Grumman Corporation common stock held in the account. A participating employee may elect to withdraw all or a portion of the vested portion of the participant account only in the case of hardship, as defined by the Plan, and may make withdrawals twice per year but not more than once per month. If a participating employee retires or employment is terminated, the vested portion of the participant account shall be distributed to the participant as soon as practicable following the next valuation date after retirement or termination occurs. Any

## **Table of Contents**

nonvested portion of the participant account shall be forfeited at that time. In the case of death of a participating employee, the entire account shall be distributed in a lump sum to the participant's beneficiary(ies).

***Forfeited Accounts*** Any amounts forfeited shall be used to reduce the Company's obligation to make company matching contributions under the Plan. In 2005, insignificant employer contributions totaling \$85 were reduced by forfeited nonvested amounts.

## **2. SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Accounting*** The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

***Use of Estimates*** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

***Risk and Uncertainties*** The Plan utilizes various securities, including U.S. Government securities, corporate debt instruments and corporate stocks. Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities may occur in the near term, and that such changes could materially affect the amounts reported in the financial statements.

***Investment Valuation and Income Recognition*** The Plan's investments in the PEI Master Trust (which in turn invests in the DC Master Trust) are stated at fair value as determined by State Street. The PEI Trustee relies on the prices provided by State Street in performing any valuations or calculations required of the PEI Trustee. The underlying investment in the PEI Master Trust is valued as follows:

Investments in common and preferred stock are valued at the last reported sales price of the stock on the last business day of the plan year. The shares of registered investment companies are valued at quoted market prices that represent the net asset values of shares held by the Plan at year end. Investments in common trust funds are valued based on the redemption price of units owned by the Plan, which is based on the current fair value of the funds underlying assets. Fair values for securities are based on information in financial publications of general circulation, statistical and valuation services, records of security exchanges, appraisals by qualified persons, transactions and bona fide offers in assets of the type in question and other information customarily used in the valuation of assets or if market values are not available, at their fair values as provided to State Street by the party with authority to trade in such securities (investment managers or the Plan's Investment Committee, as applicable).

Guaranteed investment contracts held by the Plan through the Stable Value Fund are considered to be fully benefit-responsive and therefore are recorded at contract value. Contract value represents contributions made under the contract, plus interest at the contract rate, less withdrawals and contract administrative expenses. Contract value approximates fair value. In addition, the Plan entered into synthetic investment contracts in order to manage the market risk and return of certain securities held by the Plan (see Notes 5 and 6).

**Table of Contents**

All securities and cash or cash equivalents are quoted in the local currency and then converted into U.S. dollars using the appropriate exchange rate obtained by State Street. Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date. Broker commissions, transfer taxes, and other charges and expenses incurred in connection with the purchase, sale, or other disposition of securities or other investments are added to the cost of such securities or other investments, or are deducted from the proceeds of the sale or other disposition thereof, as appropriate. Taxes, if any, on the assets of the funds, or on any gain resulting from the sale or other disposition of such assets, or on the earnings of the funds, are apportioned among the participants whose interests in the Plan are affected, and the share of such taxes apportioned to each such person is charged against his or her account in the Plan.

The PEI Master Trust and the DC Master Trust allocate investment income, realized gains and losses and unrealized appreciation and depreciation on the underlying securities to the participating plans monthly and daily, respectively, based on the market value of each plan's investment. The unrealized appreciation or depreciation in the aggregate current value of investments is the difference between current value and the cost of investments. The realized gain or loss on investments is the difference between the proceeds received and the average cost of the investments sold.

**Administrative Expenses** Administrative expenses of the Plan are paid by the Company.

**Payment of Benefits** Payments to participants are recorded upon distribution. Amounts allocated to accounts of participants who have elected to withdraw from the Plan but have not yet been paid were \$7,189 and \$2,653 at December 31, 2005 and 2004, respectively, and such amounts continue to accrue interest until paid.

**Reclassification** Certain prior year amounts have been reclassified to conform to the current year presentation.

**3. INVESTMENTS**

**PEI Master Trust** The investments of the Plan as of December 31, 2005 and 2004 are stated at fair values reported by the PEI Trustee. Proportionate interests of each participating plan were ascertained on the basis of the PEI Trustee's plan accounting method for master trust arrangements. Plan assets represented 46 percent and 48 percent of total PEI Master Trust net assets reported by the PEI Trustee as of December 31, 2005 and 2004, respectively. The Plan's interest in the PEI Master Trust did not include any interest in the PEI Master Trust's investment in the Northrop Grumman Employee Benefit Plan Master Trust as of December 31, 2005 and 2004, and for the year ended December 31, 2005

The net assets of the PEI Master Trust at fair value consist of the following as of December 31:

	<u>2005</u>	<u>2004</u>
<b>Assets:</b>		
Investment in Northrop Grumman Employee Benefit Plan Master Trust	\$ 2,160,873	\$ 1,756,922
Investment in Northrop Grumman Defined Contribution Plans Master Trust	1,774,050	1,564,357
Northrop Grumman Corporation common stock	67,797	52,457

<b>Net Assets of the PEI Master Trust</b>	<u>\$ 4,002,720</u>	<u>\$ 3,373,736</u>
---	---------------------	---------------------

**Table of Contents**

Investment income for the PEI Master Trust is as follows for the year ended December 31, 2005:

Plan interest in Northrop Grumman Employee Benefit Plan Master Trust	\$ 193,109
Plan interest in Northrop Grumman Defined Contribution Plans Master Trust	108,250
Northrop Grumman Corporation Common Stock	1,280
	<hr/>
Total Investment Income	\$ 302,639
	<hr/>

**DC Master Trust** The Plan's investments consist of a proportionate interest in certain investments held by the DC Master Trust. Those investments are stated at fair values determined and reported by State Street, in accordance with the DC Master Trust Agreement established by the Company.

Proportionate interests of each participating plan were ascertained on the basis of State Street's plan accounting method for master trust arrangements. Plan assets represent 0.02 percent of total net assets reported by the Trustee of the DC Master Trust as of December 31, 2005 and 2004.

DC Master Trust assets of \$1,030,051,000 and \$945,632,923 were on loan to third party borrowers under security lending agreements as of December 31, 2005 and 2004, respectively. Such assets could be subject to sale restrictions in the event security lending agreements are terminated and the securities have not been returned to the DC Master Trust.

The DC Master Trust held \$1,052,025,787 and \$964,720,499 of collateral for securities on loan as of December 31, 2005 and 2004, respectively.

The net assets of the DC Master Trust at fair value as of December 31 were as follows:

	<b>2005</b>	<b>2004</b>
	<hr/>	<hr/>
<b>Assets:</b>		
Common and preferred stock	\$ 4,506,263,263	\$ 3,996,701,303
Common/collective trust funds	3,525,719,304	2,497,187,691
Guaranteed and synthetic investment contracts	2,915,422,961	2,726,708,728
U.S. and foreign government securities	408,733,576	282,951,795
Corporate debt instruments	214,406,077	159,625,861
Cash equivalents and temporary investments	153,249,885	326,396,803
Receivable for investments sold	31,012,899	33,120,224
Dividends, interest and taxes receivable	10,823,852	10,142,786
Other receivables		37,008
	<hr/>	<hr/>
Total assets	11,765,631,817	10,032,872,199
<b>Liabilities:</b>		
Due to broker for securities purchased	72,628,752	66,552,095
Other	183,943	

Total liabilities	72,812,695	66,552,095
<b>Net assets of the DC Master Trust</b>	<b>\$ 11,692,819,122</b>	<b>\$ 9,966,320,104</b>



**Table of Contents**

Investment income for the DC Master Trust for the year ended December 31, 2005 is as follows:

Investment income:	
Net appreciation (depreciation) in fair value of investments:	
Common and preferred stock	\$ 336,984,568
Common/collective trust funds	212,020,634
Cash equivalents and temporary investments	264,049
Corporate debt instruments	(3,739,892)
U.S. and foreign government securities	(5,546,461)
	<hr/>
Net appreciation	539,982,898
Interest	168,239,548
Dividends	125,016,068
Other income	1,377,579
Other expenses	(179,253)
Investment manager fees	(14,588,405)
	<hr/>
Total investment income	\$ 819,848,435

Other than the Plan's interest in the PEI Master Trust there are no assets held for investment that represent 5 percent or more of the Plan's net assets at December 31, 2005 and 2004.

**4. DERIVATIVE FINANCIAL INSTRUMENTS**

Derivative financial instruments may be used by the investment managers of the DC Master Trust as part of their respective strategies. These strategies include the use of futures contracts, interest rate swaps, options on futures and options as substitutes for certain types of securities. Notional amounts disclosed below do not quantify risk or represent assets or liabilities of the DC Master Trust, but are used in the calculation of the cash settlements under the contracts.

The fair value of these instruments is recorded as investments of the DC Master Trust. To the extent that a gain has been recognized, these instruments are recorded as assets and to the extent that a loss has been recognized, these instruments are recorded as a liability. Changes in the fair value of the derivative instrument are reflected in investment income as appreciation (depreciation) in the DC Master Trust. As of December 31, 2005 and 2004, these derivative financial instruments were held for trading purposes. The notional amounts and fair values are presented below:

	<u>December 31, 2005</u>		<u>December 31, 2004</u>	
	<u>Notional Amount</u>	<u>Fair Value Asset (Liability)</u>	<u>Notional Amount</u>	<u>Fair Value Asset (Liability)</u>
Futures Contracts (net position):				
U.S. Treasury	\$ 96,369,583	\$ (833,881)	\$ (106,707,141)	\$ (342,253)

Edgar Filing: NORTHROP GRUMMAN CORP /DE/ - Form 11-K

Eurodollar	398,483,962	(1,501,874)	103,801,483	(459,296)
Index	1,433,068	(74,176)		
Interest rate swaps	86,570,000	(191,994)	46,370,000	(305,818)
Options on futures and swaps (net position)	6,440,000	(52,273)		

**Table of Contents**

**Futures Contracts** The DC Master Trust enters into futures contracts in the normal course of investing activities to manage market risk associated with equity and fixed income investments and to achieve overall investment portfolio objectives. These contracts involve elements of market risk in excess of amounts recognized in the statements of net assets available for plan benefits. The credit risk associated with these contracts is minimal as they are traded on organized exchanges and settled daily. The terms of these contracts typically do not exceed one year. Notional amounts related to these contracts in the table above are stated as a net buy (sell) position.

**Interest Rate Swaps** The DC Master Trust enters into interest rate swap contracts in the normal course of its investing activities to manage the interest rate exposure associated with fixed income investments. The credit risk associated with these contracts is minimal as they are entered into with a limited number of highly rated counterparties.

**Options on Futures and Swaps** The DC Master Trust enters into contracts in the normal course of its investing activities to manage the interest rate exposure associated with fixed income investments. The credit risk associated with these contracts is minimal as they are entered into with a limited number of highly rated counterparties. Notional amounts related to these contracts in the table above are stated as a net buy (sell) position.

**5. INTEREST IN NORTHROP GRUMMAN STABLE VALUE FUND**

The Plan's investment in the PEI Master Trust through its investment in the DC Master Trust includes amounts in the Northrop Grumman Stable Value Fund, established for the investment of the assets of certain savings plans sponsored by NGC and its affiliates. Each participating savings plan has an undivided interest in the Stable Value Fund. At December 31, 2005 and 2004, the Plan's interests in the net assets of the Stable Value Fund were .04 percent and .03 percent, respectively, of the total fund value. Investment income and administrative expenses relating to the Stable Value Fund are allocated among the participating plans on a daily basis.

Investments held in the Stable Value Fund as of December 31, 2005 and 2004 were as follows:

	<b>2005</b>	<b>2004</b>
Guaranteed and synthetic investment contracts (at contract value)	\$ 2,915,422,961	\$ 2,726,708,728
Cash and cash equivalents	28,713,205	22,365,697
<b>Total</b>	<b>\$ 2,944,136,166</b>	<b>\$ 2,749,074,425</b>

Investment income of the Stable Value Fund totaled \$136,364,903 for the year ended December 31, 2005.

The DC Master Trust has an arrangement with the investment manager of the Stable Value Fund whereby the investment manager has the ability to borrow amounts from third parties to satisfy liquidity needs of the Stable Value Fund, if necessary. As of December 31, 2005, no borrowings under this arrangement were outstanding.



**Table of Contents****6. INVESTMENT CONTRACTS WITH INSURANCE COMPANIES**

Guaranteed investment contracts at contract value owned by the Stable Value Fund consisted of the following as of December 31, 2005 and 2004 (at contract value):

	<b>2005</b>	<b>2004</b>
Synthetic investment contracts	\$ 2,915,422,961	\$ 2,699,669,681
Separate account assets		16,025,472
General account assets		11,013,575
<b>Totals</b>	<b>\$ 2,915,422,961</b>	<b>\$ 2,726,708,728</b>

The Stable Value Fund holds wrapper contracts in order to manage the market risk and return of certain securities held by the Stable Value Fund. The wrapper contracts generally modify the investment characteristics of certain underlying securities similar to those of guaranteed investment contracts. Each wrapper contract and its related underlying assets is referred to as a synthetic investment contract ( SIC ) and is recorded at contract value.

The fair value of the underlying assets related to the SICs was \$2,898,864,923 and \$2,760,543,569 as of December 31, 2005 and 2004, respectively. The fair value of non-synthetic contracts held by the Plan approximated their contract value as of December 31, 2004. The weighted average yield (excluding administrative expenses) for all investment contracts was 4.88 percent and 4.74 percent at December 31, 2005 and 2004, respectively. Average duration for all investment contracts was 3.19 years and 2.91 years at December 31, 2005 and 2004, respectively. The crediting interest rate for all investment contracts was 4.86 percent and 4.74 percent at December 31, 2005 and 2004, respectively. Crediting interest rates are reset on a quarterly basis. Resets are determined based upon the market-to-book ratio, along with the yield and duration of the underlying investments.

**7. EXEMPT PARTY-IN-INTEREST TRANSACTIONS**

Party-in-interest transactions include the purchase and sale of investments managed by affiliates, transactions involving common stock of NGC, and payments made by the Company or NGC for certain Plan administrative costs. The Plan held 1,128 shares and 570 shares with fair value of \$67,811 and \$52,425 of common stock of NGC at December 31, 2005, and 2004, respectively. The Plan received dividends of \$849 from its investment in NGC common stock during the year ended December 31, 2005.

The Plan had transactions with the PEI Trustee s and State Street s short-term investment funds, liquidity pooled funds in which participation commences and terminates on a daily basis.

The DC Master Trust utilized various investment managers to manage its net assets. These net assets may be invested into funds also managed by the investment managers. Therefore, these transactions qualify as party-in-interest transactions.

**8. PLAN TERMINATION**

Although it has not expressed any intention to do so, the Company has the right under the Plan to discontinue its contributions at any time and to terminate the Plan subject to the provisions of ERISA. In the event of the Plan's termination, participants will become 100 percent vested in their accounts.

**Table of Contents****9. FEDERAL INCOME TAX STATUS**

The Plan is intended to be qualified under the Code and the Puerto Rico Income Tax Code of 1994. The Plan obtained its latest determination letter dated December 11, 2000, in which the Internal Revenue Service determined that the Plan terms at the time of the determination letter application were in compliance with the applicable sections of the Code and, therefore, the related trust is exempt from taxation. The Plan has been amended since receiving the determination letter. Although the amendments have not yet been filed for a favorable determination letter, management will make any changes necessary to maintain the Plan's tax-qualified status. However, management believes that the Plan and the related trust are designed and currently being operated in compliance with the applicable provisions of the Code and Puerto Rico Income Tax Code of 1994. Therefore, no provision for income taxes has been included in the Plan's financial statements.

**10. RECONCILIATION OF FINANCIAL STATEMENTS TO FORM 5500**

The following is a reconciliation of net assets available for plan benefits per the financial statements to Form 5500 as of December 31:

	<u>2005</u>	<u>2004</u>
Net assets available for benefits per the financial statements	\$ 1,873,853	\$ 1,646,978
Less: Amounts allocated to withdrawing participants	(7,189)	(2,653)
Net assets per Form 5500	<u>\$ 1,866,664</u>	<u>\$ 1,644,325</u>

The following is a reconciliation of benefits paid to participants per the financial statements to Form 5500 for the year ended December 31, 2005:

Benefits paid to participants per the financial statements	\$ 143,032
Add: Amounts allocated to withdrawing participants at December 31, 2005	7,189
Less: Amounts allocated to withdrawing participants at December 31, 2004	(2,653)
Benefits paid to participants per Form 5500	<u>\$ 147,568</u>

Amounts allocated to withdrawing participants are recorded on Form 5500 for benefit claims that have been processed and approved for payment prior to December 31 but not yet paid as of that date.

\* \* \* \* \*

Table of Contents

**NORTHROP GRUMMAN PEI RETIREMENT SAVINGS PLAN**

FORM 5500, SCHEDULE H, PART IV, LINE 4i

AS OF SCHEDULE OF ASSETS (HELD AT END OF YEAR)

DECEMBER 31, 2005

<u>(b)</u>	<u>(c)</u>	<u>(d)</u>	<u>(e)</u>
Identity of Issue, Borrower, Lessor or Similar Party	Description of Investment, Including Maturity Date, Rate of Interest, Collateral, Par or Maturity Value	Cost	Current Value
* Northrop Grumman Defined Contribution Plans Master Trust	Participation in Northrop Grumman Defined Contribution Plans Master Trust	**	\$ 1,774,050
* Northrop Grumman Corporation	1,128 Shares of Northrop Grumman Corporation common stock	**	67,797
			<u>\$ 1,841,847</u>

\* Party-in-interest

\*\* Cost information is not required for participant-directed investments and therefore is not included.



**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the trustees (or other persons who administer the employee benefit plan) have duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

NORTHROP GRUMMAN PEI RETIREMENT SAVINGS PLAN

By */s/ IAN ZISKIN*  
**Ian Ziskin**

Dated: June 29, 2006

**Chairman, Benefit Plan Administrative Committee**