

KBR, INC.  
Form 10-K  
February 23, 2011  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the fiscal year ended December 31, 2010

OR

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from            to

Commission File Number 1-33146

**KBR, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation or organization)  
601 Jefferson Street

**20-4536774**  
(I.R.S. Employer Identification No.)

Edgar Filing: KBR, INC. - Form 10-K

Suite 3400

Houston, Texas 77002

(Address of principal executive offices)

Telephone Number - Area code (713) 753-3011

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each Exchange on which registered
Common Stock par value \$0.001 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the voting stock held by non-affiliates on June 30, 2010, was approximately \$3,207,690,000, determined using the closing price of shares of common stock on the New York Stock Exchange on that date of \$20.34.

As of February 11, 2011, there were 151,258,471 shares of KBR, Inc. Common Stock, \$0.001 par value per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the KBR, Inc. Company Proxy Statement for our 2011 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.



**Table of Contents**

**TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I</b>	
<u>Item 1. Business</u>	4
<u>Item 1A. Risk Factors</u>	11
<u>Item 1B. Unresolved Staff Comments</u>	21
<u>Item 2. Properties</u>	21
<u>Item 3. Legal Proceedings</u>	21
<u>Item 4. (Removed and Reserved)</u>	21
<b>PART II</b>	
<u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	22
<u>Item 6. Selected Financial Data</u>	24
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	58
<u>Item 8. Financial Statements and Supplementary Data</u>	58
<u>Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure</u>	113
<u>Item 9A. Controls and Procedures</u>	113
<u>Item 9B. Other Information</u>	115
<b>FINANCIAL STATEMENTS</b>	
<u>Report of Independent Registered Public Accounting Firm</u>	59
<u>Consolidated Statements of Income</u>	60
<u>Consolidated Balance Sheets</u>	61
<u>Consolidated Statements of Comprehensive Income</u>	62
<u>Consolidated Statements of Shareholders' Equity</u>	63
<u>Consolidated Statements of Cash Flows</u>	64
<u>Notes to Consolidated Financial Statements</u>	65
<b>PART III</b>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	115
<u>Item 11. Executive Compensation</u>	115
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	115
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	115
<u>Item 14. Principal Accounting Fees and Services</u>	115
<b>PART IV</b>	
<u>Item 15. Exhibits and Financial Statement Schedules</u>	115
<b><u>SIGNATURES</u></b>	121

**Table of Contents**

**Forward-Looking and Cautionary Statements**

*This report contains certain statements that are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Private Securities Litigation Reform Act of 1995 provides safe harbor provisions for forward looking information. Some of the statements contained in this annual report are forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. The words believe, may, estimate, continue, anticipate, intend, plan, expect and similar expressions are intended to identify forward-looking statements. Forward-looking statements include information concerning our possible or assumed future financial performance and results of operations.*

*We have based these statements on our assumptions and analyses in light of our experience and perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly affect expected results, and actual future results could differ materially from those described in such statements. While it is not possible to identify all factors, factors that could cause actual future results to differ materially include the risks and uncertainties described under Risk Factors contained in Part I of this Annual Report on Form 10-K.*

*Many of these factors are beyond our ability to control or predict. Any of these factors, or a combination of these factors, could materially and adversely affect our future financial condition or results of operations and the ultimate accuracy of the forward-looking statements. These forward-looking statements are not guarantees of our future performance, and our actual results and future developments may differ materially and adversely from those projected in the forward-looking statements. We caution against putting undue reliance on forward-looking statements or projecting any future results based on such statements or on present or prior earnings levels. In addition, each forward-looking statement speaks only as of the date of the particular statement, and we undertake no obligation to publicly update or revise any forward-looking statement.*

---

## **Table of Contents**

### **PART I**

#### **Item 1. Business**

##### **General**

KBR, Inc. and its subsidiaries (collectively, "KBR") is a global engineering, construction and services company supporting the energy, petrochemicals, government services, industrial and civil infrastructure sectors. We offer a wide range of services through our Hydrocarbons, Infrastructure, Government and Power ("IGP"), Services and Other segments. Information regarding segment disclosures are incorporated by reference in Note 5 to our consolidated financial statements and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

KBR, Inc. was incorporated in Delaware on March 21, 2006 prior to an exchange offer transaction that separated us from our prior parent, Halliburton Company, which was completed on April 5, 2007. We trace our history and culture to two businesses, The M.W. Kellogg Company (Kellogg) and Brown & Root, Inc. (Brown & Root). Kellogg dates back to a pipe fabrication business which was founded in New York in 1901 and has been creating technology for petroleum refining and petrochemicals processing since 1919. Brown & Root was founded in Houston, Texas in 1919 and built the world's first offshore platform in 1947. Brown & Root was acquired by Halliburton in 1962 and Kellogg was acquired by Halliburton in 1998 through its merger with Dresser Industries.

##### **Our Business Segments and Business Units**

We operate in four segments: Hydrocarbons; Infrastructure, Government & Power ("IGP"); Services; and Other as described below.

**Hydrocarbons.** Our Hydrocarbons business segment serves the Hydrocarbon industry by providing services ranging from prefeasibility studies to design, and construction to commissioning of process facilities in remote locations around the world. We are involved in hydrocarbon processing which includes constructing liquefied natural gas ("LNG") plants in several countries. Our global teams of engineers also execute and provide solutions for projects in the oil and gas, olefins, refining, petrochemical, biofuels and carbon capture markets. The Hydrocarbons business segment comprises the Gas Monetization, Oil & Gas, Downstream, and Technology business units.

**Gas Monetization business unit** Our Gas Monetization business unit designs and constructs facilities that enable our customers to monetize their natural gas resources. We create LNG and gas-to-liquids ("GTL") facilities that allow for the economical development and transportation of resources across the globe. Additionally, we make significant contributions in gas processing development, equipment design and innovative construction methods.

**Oil & Gas business unit** Our Oil & Gas business unit delivers onshore and offshore oil and natural gas production facilities which include platforms, floating production and subsea facilities, and pipelines. We also implement the infrastructure needed to make intricate projects feasible by managing projects ranging from deepwater through landfalls, to onshore environments, in remote desert regions, tropical rain forests, and major river crossings.

**Downstream business unit** Our Downstream business unit serves clients in the petrochemical, refining, chemicals, biofuels and syngas markets throughout the world. We leverage our differentiated process technologies, but also execute projects and complexes using non-KBR technologies. Our success is based on delivering value over the lifecycle of projects in the hydrocarbon market.

**Technology business unit** Our Technology business unit offers highly efficient, differentiated process technologies for the coal monetization, petrochemical, refining and syngas markets. In addition to offering technology licenses, we partner with our Downstream business unit on project management and EPC projects to provide fully integrated solutions worldwide.

**Infrastructure, Government & Power.** Our IGP business segment serves the Infrastructure, Government & Power industries delivering effective solutions to commercial, defense and governmental agencies worldwide, providing base operations, facilities management, border security, EPC services, and logistics support. We also deliver project management support and services for an array of complex initiatives and provide project management for the airfield design and construction program, runway expansion and widening, bridges, new cargo infrastructure and drainage improvements. For the industrial manufacturing market, we provide a full range of EPC services to a variety of heavy industrial and advanced manufacturing markets, frequently employing our clients' proprietary knowledge and technologies in strategically critical projects. For the power market, we use our full-scope EPC expertise to execute projects which play a distinctive role in increasing the world's power generation capacity from multiple fuel sources and in enhancing the efficiency and



---

**Table of Contents**

environmental compliance of existing power facilities. The IGP business segment includes the North American Government and Defense ( NAGD ), International Government and Defence ( IGD ), Infrastructure and Minerals ( I&M ), and the Power and Industrial ( P&I ) business units.

*North American Government and Defense business unit* Our NAGD business unit offers operations, maintenance, and logistics support in both contingency and sustainment environments as well as construction and design or build services to the United States Department of Defense ( DOD ) and other federal government agencies.

*International Government and Defence business unit* Our IGD business unit supports armed forces and government departments around the world by providing logistics and field support, operations and maintenance of camps and bases, program and project management, construction management, training, visualization software and engineering and support services. We provide services to government departments including the United Kingdom ( U.K. ), Europe, Middle East and Australia.

*Infrastructure & Minerals business unit* Our I&M business unit provides engineering, construction and project management services across the world on large and complex infrastructure projects. We have a focus on technical excellence, incorporating safety and sustainability factors into the planning, design and construction of our work. The I&M business unit provides global focus and leadership in four key markets – mining & minerals; transport (aviation, ports, rail and roads); water; and facilities (includes buildings and pipelines.)

*Power & Industrial business unit* Our P&I business unit provides full-scope engineering, procurement and construction ( EPC ) services for the industrial and power markets globally. Within the Industrial product line, we primarily serve clients in the forest products, manufacturing, technology, life sciences, consumer products, metals and materials sectors. Within the Power product line, we deliver fossil fuel and renewable power generation projects, plant re-powering projects and emissions control projects for customers that include regulated utilities, power cooperatives, municipalities, independent power producers and industrial cogeneration providers.

**Services.** Our Services segment delivers full-scope construction, construction management, fabrication, operations/maintenance, commissioning/startup and turnaround expertise worldwide to a broad variety of markets including oil and gas, petrochemicals and hydrocarbon processing, oil sands, mining, power, alternate energy, pulp and paper, industrial and manufacturing, and consumer product industries. Specifically, Services is organized around four major product lines; U.S. Construction, Industrial Services, Building Group and Canada Operations. Our U.S. Construction product line delivers direct hire construction and construction management for stand-alone construction projects to a variety of markets and works closely with the Hydrocarbons group and Power and Industrial business units to provide construction execution support on all domestic EPC projects. Our Industrial Services product line is a diversified maintenance organization operating on a global basis providing maintenance, on-call construction, turnaround and specialty services to a variety of markets. This group works with our other business units to identify potential for pull through opportunities and to identify upcoming EPC projects at the 80 plus locations where we have embedded KBR personnel. Our Building Group product line provides commercial general contractor-related services to education, food and beverage, health care, hospitality and entertainment, life science and technology, and mixed-use building clients. Our Canada Operations product line is a diversified construction and fabrication operation providing direct hire construction, construction management, module assembly, fabrication and maintenance services to our Canadian customers. This product line serves a number of markets including oil and gas customers operating in the oil sands, pulp and paper, mining, and industrial markets.

**Other.** Included in our Other segment is the Ventures business unit and other operations. The Ventures business unit invests KBR equity alongside clients' equity in projects where one or more of KBR's other business units has a direct role in technology supply, engineering, construction, construction management or operations and maintenance. Project equity investments under current management include defense equipment and housing, toll roads and petrochemicals.

In addition to the Ventures business unit, other business operations are reported in our Other segment including the Allstates staffing business acquired in the BE&K, Inc. ( BE&K ) acquisition in 2008, our engineering resource operations and other operations that do not individually meet the criteria for reportable segment presentation under Accounting Standards Codification ( ASC ) 280 – Segment Reporting.



## **Table of Contents**

### **Our Business Strategy**

Our business strategy is to create shareholder value by providing our customers differentiated capital project delivery and services offerings across the entire engineering, construction and operations project lifecycle. We execute our business strategy on a global scale delivering consistent, predictable results in all markets where we operate. Our core skills are conceptual design, FEED (front-end engineering design), engineering, project management, procurement, construction, construction management, logistics, commissioning, operations and maintenance. We will complement organic growth by pursuing targeted acquisitions that focus on expanding our capabilities, market coverage or accelerating business unit growth strategies. Key features of our business unit strategies include:

*The Hydrocarbons business segment* will build on our world-class strength and experience with gas monetization projects and seek to expand our footprint in both offshore and onshore oil and gas services. Our Downstream business unit will grow by utilizing our leading technology and execution excellence to provide high value process facilities to customers. Our Technology business unit will expand its portfolio of differentiated process technologies and associated service, proprietary equipment and catalyst offerings and deliver through an expanded global platform.

*The Infrastructure, Government & Power business segment* will broaden our commercial, government operations, logistics, construction and maintenance services both domestically and in foreign lands. We will apply our design, project management and construction skills to infrastructure, industrial and power markets utilizing the same global delivery platform already in place for Hydrocarbons.

*The Services segment* will capitalize on our brand reputation and core competencies to expand our construction and industrial services operations both domestically and internationally with focus on safe operations and high value predictable outcomes.

*The Ventures business unit* will invest alongside our clients in selected projects to both earn a return on our capital and secure capital projects for our business units to design and build.

### **Competition and Scope of Global Operations**

We operate in highly competitive markets throughout the world. The principal methods of competition with respect to sales of our capital project and service offerings include:

customer relationships;

successful execution of large projects in difficult locations;

technical excellence and differentiation;

high value in our delivered projects and services measured by performance, quality, operability and cost;

service delivery, including the ability to deliver personnel, processes, systems and technology on an as needed, where needed and when needed basis with the required local content and presence;

consistent superior service quality;

market leading health, safety, and environmental standards and sustainable practices;

financial strength through liquidity and capital capacity and the ability to support our warranties;

breadth of proprietary technology and technical sophistication;

robust risk awareness and management processes.

We conduct business in over 65 countries. Based on the location of services provided, our operations in countries other than the United States accounted for 79% of our consolidated revenue during 2010 and 2009, and 85% of our consolidated revenue during 2008. Revenue from our operations in Iraq, primarily related to our work for the U.S. government, was 29% of our consolidated revenue in 2010, 35% of our consolidated revenue in 2009 and 43% of our consolidated revenue in 2008. See Note 5 to our consolidated financial statements for selected geographic information.

We market substantially all of our capital project and service offerings through our business segments. We have many substantial competitors in the markets that we serve. The companies competing in the markets that we serve include but are

---

## **Table of Contents**

not limited to AMEC, Bechtel Corporation, CH2M Hill Companies Ltd., Chicago Bridge and Iron Co., N.V., Chiyoda, DynCorp, Fluor Corporation, Foster Wheeler Ltd., Jacobs Engineering Group, Inc., JGC Corp, John Wood Group PLC, McDermott International, Petrofac PLC, Saipem S.P.A., Shaw Group, Inc., Technip, URS Corporation, and Worley Parsons Ltd. Since the markets for our services are vast and covers broad geography, we cannot make a meaningful estimate of the total number of our competitors.

Our operations in some countries may be adversely affected by unsettled political conditions, acts of terrorism, civil unrest, force majeure, war or other armed conflict, expropriation or other governmental actions, inflation, exchange controls and currency fluctuations. We strive to mitigate these risks through a variety of tactics including insurance schemes, hedging, contract provisions, contingency planning and other risk management techniques. Please read Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Financial Instruments Market Risk, Risk Factors International and political events may adversely affect our operations, and Note 14 to our consolidated financial statements for information regarding our exposures to foreign currency fluctuations, risk concentration, and financial instruments used to manage our risks.

### **Recent Acquisitions and Other Transactions**

On December 31, 2010, we obtained control of the remaining 44.94% interest in our M.W. Kellogg Limited ( MWKL ) consolidated joint venture previously held by JGC Corporation. MWKL is located in the U.K. and provides EPC services primarily for LNG, GTL and onshore oil and gas projects. MWKL will continue to support our LNG and other Hydrocarbons projects.

On December 21, 2010, we completed the acquisition of 100% of the outstanding common shares of ENI Holdings, Inc. ( ENI ). ENI is the parent to the Roberts & Schaefer Company ( R&S ), a privately held, EPC services company for material handling systems. Headquartered in Chicago, Illinois, R&S provides services and associated processing infrastructure to customers in the mining and minerals, power, industrial, refining, aggregates, precious and base metals industries. ENI and its acquired businesses will be integrated into our IGP business segment.

In January 2010, we entered into a collaboration agreement with BP p.l.c. to market and license certain technology. In conjunction with this arrangement, we acquired a 25-year license granting us the exclusive right to the technology. The activity associated with this arrangement is integrated into our Hydrocarbons business segment.

On April 5, 2010, we acquired 100% of the outstanding common stock of Houston-based Energo Engineering ( Energo ) which provides Integrity Management (IM) and advanced structural engineering services to the offshore oil and gas industry. Energo's results of operations were integrated into our Hydrocarbons business segment.

In October 2008, we acquired 100% of the outstanding common stock of Wabi Development Corporation ( Wabi ). Wabi is a privately held Canada-based general contractor, which provides services for the energy, forestry and mining industries. Wabi provides maintenance, fabrication, construction and construction management services to a variety of clients in Canada and Mexico. Wabi was integrated into our Services business segment and it provides additional growth opportunities for our heavy hydrocarbon, forestry, oil sand, general industrial and maintenance services business.

In July 2008, we acquired 100% of the outstanding common shares of BE&K a privately held, Birmingham, Alabama-based engineering, construction and maintenance services company. The acquisition of BE&K enhances our ability to provide contractor and maintenance services in North America. BE&K and its acquired divisions were integrated into our IGP, Hydrocarbons and Services business segments based upon the nature of the underlying projects acquired.

In April 2008, we acquired 100% of the outstanding common stock of Turnaround Group of Texas, Inc. ( TGI ) and Catalyst Interactive. TGI is a Houston-based turnaround management and consulting company that specializes in the planning and execution of turnarounds and outages in the petrochemical, power, and pulp & paper industries. Catalyst Interactive is an Australian e-learning and training solution provider that specializes in the defense, government and industry training sectors. TGI's results of operations are included in our Services business segment. Catalyst Interactive's results of operations are included in our IGP business segment.

See Note 3 to our consolidated financial statements for further discussion of our recent acquisitions.

---

## **Table of Contents**

### **Joint Ventures and Alliances**

We enter into joint ventures and alliances with other industry participants in order to reduce and diversify risk, increase the number of opportunities that can be pursued, capitalize on the strengths of each party, expand or create the relationships of each party with different potential customers, and allow for greater flexibility in delivering our services based on cost and geographical efficiency. Several of our significant joint ventures and alliances are described below. All joint venture ownership percentages presented are as of December 31, 2010.

Kellogg Joint Venture ( KJV ) is a joint venture consisting of JGC, Hatch Associates, Clough and KBR for the purpose of design, procurement, fabrication, construction, commissioning and testing of the Gorgon Downstream LNG Project located on Barrow Island off the northwest coast of Western Australia. We hold a 30% interest in the joint venture which is consolidated for financial accounting purposes and it is reported in our Hydrocarbons business segment.

Aspire Defence Allenby & Connaught is a joint venture between us, Carillion Plc. and two financial investors formed to contract with the U.K. Ministry of Defence to upgrade and provide a range of services to the British Army's garrisons at Aldershot and around the Salisbury Plain in the United Kingdom. We own a 45% interest in Aspire Defence which is reported in our Ventures business unit that included in our Other segment. In addition, we own a 50% interest in each of the two joint ventures within our IGP segment that provide the construction and related support services to Aspire Defence. We account for our investments in these entities using the equity method of accounting.

MMM is a joint venture formed under a Partners Agreement with Grupo R affiliated entities. The principal Grupo R entity is Corporative Grupo R, S.A. de C.V. and Discoverer ASA, Ltd a Cayman Islands company. The partners agreement covers five joint venture entities executing Mexican contracts with PEMEX. The MMM joint venture was set up under Mexican maritime law in order to hold navigation permits to operate in Mexican waters. The scope of the business is to render services of maintenance, repair and restoration of offshore oil and gas platforms and provisions of quartering in the territorial waters of Mexico. We own a 50% interest in MMM and in each of the four other joint ventures. We account for our investment in these entities using the equity method of accounting and it is reported in our Services segment.

### **Backlog**

Backlog represents the dollar amount of revenue we expect to realize in the future as a result of performing work on contracts awarded and in progress. Our backlog was \$12 billion and \$14.1 billion at December 31, 2010 and 2009, respectively. We estimate that as of December 31, 2010, 55% of our backlog will be recognized as revenue within one year. All backlog is attributable to firm orders at December 31, 2010 and December 31, 2009. For additional information regarding backlog see our discussion within Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### **Contracts**

Our contracts are broadly categorized as either cost-reimbursable or fixed-price, although both categories contain a portion of hybrid contracts containing both cost-reimbursable and fixed-price scope.

Fixed-price contracts are for a fixed sum to cover all costs and any profit element for a defined scope of work. Fixed-price contracts entail more risk to us because they require us to predetermine both the quantities of work to be performed and the costs associated with executing the work. Although fixed-price contracts involve greater risk than cost-reimbursable contracts, they also are potentially more profitable since the owner/customer pays a premium to transfer more project risk to us.

Cost-reimbursable contracts include contracts where the price is variable based upon our actual costs incurred for time and materials, or for variable quantities of work priced at defined unit rates, including reimbursable labor hour contracts. Profit on cost-reimbursable contracts may be a fixed amount, a mark-up applied to costs incurred, or a combination of the two. Cost reimbursable contracts are generally less risky than fixed-price contracts because the owner/customer retains many of the project risks.

Our IGP business segment provides substantial work under cost-reimbursable contracts with the U.S. Department of Defense ( DoD ) and other governmental agencies which are generally subject to applicable statutes and regulations. If the Government finds that we improperly charged any costs to a contract under the terms of the contract or applicable Federal Procurement Regulations, these costs are potentially not reimbursable or, if already reimbursed, we may be required to refund the costs to the customer. Such conditions may also include financial penalties. If performance issues arise under any of our



---

## **Table of Contents**

government contracts, the government retains the right to pursue remedies, which could include termination under any affected contract. Furthermore, the government has the contractual right to terminate or reduce the amount of work under our contracts at any time. See *Risk Factors Our U.S. government contracts work is regularly reviewed and audited by our customer, U.S. government auditors and others, and these reviews can lead to withholding or delay of payments to us, non-receipt of award fees, legal actions, fines, penalties and liabilities and other remedies against us.*

### **Significant Customers**

We provide services to a diverse customer base, including international and national oil and gas companies, independent refiners, petrochemical producers, fertilizer producers and domestic and foreign governments. Revenue from the United States government, which was derived almost entirely from our IGP business segment, totaled \$3.3 billion, or 32% of consolidated revenue, in 2010, \$5.2 billion, or 43% of consolidated revenue, in 2009 and \$6.2 billion, or 53% of consolidated revenue in 2008. Revenue from the Chevron Corporation, which was derived almost entirely from our Hydrocarbons business segment, totaled \$1.8 billion or 18% of consolidated revenue in 2010, \$1.4 billion or 11% of consolidated revenue in 2009, and was \$1.1 billion or 9% of our consolidated revenues in 2008. No other customers represented 10% or more of consolidated revenues in any of the periods presented.

### **Raw Materials**

Equipment and materials essential to our business are available from worldwide sources. The principal equipment and materials we use in our business are subject to availability and pricing fluctuations due to customer demand, producer capacity and market conditions. We monitor the availability and pricing of equipment and materials on a regular basis. Our procurement department actively leverages our size and buying power to ensure that we have access to key equipment and materials at the best possible prices and delivery schedule. While we do not currently foresee any significant lack of availability of equipment and materials in the near term, the availability of these items may vary significantly from year to year and any prolonged unavailability or significant price increases for equipment and materials necessary to our projects and services could have a material adverse effect on our business. Please read, *Risk Factors The nature of our contracts, particularly our fixed-price contracts, subject us to risks associated with cost over-runs, operating cost inflation and potential claims for liquidated damages.* and *Risk Factors The current worldwide economic recession will likely affect a portion of our client base, subcontractors and suppliers and could materially affect our backlog and profits.*

### **Intellectual Property**

We have developed or otherwise have the right to license leading technologies, including technologies held under license from third parties, used for the production of a variety of petrochemicals and chemicals and in the areas of olefins, refining, fertilizers and semi-submersible technology. We also license a variety of technologies for the transformation of raw materials into commodity chemicals such as phenol and aniline used in the production of consumer end-products. We are also a licensor of ammonia process technologies used in the conversion of Syngas to ammonia. We believe our technology portfolio and experience in the commercial application of these technologies and related know-how differentiates us from other contractors, enhances our margins and encourages customers to utilize our broad range of engineering, procurement, construction and construction services ( EPC-CS ) services.

Our rights to make use of technologies licensed to us are governed by written agreements of varying durations, including some with fixed terms that are subject to renewal based on mutual agreement. Generally, each agreement may be further extended and we have historically been able to renew existing agreements before they expire. We expect these and other similar agreements to be extended so long as it is mutually advantageous to both parties at the time of renewal. For technologies we own, we protect our rights through patents and confidentiality agreements to protect our know-how and trade secrets. Our expenditures for research and development activities were immaterial in each of the past three fiscal years.

### **Seasonality**

On an overall basis, our operations are not generally affected by seasonality. Weather and natural phenomena can temporarily affect the performance of our services, but the widespread geographic scope of our operations mitigates those effects.

---

## **Table of Contents**

### **Employees**

As of December 31, 2010, we had approximately 35,000 employees in our continuing operations, of which approximately 10% were subject to collective bargaining agreements. Based upon the geographic diversification of our employees, we believe any risk of loss from employee strikes or other collective actions would not be material to the conduct of our operations taken as a whole. We believe that our employee relations are good.

### **Health and Safety**

We are subject to numerous health and safety laws and regulations. In the United States, these laws and regulations include: the Federal Occupation Safety and Health Act and comparable state legislation, the Mine Safety and Health Administration laws, and safety requirements of the Departments of State, Defense, Energy and Transportation. We are also subject to similar requirements in other countries in which we have extensive operations, including the United Kingdom where we are subject to the various regulations enacted by the Health and Safety Act of 1974.

These regulations are frequently changing, and it is impossible to predict the effect of such laws and regulations on us in the future. We actively seek to maintain a safe, healthy and environmentally friendly work place for all of our employees and those who work with us. However, we provide some of our services in high-risk locations and, as a result, we may incur substantial costs to maintain the safety of our personnel.

### **Environmental Regulation**

We are subject to numerous environmental, legal, and regulatory requirements related to our operations worldwide. In the United States, these laws and regulations include, among others: the Comprehensive Environmental Response, Compensation, and Liability Act; the Resources Conservation and Recovery Act; the Clean Air Act; the Federal Water Pollution Control Act; and the Toxic Substances Control Act. In addition to federal and state laws and regulations, other countries where we do business often have numerous environmental regulatory requirements by which we must abide in the normal course of our operations. These requirements apply to our business segments where we perform construction and industrial maintenance services or operate and maintain facilities.

We continue to monitor site conditions and until further information is available, we are only able to estimate a possible range of remediation costs. These locations were primarily utilized for manufacturing or fabrication work and are no longer in operation. The use of these facilities created various environmental issues including deposits of metals, volatile and semi-volatile compounds, and hydrocarbons impacting surface and subsurface soils and groundwater. The range of remediation costs could change depending on our ongoing site analysis and the timing and techniques used to implement remediation activities. We do not expect costs related to environmental matters will have a material adverse effect on our condensed consolidated financial position or results of operations. Based on the information presently available to us, we have accrued approximately \$7 million for the assessment and remediation costs associated with all environmental matters, which represents the low end of the range of possible costs that could be as much as \$14 million. See Note 10 to our consolidated financial statements for more information on environmental matters.

We have been named as a potentially responsible party ( PRP ) in various clean-up actions taken by federal and state agencies in the U.S. Based on the early stages of these actions, we are unable to determine whether we will ultimately be deemed responsible for any costs associated with these actions.

Existing or pending climate change legislation, regulations, international treaties or accords are not expected to have a material direct effect on our business or the markets that we serve, nor on our results of operations or financial position. However, climate change legislation could have a direct effect on our customers or suppliers which could have an indirect effect on our business. For example, our commodity-based markets depend on the level of activity of mineral and oil and gas companies, and existing or future laws, regulations, treaties or international agreements related to climate change, including incentives to conserve energy or use alternative energy sources, could have an indirect impact on our business if such laws, regulations, treaties, or international agreements reduce the worldwide demand for minerals, oil and natural gas. We will continue to monitor emerging developments in this area.

---

## **Table of Contents**

### **Website Access**

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act of 1934 are made available free of charge on our internet website at [www.kbr.com](http://www.kbr.com) as soon as reasonably practicable after we have electronically filed the material with, or furnished it to, the SEC. The public may read and copy any materials we have filed with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains our reports, proxy and information statements, and our other SEC filings. The address of that site is [www.sec.gov](http://www.sec.gov). We have posted on our website our Code of Business Conduct, which applies to all of our employees and Directors and serves as a code of ethics for our principal executive officer, principal financial officer, principal accounting officer, and other persons performing similar functions. Any amendments to our Code of Business Conduct or any waivers from provisions of our Code of Business Conduct granted to the specified officers above are disclosed on our website within four business days after the date of any amendment or waiver pertaining to these officers.

### **Item 1A. Risk Factors**

*Demand for our services depends on demand and capital spending by customers in their target markets, many of which are cyclical in nature.*

Demand for many of our services, especially in our commodity-based markets, depends on capital spending by oil and natural gas companies, including national and international oil companies, and by industrial, mining and power companies, which is directly affected by trends in oil, natural gas and commodities prices. Capital expenditures for refining and distribution facilities by large oil and gas companies have a significant impact on the activity levels of our businesses. Demand for LNG facilities for which we provide construction services could decrease in the event of a sustained reduction in crude oil or natural gas prices. Perceptions of longer-term lower oil and natural gas prices by oil and gas companies or longer-term higher material and contractor prices impacting facility costs can similarly reduce or defer major expenditures given the long-term nature of many large-scale projects. Prices for oil, natural gas and commodities are subject to large fluctuations in response to relatively minor changes in supply and demand, market uncertainty, and a variety of other factors that are beyond our control. Factors affecting the prices of oil, natural gas and other commodities include:

worldwide political, social unrest, military, and economic conditions;

the level of demand for oil, natural gas, industrial services and power generation;

governmental regulations or policies, including the policies of governments regarding the use of energy and the exploration for and production and development of their oil and natural gas reserves;

a reduction in energy demand as a result of energy taxation or a change in consumer spending patterns;

global economic growth or decline;

the level of oil production by non-OPEC countries and the available excess production capacity within OPEC;

global weather conditions and natural disasters;

oil refining capacity;



## Edgar Filing: KBR, INC. - Form 10-K

shifts in end-customer preferences toward fuel efficiency and the use of natural gas;

potential acceleration of the development and expanded use of alternative fuels;

environmental regulation, including limitations on fossil fuel consumption based on concerns about its relationship to climate change; and

reduction in demand for the commodity-based markets we serve.

Historically, the markets for oil and natural gas have been volatile and are likely to continue to be volatile in the future.

---

**Table of Contents**

Additionally, demand for our services may also be materially and adversely affected by the consolidation of our customers, which:

could cause customers to reduce their capital spending, which in turn reduces the demand for our services; and

could result in customer personnel changes, which in turn affects the timing of contract negotiations and settlements of claims and claim negotiations with engineering and construction customers on cost variances and change orders on major projects.

***The nature of our contracts, particularly those that are fixed-price, subject us to risks associated with cost over-runs, operating cost inflation and potential claims for liquidated damages.***

Our long-term contracts to provide services can be cost-reimbursable, fixed-price or hybrid. In connection with projects or portions of projects that are fixed-price, we bear a significant portion of the risk of cost over-runs, operating cost inflation, labor availability and productivity, and supplier and subcontractor pricing and performance. Our failure to accurately estimate the resources and time required for a fixed-price contract or our failure to complete our contractual obligations within the time frame and costs committed could have a material adverse effect on our business, results of operations and financial condition. Risks under our contracts include:

Our engineering, procurement and construction projects may encounter difficulties in the design or engineering phases related to the procurement of supplies, schedule changes, equipment performance failures, and other factors that may result in additional costs to us, reductions in revenue, claims or disputes.

We may not be able to obtain compensation for additional work or expenses, particularly on our fixed-price contracts, incurred as a result of customer change orders or our customers providing deficient design or engineering information, equipment or materials.

We may be required to pay liquidated damages upon our failure to meet schedule or performance requirements of our contracts.

Difficulties in engaging third party subcontractors, equipment manufacturers or materials suppliers or failures by third party subcontractors, equipment manufacturers or materials suppliers to perform could result in project delays and cause us to incur additional costs.

Our projects expose us to potential professional liability, product liability, warranty, performance and other claims that may exceed our available insurance coverage. Although we have historically been able to secure our insurance needs, there can be no assurances that we can secure all necessary or appropriate insurance in the future.

***The nature of our engineering and construction business exposes us to potential liability claims and contract disputes which may reduce our profits.***

We engage in engineering and construction activities for large facilities where design, construction or systems failures can result in substantial injury or damage to third parties. In addition, the nature of our business results in clients, subcontractors and vendors occasionally presenting claims against us for recovery of cost they incurred in excess of what they expected to incur, or for which they believe they are not contractually liable. We have been and may in the future be named as a defendant in legal proceedings where parties may make a claim for damages or other remedies with respect to our projects or other matters. These claims generally arise in the normal course of our business. When it is determined that we have liability, we may not be covered by insurance or, if covered, the dollar amount of these liabilities may exceed our policy limits. Our professional liability coverage is on a claims-made basis covering only claims actually made during the policy period currently in effect. In addition, even where insurance is maintained for such exposures, the policies have deductibles resulting in our assuming exposure for a layer of coverage with respect to any such claims. Any liability not covered by our insurance, in excess of our insurance limits or, if covered by insurance but subject to a high deductible, could result in a significant loss for us, which may reduce our profits and cash available for operations.

## Edgar Filing: KBR, INC. - Form 10-K

We occasionally bring claims against project owners for additional cost exceeding the contract price or for amounts not included in the original contract price. These types of claims occur due to matters such as owner-caused delays or changes from the initial project scope, which result in additional cost, both direct and indirect. Often, these claims can be the subject of lengthy arbitration or litigation proceedings, and it is often difficult to accurately predict when these claims will be fully resolved. When these types of events occur and unresolved claims are pending, we may invest significant working

---

## **Table of Contents**

capital in projects to cover cost overruns pending the resolution of the relevant claims. A failure to promptly recover on these types of claims could have a material adverse impact on our liquidity and financial results.

***Demand for our services provided under U.S. government contracts are directly affected by spending and capital expenditures by our customers and our ability to contract with our customers.***

We derive a significant portion of our revenue from contracts with agencies and departments of the U.S. government which is directly affected by changes in government spending and availability of adequate funding. For example, we are currently the sole service provider under our LogCAP III contract in the Middle East and elsewhere and have been awarded a portion of the LogCAP IV contract. However, the current level of government services being provided in the Middle East will not likely continue for an extended period of time and we expect our overall volume of work to decline as our customer scales back its requirements for the types and the amounts of service we provide. Factors that could impact current and future U.S. government spending include:

policy and/or spending changes implemented by the current administration, DoD or other government agencies;

changes, delays or cancellations of U.S. government programs or requirements;

adoption of new laws or regulations that affect companies providing services to the U.S. government;

curtailment of the U.S. governments outsourcing of services to private contractors;

The loss of or a significant decrease in the magnitude of work we perform for the U.S. government in the Middle East or other decreases in governmental spending and outsourcing of the type that we provide could have a material adverse effect on our business, results of operations and cash flow.

***The U.S. government awards its contracts through a rigorous competitive process and our efforts to obtain future contract awards from the U.S. government may be unsuccessful.***

The U.S. government conducts a rigorous competitive process for awarding most contracts. In the services arena, the U.S. government uses multiple contracting approaches. It uses omnibus contract vehicles, such as LogCAP, for work that is done on a contingency or as-needed basis. In more predictable sustainment environments, contracts may include both fixed-price and cost-reimbursable elements. The U.S. government has also recently favored multiple award task order contracts, in which several contractors are selected as eligible bidders for future work. Such processes require successful contractors to continually anticipate customer requirements and develop rapid-response bid and proposal teams as well as have supplier relationships and delivery systems in place to react to emerging needs. We will face rigorous competition and pricing pressures for any additional contract awards from the U.S. government, and we may be required to qualify or continue to qualify under the various multiple award task order contract criteria. The DoD has awarded us a portion of the LogCAP IV contract, which is a multiple award task order contract, and has also extended our performance under the LogCAP III contract to the end of 2011 under which we are the sole provider. We may not be awarded any further task orders under the LogCAP IV contract, which could have a material adverse effect on future results of operations. It may be more difficult for us to win future awards from the U.S. government and we may have other contractors sharing in any U.S. government awards that we win. In addition, negative publicity regarding findings stemming from DCAA audits and Congressional investigations may adversely affect our ability to obtain future awards. See *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Analysis - U.S. Government Matters.*

***Our U.S. government contract work is regularly reviewed and audited by our customer, U.S. government auditors and others, and these reviews can lead to withholding or delay of payments to us, non-receipt of award fees, legal actions, fines, penalties and liabilities and other remedies against us.***

U.S. government contracts are subject to specific regulations such as the Federal Acquisition Regulation ( FAR ), the Truth in Negotiations Act, the Cost Accounting Standards ( CAS ), the Service Contract Act and Department of Defense security regulations. Failure to comply with any of these regulations, requirements or statutes may result in contract termination. Our U.S. government contracts are subject to audits, cost reviews and investigations by U.S. government contracting oversight agencies such as the Defense Contract Audit Agency ( DCAA ). The DCAA reviews

## Edgar Filing: KBR, INC. - Form 10-K

the adequacy of, and our compliance with, our internal control systems and policies, including our labor, billing, accounting, purchasing, property, estimating, compensation and management information systems. The DCAA has the authority to conduct audits and reviews to determine if KBR is complying with the requirements under the FAR and CAS, pertaining to the allocation, period assignment, allowability, and allocation of costs assigned to US Government contracts. The DCAA presents its report

---

**Table of Contents**

findings to the Defense Contract Management Agency ( DCMA ). Should the DCMA determine that we have not complied with the terms of our contract and applicable statutes and regulations, payments to us may be disallowed which could result in adjustments to previously reported revenues and refunding of previously collected cash proceeds.

Given the demands of working in the Middle East and elsewhere for the U.S. government, we expect that from time to time we will have disagreements or experience performance issues with the various government customers for which we work. If performance issues arise under any of our government contracts, the government retains the right to pursue remedies, which could include threatened termination or termination under any affected contract. If any contract were so terminated, we may not receive award fees under the affected contract and our ability to secure future contracts could be adversely affected, although we would receive payment for amounts owed for our allowable costs under cost-reimbursable contracts. Other remedies that our government customers may seek for performance issues include sanctions such as forfeiture of profits, suspension of payments, fines and suspensions or debarment from doing business with the government. Further, the negative publicity that could arise from disagreements with our customers or sanctions as a result thereof could have an adverse effect on our reputation in the industry, reduce our ability to compete for new contracts, and may also have a material adverse effect on our business, financial condition, results of operations and cash flow.

***Our results of operations depend on the award of new contracts and the timing of the performance of these contracts.***

A substantial portion of our revenue is directly or indirectly derived from new contract awards. Delays in the timing of the awards or potential cancellations of such prospects as a result of economic conditions, material and equipment pricing and availability, or other factors could impact our long term projected results. It is particularly difficult to predict whether or when we will receive large-scale international and domestic projects as these contracts frequently involve a lengthy and complex bidding and selection process which is affected by a number of factors, such as market conditions, governmental approvals and environmental matters. Because a significant portion of our revenue is generated from such projects, our results of operations and cash flow can fluctuate significantly from quarter to quarter depending on the timing of our contract awards and the commencement or progress of work under awarded contracts. In addition, many of these contracts are subject to financing contingencies and, as a result, we are subject to the risk that the customer will not be able to secure the necessary financing for the project.

***We may be unable to obtain new contract awards if we are unable to provide our customers with bonds, letters of credit or other credit enhancements.***

Customers may require us to provide credit enhancements, including surety bonds, letters of credit or bank guarantees. We are often required to provide performance guarantees to customers to indemnify the customer should we fail to perform our obligations under the contract. Failure to provide a bond on terms required by a customer may result in an inability to bid on or win a contract award. Historically, we have had adequate bonding capacity but such bonding beyond the capacity of our Revolving Credit Agreement is generally at the provider's sole discretion. Due to events that affect the insurance and bonding markets generally, bonding may be difficult to obtain or may only be available at significant cost. Moreover, many projects are often very large and complex, which often necessitates the use of a joint venture, often with a competitor, to bid on and perform the contract. However, entering into joint ventures or partnerships exposes us to the credit and performance risk of third parties, many of whom are not as financially strong as us. If our joint ventures or partners fail to perform, we could suffer negative results. In addition, future projects may require us to obtain letters of credit that extend beyond the term of our current credit facility. Any inability to obtain adequate bonding and/or provide letters of credit or other customary credit enhancements and, as a result, to bid on or win new contracts could have a material adverse effect on our business prospects and future revenue.

***The uncertainty of the timing of future contract awards may inhibit our ability to recover our labor costs.***

The uncertainty of our contract award timing can also present difficulties in matching workforce size with contract needs. In some cases, we maintain and bear the cost of a ready workforce that is larger than called for under existing contracts in anticipation of future workforce needs for expected contract awards. If an expected contract award is delayed or not received, we may incur additional costs resulting from reductions in staff or redundancy of facilities, which could have a material adverse effect on us.

---

**Table of Contents**

***Our backlog is subject to unexpected adjustments and cancellations.***

As of December 31, 2010, our backlog was approximately \$12 billion. We cannot guarantee that the revenue projected in our backlog will be realized or profitable. Project terminations or suspensions and changes in project scope may occur, from time to time, with respect to contracts reflected in our backlog and could reduce the dollar amount of our backlog and the revenue and profits that we actually earn. Many of our contracts have termination for convenience provisions in them. In addition, projects may remain in our backlog for an extended period of time. Finally, poor project performance could also impact our backlog and profits if it results in termination of the contract. We cannot predict the impact the recent worldwide economic recession may have on our backlog which could include a diminished ability to replace backlog once projects are completed and/or could result in the termination, modification or suspension of projects currently in our backlog. Such developments could have a material adverse affect on our financial condition, results of operations and cash flows.

***We conduct a portion of our engineering and construction operations through large project-specific joint ventures. The failure of our joint venture partners to perform their joint venture obligations could impose on us additional financial and performance obligations that could result in reduced profits or, in some cases, significant losses.***

We conduct a portion of our engineering, procurement and construction operations through large project-specific joint ventures, where control may be shared with unaffiliated third parties. As with any joint venture arrangement, differences in views among the joint venture participants may result in delayed decisions or in failures to agree on major issues. We also cannot control the actions of our joint venture partners, including any nonperformance, default, or bankruptcy of our joint venture partners, and we typically have joint and several liability with our joint venture partners under these joint venture arrangements. If our partners do not meet their obligations, the joint venture may be unable to adequately perform and deliver its contracted services requiring us to make additional investments or provide additional services. These factors could have a material adverse affect the business operations of the joint venture and, in turn, our business operations as well as our reputation within our industry and our client base.

Operating through joint ventures in which we have a minority interest could result in us having limited control over many decisions made with respect to projects and internal controls relating to projects. These joint ventures may not be subject to the same requirements regarding internal controls and internal control reporting that we follow. As a result, internal control issues may arise, which could have a material adverse effect on our financial condition and results of operation. When entering into joint ventures, in order to establish or preserve relationships with our joint venture partners, we may agree to risks and contributions of resources that are proportionately greater than the returns we could receive, which could reduce our income and returns on these investments compared to what we would have received if the risks and resources we contributed were always proportionate to our returns.

***We make equity investments in privately financed projects in which we could sustain significant losses.***

We participate in privately financed projects that enable our government and other customers to finance large-scale projects, such as major military equipment, capital project and service purchases. These projects typically include the facilitation of non-recourse financing, the design and construction of facilities, and the provision of operation and maintenance services for an agreed to period after the facilities have been completed. We may incur contractually reimbursable costs and typically make an equity investment prior to an entity achieving operational status or completing its full project financing. If a project is unable to obtain financing, we could incur losses including our contractual receivables and our equity investment. After completion of these projects, our equity investments can be at risk, depending on the operation of the project and market factors, which may not be under our control. As a result, we could sustain a loss on our equity investment in these projects.

***Intense competition in the engineering and construction industry could reduce our market share and profits.***

We serve markets that are highly competitive and in which a large number of multinational companies compete. These highly competitive markets require substantial resources and capital investment in equipment, technology and skilled personnel. Our projects are frequently awarded through a competitive bidding process, which is standard in our industry. We are constantly competing for project awards based on pricing and the breadth and technological sophistication of our services. Any increase in competition or reduction in our competitive capabilities could have a significant adverse impact on the margins we generate from our projects or our ability to retain market share.

**Table of Contents**

***If we are unable to attract and retain a sufficient number of affordable trained engineers and other skilled workers, our ability to pursue projects may be adversely affected and our costs may increase.***

Our rate of growth and success of our business depends upon our ability to attract, develop and retain a sufficient number of affordable trained engineers and other skilled workers either through direct hire or acquisition of other firms employing such professionals. The market for these professionals is competitive. If we are unable to attract and retain a sufficient number of skilled personnel, our ability to acquire projects may be adversely affected and the costs of performing our existing and future projects may increase, which may adversely impact our margins.

***We ship a significant amount of cargo using seagoing vessels which expose us to certain maritime risks.***

We execute different projects around the world that include remote locations. Depending on the type of contract, location and the nature of the work, we may charter vessels under time and bareboat charter parties that assume certain risks typical of those agreements. Such risks may include damage to the ship and liability for cargo and liability which charterers and vessel operators have to third parties at law. In addition, we ship a significant amount of cargo and are subject to hazards of the shipping and transportation industry.

***If we are unable to enforce our intellectual property rights or if our intellectual property rights become obsolete, our competitive position could be adversely impacted.***

We utilize a variety of intellectual property rights in our services. We view our portfolio of process and design technologies as one of our competitive strengths and we use it as part of our efforts to differentiate our service offerings. We may not be able to successfully preserve these intellectual property rights in the future and these rights could be invalidated, circumvented, or challenged. In addition, the laws of some foreign countries in which our services may be sold do not protect intellectual property rights to the same extent as the laws of the United States. Because we license technologies from third parties, there is a risk that our relationships with licensors may terminate or expire or may be interrupted or harmed. In some, but not all cases, we may be able to obtain the necessary intellectual property rights from alternative sources. If we are unable to protect and maintain our intellectual property rights, or if there are any successful intellectual property challenges or infringement proceedings against us, our ability to differentiate our service offerings could be reduced. In addition, if our intellectual property rights or work processes become obsolete, we may not be able to differentiate our service offerings, and some of our competitors may be able to offer more attractive services to our customers. As a result, our business and revenue could be materially and adversely affected.

***Recent or future economic recessions may affect a portion of our client base, subcontractors and suppliers and could materially affect our backlog and profits.***

A recession could reduce the availability of liquidity and credit to fund or support the continuation and expansion of industrial business operations as occurred with the recent worldwide economic recession. A disruption of the credit markets could adversely affect our clients borrowing capacity, which support the continuation and expansion of projects worldwide, and could result in contract cancellations or suspensions, project delays, payment delays or defaults by our clients. In addition, clients may choose to make fewer capital expenditures, to otherwise slow their spending on our services or to seek contract terms more favorable to them. Our government clients may face budget deficits that prohibit them from funding proposed and existing projects or that cause them to exercise their right to terminate our contracts with little or no prior notice. Furthermore, any financial difficulties suffered by our subcontractors or suppliers could increase our cost or adversely impact project schedules. These disruptions could materially impact our backlog and profits.



---

**Table of Contents**

***We may not be able to raise additional capital or obtain additional financing in the future for working capital, capital expenditures and/or acquisitions.***

The financial market condition and recent worldwide economic recession weakened the capital and credit markets which could make it more difficult for us to raise additional capital or obtain additional financing. Our ability to obtain such additional capital or financing will depend in part upon prevailing market conditions, as well as conditions in our business and our operating results; and those factors may affect our efforts to arrange additional financings on terms that are satisfactory to us. We cannot be certain that additional funds will be available if needed to make future investments in certain projects, take advantage of acquisitions or other future opportunities, or respond to competitive pressures. If additional funds are not available, or are not available on terms satisfactory to us, there could be a material adverse impact on our business and operations.

***Our revolving credit facility imposes restrictions that limit our operating flexibility and may result in additional expenses, and this credit facility will not be available if financial covenants are not met or if an event of default occurs.***

Our Revolving Credit Facility provides up to \$1.1 billion of borrowing, including \$880 million in letters of credit fronting commitments at December 31, 2010, and expires in November 2012. The Revolving Credit Facility contains a number of covenants restricting, among other things, incurrence of additional indebtedness and liens, sales of our assets, the amount of investments we can make, and the amount of dividends we can declare to pay or equity shares that can be repurchased. We are also subject to certain financial covenants, including maintenance of ratios with respect to consolidated debt to consolidated EBITDA and a minimum consolidated net worth. If we fail to meet the covenants or an event of default occurs, we would not have available the liquidity that the facility provides.

A breach of any covenant or our inability to comply with the required financial ratios could result in a default under our Revolving Credit Facility, and we can provide no assurance that we will be able to obtain the necessary waivers or amendments from our lenders to remedy a default. In the event of any default not cured or waived, the lenders under our Revolving Credit Facility are not required to lend any additional amounts or issue letters of credit and could elect to require us to apply all of our available cash to collateralize any outstanding letters of credit, declare any outstanding borrowings, together with accrued interest and other fees, to be immediately due and payable or require us to apply all of our available cash to repay any borrowings then outstanding at the time of default. If we are unable to collateralize our letters of credit or repay borrowings with respect to our Revolving Credit Facility when due, our lenders could proceed against the guarantees of our major domestic subsidiaries. If any future indebtedness under our Revolving Credit Facility is accelerated, we can provide no assurance that our assets would be sufficient to repay such indebtedness in full.

***An impairment of all or part of our goodwill and/or our intangible assets could have a material adverse impact to our net earnings and net worth.***

As of December 31, 2010, we had \$947 million of goodwill and \$127 million of intangible assets recorded on our consolidated balance sheet. Goodwill represents the excess of cost over the fair market value of net assets acquired in business combinations. If our market capitalization drops significantly below the amount of net equity recorded on our balance sheet, it might indicate a decline in our fair value and would require us to further evaluate whether our goodwill has been impaired. We also perform an annual review of our goodwill and intangible assets to determine if it has become impaired which would require us to write down the impaired portion of these assets. An impairment of all or a significant part of our goodwill and/or intangible assets would have a material adverse impact to our net earnings and net worth.

***We are subject to certain U.S. laws and regulations, which are the subject of rigorous enforcement by the U.S. government.***

To the extent that we export products, technical data and services outside of the United States we are subject to laws and regulations governing trade and exports, including but not limited to, the International Traffic in Arms Regulations, the Export Administration Regulations and trade sanctions against embargoed countries, which are administered by the Office of Foreign Asset Control within the Department of the Treasury. A failure to comply with these laws and regulations could result in civil and/or criminal sanctions, including the imposition of fines upon us as well as the denial of export privileges and debarment from participation in U.S. government contracts. Additionally, we may be subject to qui tam litigation brought by private individuals on behalf of the U.S. government under the Federal False Claims Act, which could include claims for treble damages. U.S. government contract violations could result in the imposition of civil and criminal penalties or sanctions, contract termination, forfeiture of profit, and/or suspension of payment, any of which could make us lose our status as an eligible U.S. government contractor and cause us to suffer serious harm to our reputation. Any suspension or

---

**Table of Contents**

termination of our U.S. government contractor status could have a negative adverse impact to our business, financial condition or results of operations.

*We are subject to anti-bribery laws in the U.S. and other jurisdictions, violations of which could include suspension or debarment of our ability to contract with the United States, state or local governments, U.S. government agencies or the MoD, third party claims, loss of customers, adverse financial impact, damage to reputation and adverse consequences on financing for current or future projects.*

The FCPA in the U.S. and similar anti-bribery laws in other jurisdictions generally prohibit companies and their intermediaries from making improper payments to non-U.S. officials for the purpose of obtaining or retaining business. Our policies mandate compliance with these anti-bribery laws. We operate in many parts of the world that have experienced governmental corruption to some degree and, in certain circumstances, strict compliance with anti-bribery laws may conflict with local customs and practices. We train our staff concerning FCPA issues, and we also inform our partners, subcontractors, agents and other third parties who work for us or on our behalf that they must comply with the requirements of the FCPA and other anti-corruption laws. We also have procedures and controls in place to monitor internal and external compliance. We cannot assure you that our internal controls and procedures always will protect us from the reckless or criminal acts committed by our employees or third parties working on our behalf. If we are found to be liable for violations of these laws (either due to our own acts or our inadvertence, or due to the acts or inadvertence of others), we could suffer from criminal or civil penalties or other sanctions which could have a material adverse effect on our business.

*Our current business strategy includes acquisitions which present certain risks and uncertainties.*

We seek business acquisition activities as a means of broadening our offerings and capturing additional market opportunities by our business units. As a result, we may incur certain additional risks accompanying these activities. These risks include the following:

Valuation methodologies may not accurately capture the value proposition;

Future completed acquisitions may not be integrated within our operations with the efficiency and effectiveness initially expected resulting in a potentially significant detriment to the associated product service line financial results, and pose additional risks to our operations as a whole;

We may have difficulty managing the growth from acquisition activities;

Key personnel within an acquired organization may resign from their related positions resulting in a significant loss to our strategic and operational efficiency associated with the acquired company;

The effectiveness of our daily operations may be reduced by the redirection of employees and other resources to acquisition activities;

We may assume liabilities of an acquired business (e.g. litigation, tax liabilities, contingent liabilities, environmental issues), including liabilities that were unknown at the time the acquisition, that pose future risks to our working capital needs, cash flows and the profitability of related operations;

Business acquisitions may include substantial transactional costs to complete the acquisition that exceed the estimated financial and operational benefits;

## Edgar Filing: KBR, INC. - Form 10-K

Future acquisitions may require us to obtain additional equity or debt financing, which may not be available on attractive terms. Moreover, to the extent an acquisition transaction results in additional goodwill, it will reduce our tangible net worth, which might have an adverse effect on our credit capacity.

***If we need to sell or issue additional common shares to finance future acquisitions, our existing shareholder ownership could be diluted.***

Part of our business strategy is to expand into new markets and enhance our position in existing markets both domestically and internationally through the merging and acquiring of complementary businesses. To successfully fund and complete such identified, potential acquisitions, we may issue additional equity securities that have the potential to dilute our earnings per share and our existing shareholder ownership.

---

**Table of Contents**

*Provisions in our charter documents and Delaware law may inhibit a takeover or impact operational control which could adversely affect the value of our common stock.*

Our certificate of incorporation and bylaws, as well as Delaware corporate law, contain provisions that could delay or prevent a change of control or changes in our management that a stockholder might consider favorable. These provisions include, among others, a staggered board of directors, prohibiting stockholder action by written consent, advance notice for raising business or making nominations at meetings of stockholders and the issuance of preferred stock with rights that may be senior to those of our common stock without stockholder approval. Many of these provisions became effective following the exchange offer. These provisions would apply even if a takeover offer may be considered beneficial by some of our stockholders. If a change of control or change in management is delayed or prevented, the market price of our common stock could decline.

*International and political events may adversely affect our operations.*

A significant portion of our revenue is derived from our foreign operations, which exposes us to risks inherent in doing business in each of the countries in which we transact business. The occurrence of any of the risks described below could have a material adverse effect on our results of operations and financial condition. With respect to any particular country, these risks may include:

expropriation and nationalization of our assets in that country;

political and economic instability;

civil unrest, acts of terrorism, force majeure, war, or other armed conflict;

currency fluctuations, devaluations, and conversion restrictions;

confiscatory taxation or other adverse tax policies;

governmental activities that limit or disrupt markets, restrict payments, or limit the movement of funds;

governmental activities that may result in the deprivation of contract rights; and

governmental activities that may result in the inability to obtain or retain licenses required for operation.

Due to the unsettled political conditions in many oil-producing countries and countries in which we provide governmental logistical support, our revenue and profits are subject to the adverse consequences of war, the effects of terrorism, civil unrest, strikes, currency controls, and governmental actions. Countries where we operate that have significant amounts of political risk include: Afghanistan, Algeria, Indonesia, Iraq, Nigeria, Russia, China, Egypt, Yemen and Saudi Arabia. In addition, military action or continued unrest in the Middle East could impact the supply and pricing for oil and gas, disrupt our operations in the region and elsewhere, and increase our costs for security worldwide.

*We may have additional tax liabilities associated with our international operations.*

We are subject to income taxes in the United States and numerous foreign jurisdictions, many of which are developing countries. Significant judgment is required in determining our worldwide provision for income taxes due to lack of clear and concise tax laws and regulations in certain developing jurisdictions. It is not unlikely that laws may be changed or clarified and such changes may adversely affect our tax provisions. Also, in the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination may be uncertain. We are regularly under audit by various tax authorities. Although we believe that our tax estimates are reasonable, the final

outcome of tax audits and related litigation could be materially different from that which is reflected in our financial statements.

***We work in international locations where there are high security risks, which could result in harm to our employees and contractors or substantial costs.***

Some of our services are performed in high-risk locations, such as Iraq, Afghanistan, Nigeria, Algeria, Egypt and Saudi Arabia where the country or location is suffering from political, social or economic issues, or war or civil unrest. In those locations where we have employees or operations, we may incur substantial costs to maintain the safety of our personnel. Despite these precautions, the safety of our personnel in these locations may continue to be at risk, and we have in the past and may in the future suffer the loss of employees and contractors.

---

**Table of Contents**

*We are subject to significant foreign exchange and currency risks that could adversely affect our operations and our ability to reinvest earnings from operations, and our ability to limit our foreign exchange risk through hedging transactions may be limited.*

We generally attempt to denominate our contracts in U.S. Dollars or in the currencies of our costs. A sizable portion of our consolidated revenue and consolidated operating expenses are in foreign currencies. As a result, we are subject to significant risks, including:

foreign exchange risks resulting from changes in foreign exchange rates and the implementation of exchange controls; and

limitations on our ability to reinvest earnings from operations in one country to fund the capital needs of our operations in other countries.

In particular, we may conduct business in countries that have non-traded or soft currencies which, because of their restricted or limited trading markets, may be difficult to exchange for hard currencies. The national governments in some of these countries are often not able to establish the exchange rates for the local currency. As a result, it may not be possible for us to engage in hedging transactions to mitigate the risks associated with fluctuations of the particular currency. We are often required to pay all or a portion of our costs associated with a project in the local soft currency. As a result, we generally attempt to negotiate contract terms with our customer, who is often affiliated with the local government, to provide that we are paid in the local currency in amounts that match our local expenses. If we are unable to match our costs with matching revenue in the local currency, we would be exposed to the risk of an adverse change in currency exchange rates.

Where possible, we selectively use hedging transactions to limit our exposure to risks from doing business in foreign currencies. Our ability to hedge may be limited because pricing of hedging instruments, where they exist, is often volatile and not necessarily efficient.

In addition, the value of the derivative instruments could be impacted by:

adverse movements in foreign exchange rates;

interest rates;

commodity prices; or

the value and time period of the derivative being different than the exposures or cash flow being hedged.

***Halliburton's indemnity for matters relating to the Barracuda-Caratinga project only applies to the replacement of certain subsea bolts, and Halliburton's actions may not be in our stockholders' best interests.***

Under the terms of our master separation agreement with our former parent Halliburton, Halliburton agreed to indemnify us for out-of-pocket cash costs and expenses, or cash settlements or cash arbitration awards in lieu thereof, we incur as a result of the replacement of certain subsea flow-line bolts installed in connection with the Barracuda-Caratinga project, which we refer to as B-C Matters. At our cost, we will control the defense, counterclaim and/or settlement with respect to B-C Matters, but Halliburton will have discretion to determine whether to agree to any settlement or other resolution of B-C Matters. We expect Halliburton will take actions that are in the best interests of its stockholders, which may or may not be in our or our stockholders' best interests. Halliburton has the right to assume control over the defense, counterclaim and/or settlement of B-C Matters at any time. If Halliburton assumes control over the defense, counterclaim and/or settlement of B-C Matters, or refuses a settlement proposed by us, it could result in material and adverse consequences to us or our business that would not be subject to Halliburton's indemnification. In addition, if Halliburton assumes control over the defense, counterclaim and/or settlement of B-C Matters, and we refuse a settlement proposed by Halliburton, Halliburton may terminate the indemnity. Also, if we materially breach our obligation to cooperate with Halliburton or we enter into a settlement of B-C Matters without Halliburton's consent, Halliburton may terminate the indemnity. Please read Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Transactions with Former Parent,



**Table of Contents****Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

We own or lease properties in domestic and foreign locations. The following locations represent our major facilities.

<b>Location</b>	<b>Owned/Leased</b>	<b>Description</b>	<b>Business Segment</b>
Houston, Texas	Leased(1)	Office facilities	All and Corporate
Arlington, Virginia	Leased	Office facilities	IGP
Houston, Texas	Owned	Campus facility	All and Corporate
Birmingham, Alabama	Owned	Campus facility	All and Corporate
Leatherhead, United Kingdom	Owned	Campus facility	All
Greenford, Middlesex	Owned	Office facilities	Hydrocarbons
United Kingdom			

(1) At December 31, 2010, we had a 50% interest in a joint venture which owns a high-rise office building in which we lease office space. We also lease office space in other buildings owned by unrelated parties.

We also own or lease numerous small facilities that include our technology center, sales offices and project offices throughout the world. We own or lease marine fabrication facilities, which are currently for sale, covering approximately 300 acres in Scotland. All of our owned properties are unencumbered and we believe all properties that we currently occupy are suitable for their intended use.

**Item 3. Legal Proceedings**

Information relating to various commitments and contingencies is described in **Risk Factors** contained in Part I of this Annual Report on Form 10-K and **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations** and in Notes 9 and 10 to our consolidated financial statements and the information discussed therein is incorporated by reference into this Item 3.

**Item 4. (Removed and reserved)**



**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is traded on the New York Stock Exchange under the symbol KBR. The following table sets forth, on a per share basis for the periods indicated, the high and low sale prices per share for our common stock as reported by the New York Stock Exchange and dividends declared:

	Common Stock Price Range		Dividends Declared Per Share
	High	Low	
<b>Fiscal Year 2010</b>			
First quarter ended March 31, 2010	\$ 23.00	\$ 17.30	\$
Second quarter ended June 30, 2010	24.40	19.31	0.05
Third quarter ended September 30, 2010	24.89	19.53	0.05
Fourth quarter ended December 31, 2010	31.42	24.53	0.05
<b>Fiscal Year 2009</b>			
First quarter ended March 31, 2009	\$ 17.67	\$ 11.41	\$
Second quarter ended June 30, 2009	19.74	13.31	0.05
Third quarter ended September 30, 2009	24.73	16.29	0.05
Fourth quarter ended December 31, 2009	24.68	17.28	0.10

At February 11, 2011, there were 139 shareholders of record. In calculating the number of shareholders, we consider clearing agencies and security position listings as one shareholder for each agency or listing.

On June 8, 2010, we initiated a Board of Directors authorized share repurchase program to repurchase up to 10 million of our outstanding common shares in the open market or privately negotiated transactions to reduce and we may maintain, over time, our outstanding shares at approximately 150 million shares. We entered into an agreement with an agent to conduct a designated portion of the repurchase program in accordance with Rules 10b-18 and 10b5-1 under the Securities Exchange Act of 1934. In October 2010, we repurchased approximately 0.6 million of our outstanding common shares which completed our repurchase of 10 million shares under the share repurchase program initiated on June 8, 2010. The following is a summary of share repurchases of our common stock during the three months ended December 31, 2010.

Purchase Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(a)</sup>
			as Part of Publicly Announced Plans or Programs	
October 1 - 22, 2010				
Repurchase Program <sup>(a)</sup>	577,269	\$ 24.75	577,269	
Employee Transactions <sup>(b)</sup>	10,813	\$ 25.15		
November 1 - 23, 2010				
Repurchase Program		\$		
Employee Transactions <sup>(b)</sup>	31,282	\$ 27.51		
December 9 - 27, 2010				
Repurchase Program		\$		
Employee Transactions <sup>(b)</sup>	275	\$ 29.83		
Total				
Repurchase Program <sup>(a)</sup>	577,269	\$ 24.75	577,269	
Employee Transactions <sup>(b)</sup>	42,370	\$ 26.92		

## Edgar Filing: KBR, INC. - Form 10-K

- (a) We may continue to repurchase shares of our outstanding common shares as necessary to maintain, over time, our outstanding shares at approximately 150 million shares.
- (b) Reflects shares acquired from employees in connection with the settlement of income tax and related benefit withholding obligations arising from vesting in restricted stock units.

**Table of Contents**

Our Revolving Credit Facility restricts, among other things, the total dollar amount we may pay for dividends and equity repurchases of our common stock to a maximum of \$400 million in the aggregate during the term of the facility. At December 31, 2010, we have the capacity to pay additional dividends or repurchase shares in the amount of \$137 million after the declaration of dividends and shares repurchased. See Note 8 to our consolidated financial statements. The declaration and payment of any future dividends will be at the discretion of our Board of Directors and will depend upon, among other things, future earnings, general financial condition and liquidity, success in business activities, capital requirements, and general business conditions.

**Performance Graph**

The chart below compares the cumulative total shareholder return on our common shares from November 16, 2006 (the date of our initial public offering) to the end of the year with the cumulative total return on the Dow Jones Heavy Construction Industry Index and the Russell 1000 Index for the same period. The comparison assumes the investment of \$100 on November 16, 2006, and reinvestment of all dividends. The shareholder return is not necessarily indicative of future performance.

**Table of Contents****Item 6. Selected Financial Data**

The following table presents selected financial data for the last five years. You should read the following information in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and the related notes to the consolidated financial statements.

	Years Ended December 31,				
	2010	2009	2008	2007	2006
<b>(In millions, except for per share amounts)</b>					
<b>Statements of Operations Data:</b>					
Total revenue	\$ 10,099	\$ 12,105	\$ 11,581	\$ 8,745	\$ 8,805
Operating income	609	536	541	294	152
Income from continuing operations, net of tax	395	364	356	204	34
Income from discontinued operations, net of tax			11	132	114
Net income (loss) attributable to noncontrolling interests	68	74	48	34	(20)
Net income attributable to KBR	327	290	319	302	168
Basic net income attributable to KBR per share:					
Continuing operations	\$ 2.08	\$ 1.80	\$ 1.84	\$ 1.08	\$ 0.39
Discontinued operations (a)			0.07	0.71	0.81
Basic net income attributable to KBR per share	\$ 2.08	\$ 1.80	\$ 1.91	\$ 1.79	\$ 1.20
Diluted net income attributable to KBR per share:					
Continuing operations	\$ 2.07	\$ 1.79	\$ 1.84	\$ 1.08	\$ 0.39
Discontinued operations (a)			0.07	0.71	0.81
Diluted net income attributable to KBR per share	\$ 2.07	\$ 1.79	\$ 1.90	\$ 1.78	\$ 1.20
Basic weighted average shares outstanding	156	160	166	168	140
Diluted weighted average shares outstanding	157	161	167	169	140
Cash dividends declared per share	\$ 0.15	\$ 0.20	\$ 0.25	\$	\$
<b>Balance Sheet Data (as of the end of period):</b>					
Cash and equivalents	\$ 786	\$ 941	\$ 1,145	\$ 1,861	\$ 1,410
Net working capital	915	1,350	1,099	1,433	915
Total assets	5,417	5,327	5,884	5,203	5,414
Non-recourse long-term debt	101				
Total shareholders' equity	\$ 2,204	\$ 2,296	\$ 2,034	\$ 2,235	\$ 1,829
<b>Other Financial Data:</b>					
Backlog at year end	\$ 12,041	\$ 14,098	\$ 14,097	\$ 13,051	\$ 12,437
Gross operating margin percentage	6.0%	4.4%	4.7%	3.4%	1.7%
Capital expenditures (b)	\$ 66	\$ 41	\$ 37	\$ 36	\$ 47
Depreciation and amortization expense (c)	\$ 62	\$ 55	\$ 49	\$ 31	\$ 29

(a) We completed the sale of the Production Services group in May 2006 and the disposition of our 51% interest in Devonport Management Limited ( DML ) in June 2007. The results of operations of Production Services group and DML for all periods presented have been reported as discontinued operations.

## Edgar Filing: KBR, INC. - Form 10-K

- (b) Capital expenditures do not include expenditures related to the noncash investing activities for the purchase of computer software of \$19 million in 2010 and the discontinued operations for DML of \$7 million and \$10 million for the years ended December 31, 2007 and 2006, respectively.
- (c) Depreciation and amortization expense does not include expenses related to the discontinued operations for DML of \$10 million and \$18 million for the years ended December 31, 2007 and 2006, respectively.

---

## **Table of Contents**

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **Introduction**

Management's discussion and analysis ( MD&A ) should be read in conjunction with the consolidated financial statements and related notes included in Item 8 of this Annual Report.

#### **Executive Overview**

##### *Business Environment*

*Hydrocarbons Markets.* We provide a full range of engineering, procurement and construction services for large and complex upstream and downstream projects, including LNG and GTL facilities, onshore and offshore oil and gas production facilities, industrial and other projects. We serve customers in the gas monetization, oil and gas, petrochemical, refining and chemical markets throughout the world. Our projects are generally long term in nature and are impacted by factors including market conditions, financing arrangements, governmental approvals and environmental matters. Demand for our services depends primarily on our customers' capital expenditures in our construction market sectors.

We have benefited in recent years from increased capital expenditures from our petroleum and petrochemical customers driven by historically high crude oil and natural gas prices and general global economic expansion that occurred prior to mid-2008. We have indications that the hydrocarbons market in most international regions has partially recovered from the worldwide economic recession and financial market condition. We continue to see long term growth in environmentally and economically driven energy projects and for related licensed process technologies for offshore gas production, LNG, biofuels, motor fuels, chemicals and fertilizers. Feasibility studies and front-end engineering and design projects remain steady reflecting clients' intentions to invest in capital intensive energy projects, albeit releasing and proceeding with projects in phases and conducting increased levels of economic analysis. For construction and maintenance in the United States, we see an improving market with a return of more material projects driven by low natural gas prices, improved refining utilization and increasing energy demands.

*Infrastructure, Government and Power Markets ( IGP ).* A significant portion of our IGP business segment's current activities supports the United States' and the United Kingdom's government operations in Iraq, Afghanistan and in other parts of the Middle East region. These operations have resulted in one of the largest military deployments since World War II, which has caused a parallel increase in government spending. The logistics support services that KBR provides the U.S. military are delivered under our LogCAP III, LogCAP IV and other contracts which are competitively bid contracts. Revenues under the LogCAP III project were approximately \$2.8 billion, \$4.8 billion, and \$5.5 billion for the years ended December 31, 2010, 2009, and 2008, respectively. KBR is the only company providing services under the LogCAP III contract. Currently, the U.S. government is transitioning work from LogCAP III to LogCAP IV, which is a multiple award contract with three contractors, including KBR, who can each bid and potentially win specific task orders. As troop deployments shift within the Middle East region, and as additional work is awarded under LogCAP IV, we have seen a decline in work under LogCAP III and we expect this decline will continue. We expect the U.K. military will remain engaged in the region, although their presence has shifted from Iraq to Afghanistan.

We operate in diverse civil infrastructure markets, including transportation, water and waste treatment and facilities maintenance. In addition to U.S. state, local and federal agencies, we provide these services to governments around the world including the U.K., Australia and the Middle East. In Australia, we also provide related services to the global mining industry. There has been a general trend of historic under-investment in infrastructure, particularly related to the quality of water, wastewater, roads and transit, airports, and educational facilities which has historically declined while demand for expanded and improved infrastructure has historically outpaced funding. We have seen increased activity related to these types of projects, however, the global economic recession has caused markets to remain flat in America and the U.K., which has resulted in delays or slow start-ups to major projects. Stimulus spending and a general economic recovery should result in increased opportunities in the future across all sectors.

In the industrial sector, we operate in a number of markets, including forest products, advanced manufacturing, minerals and metals and consumer products, primarily with a domestic focus but with our international opportunities increasing. Forest products, advanced manufacturing and consumer products are experiencing modest market improvements while the minerals and metals markets are driven by global demand for commodities. In the power sector, we serve regulated utilities, power cooperatives, municipalities and various non-regulated providers, primarily in the U.S. and U.K. markets. The power sector continues to be driven by long-term economic and demographic trends and changes in environmental regulations. Projects in the power sector are currently concentrated in emissions control, repowering, renewable power and new gas-fired power generation.



---

## **Table of Contents**

We provide a wide range of construction and maintenance services to a variety of industries in the U.S. and Canada, including forest products, power, commercial and institutional buildings, general industrial and manufacturing. We continued to see an increase in bid requests and feasibility estimates from our clients and expect a number of our markets to strengthen in 2011.

### *Summary of Consolidated Results*

#### *2010 compared to 2009*

Consolidated revenue in 2010 decreased approximately \$2 billion, or 17%, to \$10.1 billion compared to \$12.1 billion in 2009 primarily driven by decreases in our IGP and Services segments. The decrease in IGP business segment revenue includes a \$1.9 billion decline in our NAGD business unit resulting from an overall reduction in volume for U.S. military support activities primarily in Iraq under our LogCAP III contract. In 2010, the total number of staff working on the LogCAP III project decreased by approximately 56% including direct hires, subcontractors and local hires. Additionally, the U.S. Army has transitioned work in Kuwait and Afghanistan from the LogCAP III contract to the LogCAP IV contract. Although we have been awarded task orders under the LogCAP IV contract primarily in Iraq, we expect our overall volume of work to continue to decrease in the region. Also contributing to the decline in IGP revenue in 2010 were revenue decreases in the I&M and P&I business units largely as a result of the completion of fieldwork on certain projects in early 2010 and declining workload from other projects nearing completion. Partially offsetting these declines in revenue was an increase in revenue in our IGD business unit primarily related to the ongoing presence of troops in Afghanistan where we provide contingency logistics, operations and maintenance and other services to the U.K. MoD and NATO. The Services segment also experienced a decline in revenue for 2010 primarily due to the completion several projects or projects being near completion. Revenue in our Hydrocarbons business segment increased slightly overall primarily driven by the Gas Monetization business unit and our Downstream business unit.

Consolidated operating income in 2010 increased approximately \$73 million, or 14%, to \$609 million compared to \$536 million in 2009. Job income for 2010 from the IGP business segment was up approximately \$84 million primarily from our NAGD business unit which increased by \$117 million. In 2009, we recognized a net charge of \$65 million related to the write-off of award fees previously accrued on the LogCAP III contract that did not recur in 2010. In 2010, we recognized job income related to LogCAP III award fees of \$94 million for periods of performance from May 2008 through May 2010 which were awarded to us in the second and third quarters of 2010. Partially offsetting the increase related to award fees was lower volume of activity on the LogCAP III contract as a result of the overall reduction in volume of U.S. military support activities primarily in Iraq and higher charges for potentially unallowable costs. Our Hydrocarbons job income decreased by approximately \$64 million largely due to the EPC 1 favorable arbitration award recognized in 2009 that did not recur in 2010 partially offset by increases in job income in our Gas Monetization and Downstream business units.

#### *2009 compared to 2008*

Consolidated revenue in 2009 increased approximately \$524 million, or 5%, to \$12.1 billion compared to \$11.6 billion in 2008. The primary drivers of this increase were from our Hydrocarbons and Services segments. In the Hydrocarbons business segment, the Gas Monetization business unit revenue grew \$599 million in 2009, or 28%, largely as a result of several cost reimbursable LNG and GTL projects. Although the worldwide economic recession and disrupted financial market conditions in 2009 continued to impact our customers in the hydrocarbons market, most of our ongoing LNG and GTL projects were under development and awarded prior to mid-2008 and continued to have a positive impact on Gas Monetization revenue growth and backlog. Our Services segment revenue increased \$675 million in 2009, or 57%, primarily as a result of our July 1, 2008 acquisition of BE&K, an Alabama-based engineering, construction and maintenance services company that has greatly increased our presence in the North American engineering and construction markets. Revenue from our IGP business segment was down approximately \$835 million, or 12%, primarily due to decreases in the NAGD and IGD business units which were down a combined \$971 million in 2009, or 15%, compared to 2008. The majority of this decrease is due to our NAGD business unit where U.S. military troop level reductions in Iraq resulted in a significant impact to our staffing levels on the LogCAP III contract. In 2009, the total number of staff working on the LogCAP III project decreased by approximately 17% including direct hires, subcontractors and local hires. Also contributing to the decline in the IGP revenue in 2009 was the IGD business unit due to reduced levels of activities for the U.K. military in Iraq and Afghanistan as well as a number of engineering projects completed during the year.

Consolidated operating income in 2009 decreased approximately \$5 million, or 1%, to \$536 million compared to \$541 million in 2008. Job income for 2009 from our IGP business segment was down approximately \$168 million in 2009 mainly as a result of the \$130 million reduction in our award fee income as compared to the prior year and lower volume of activity on our LogCAP III contract. IGP business segment overheads increased \$32 million, or 27%, primarily due to lower recoverability of certain costs as a result of decreased activity as well as higher bid and proposal expenses. Additionally, the





---

## **Table of Contents**

Services segment overheads increased \$32 million, or 82%, due to the additional overhead resulting from the BE&K acquisition on July 1, 2008. Income in 2009 from our Hydrocarbons business segment increased by approximately \$133 million, or 94%, primarily due to the favorable arbitration award on the EPC 1 project performed for PEMEX in our Oil and Gas business unit which resulted in \$183 million of job income for 2009 and was partially offset by decreases in profit on other projects.

For a more detailed discussion of the results of operations for each of our business units, corporate general and administrative expense, income taxes and other items, see Results of Operations below.

### *Acquisition of Roberts & Schaefer Company*

On December 21, 2010, we completed the acquisition of 100% of the outstanding common shares of ENI Holdings, Inc. ( ENI ). ENI is the parent to the Roberts & Schaefer Company ( R&S ), a privately held, EPC services company for material handling and processing systems. Headquartered in Chicago, Illinois, R&S provides services and associated material handling infrastructure to customers in the mining and minerals, power, industrial, refining, aggregates, precious and base metals industries. The purchase price was \$280 million plus preliminary working capital of \$17 million which included cash acquired of \$8 million. The total net cash paid at closing of \$289 million is subject to an escrowed holdback amount of \$43 million to secure post closing working capital adjustments, indemnifications obligations of the sellers and other contingent obligations related to the operations of the business. R&S and its acquired divisions will be integrated into our IGP business segment. See Note 3 to our consolidated financial statements for further discussion of the R&S acquisition.

### *Acquisition of remaining interest in M.W. Kellogg Limited.*

On December 31, 2010, we obtained control of the remaining 44.94% interest of our MWKL subsidiary located in the U.K for approximately \$165 million subject to certain post-closing adjustments to be determined during the first quarter of 2011. Under the terms of the purchase agreement, the \$165 million (£107 million) initial purchase price was paid on January 5, 2011 and recorded as Obligation to former noncontrolling shareholder in our consolidated balance sheet. In addition, we agreed to pay the former noncontrolling shareholder 44.94% of future proceeds collected on certain receivables owed to MWKL for which we recognized an additional \$15 million net liability recorded as Obligation to former noncontrolling shareholder . The acquisition was recorded as an equity transaction that reduced noncontrolling interests, accumulated other comprehensive income ( AOCI ) and additional paid-in capital by \$180 million.

### *Acquisition of Energo Engineering*

On April 5, 2010, we acquired 100% of the outstanding common stock of Houston-based Energo Engineering ( Energo ) for approximately \$16 million in cash, subject to an escrowed holdback amount of \$6 million to secure working capital adjustments, indemnification obligations of the sellers, and other contingent obligations related to the operation of the business. As a result of the acquisition, we recognized goodwill of \$6 million and other intangible assets of \$3 million. Energo provides Integrity Management (IM) and advanced structural engineering services to the offshore oil and gas industry. Energo s results of operations were integrated into our Hydrocarbons segment.

### *Technology License Agreement*

In January 2010, we entered into a collaboration agreement with BP p.l.c. to market and license certain technology. In conjunction with this arrangement, we acquired a 25-year license granting us the exclusive right to the technology. As partial consideration for the license, we paid an initial fee of \$20 million.

### *Acquisition of Wabi Development Corporation*

In October 2008, we acquired 100% of the outstanding common stock of Wabi Development Corporation ( Wabi ) for approximately \$20 million in cash. As a result of the acquisition, we recognized goodwill of \$5 million and other intangible assets of \$5 million. Wabi is a privately held Canada-based general contractor, which provides services for the energy, forestry and mining industries. Wabi provides maintenance, fabrication, construction and construction management services to a variety of clients in Canada and Mexico. The integration of Wabi into our Services segment provides additional growth opportunities for our heavy hydrocarbon, forest products, oil sand, general industrial and maintenance services business.

---

## **Table of Contents**

### *Acquisition of BE&K, Inc.*

On July 1, 2008, we acquired 100% of the outstanding common shares of BE&K, Inc., ( BE&K ) a privately held, Birmingham, Alabama-based engineering, construction and maintenance services company serving both domestic and international customers. BE&K's international operations are located in Poland and Russia. The acquisition of BE&K enhances our ability to provide engineering, construction and maintenance services to a broader variety of industries in North America. We paid approximately \$559 million in cash including certain stockholders equity adjustments as defined in the stock purchase agreement and direct transaction costs. BE&K and its acquired divisions have been integrated into our Hydrocarbons, IGP and Services segments based upon the nature of the underlying projects and customer relationships acquired. As a result of the acquisition, the condensed consolidated statements of income include the results of operations of BE&K since the date of acquisition. See Note 3 to our consolidated financial statements for further discussion of the BE&K acquisition.

### *Business Reorganization*

During the first quarter of 2010, we reorganized our business segments into discrete business units, each focused on a specific segment of the market with identifiable customers, business strategies, and sales and marketing capabilities. The reorganization includes the realignment of certain underlying projects among our existing business units as well as the transfer of certain projects to several newly formed business units. Certain realigned business units are reported under the newly formed Hydrocarbons and Infrastructure, Government & Power ( IGP ) business segments. Our Services segment and Ventures business unit continue to operate on a stand-alone basis. See Item 1. Business Our Business Segments and Business Units for further description of our realigned business reorganization.

### **Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to select appropriate accounting policies and to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. Our critical accounting policies are described below to provide a better understanding of how we develop our assumptions and judgments about future events and related estimations and how they can impact our financial statements. A critical accounting estimate is one that requires our most difficult, subjective, or complex estimates and assessments and is fundamental to our results of operations.

We base our estimates on historical experience and on various other assumptions we believe to be reasonable according to the current facts and circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We believe the following are the critical accounting policies used in the preparation of our consolidated financial statements in accordance with accounting principles generally accepted in the United States, as well as the significant estimates and judgments affecting the application of these policies. This discussion and analysis should be read in conjunction with our consolidated financial statements and related notes.

*Percentage of completion.* Revenue from long-term contracts to provide construction, engineering, design or similar services is reported on the percentage-of-completion method of accounting. This method of accounting requires us to calculate job profit to be recognized in each reporting period for each job based upon our projections of future outcomes, which include estimates of the total cost to complete the project; estimates of the project schedule and completion date; estimates of the extent of progress toward completion; and amounts of any probable unapproved claims and change orders included in revenue. Progress is generally based upon physical progress, man-hours or costs incurred depending on the type of job. Physical progress is determined as a combination of input and output measures as deemed appropriate by the circumstances.

At the outset of each contract, we prepare a detailed analysis of our estimated cost to complete the project. Risks relating to service delivery, usage, productivity, and other factors are considered in the estimation process. Our project personnel periodically evaluate the estimated costs, claims, change orders, and percentage of completion at the project level. The recording of profits and losses on long-term contracts requires an estimate of the total profit or loss over the life of each contract. This estimate requires consideration of total contract value, change orders, and claims, less costs incurred and estimated costs to complete. We also take into account liquidated damages when determining total contract profit or loss. Our contracts often require us to pay liquidated damages should we not meet certain performance requirements, including completion of the project in accordance with a scheduled time. We include an estimate of liquidated damages in contract costs when it is deemed probable that they will be paid. Anticipated losses on contracts are recorded in full in the period in which they become evident. Profits are recorded based upon the product of estimated contract profit at completion times the current percentage-complete for the contract.

---

## Table of Contents

When calculating the amount of total profit or loss on a long-term contract, we include unapproved claims in contract value when the collection is deemed probable based upon the four criteria for recognizing unapproved claims under FASB ASC 605-35 regarding accounting for performance of construction-type and certain production-type contracts. Including probable unapproved claims in this calculation increases the operating income (or reduces the operating loss) that would otherwise be recorded without consideration of the probable unapproved claims. Probable unapproved claims are recorded to the extent of costs incurred and include no profit element. In all cases, the probable unapproved claims included in determining contract profit or loss are less than the actual claim that will be or has been presented to the customer. We are actively engaged in claims negotiations with our customers, and the success of claims negotiations has a direct impact on the profit or loss recorded for any related long-term contract. Unsuccessful claims negotiations could result in decreases in estimated contract profits or additional contract losses, and successful claims negotiations could result in increases in estimated contract profits or recovery of previously recorded contract losses.

At least quarterly, significant projects are reviewed in detail by senior management. We have a long history of working with multiple types of projects and in preparing cost estimates. However, there are many factors that impact future costs, including but not limited to weather, inflation, labor and community disruptions, timely availability of materials, productivity, and other factors as outlined in our Risk Factors contained in Part I of this Annual Report on Form 10-K. These factors can affect the accuracy of our estimates and materially impact our future reported earnings.

*Estimated Losses on Uncompleted Contracts and Changes in Contract Estimates.* We record provisions for estimated losses on uncompleted contracts in the period in which such losses are identified. The cumulative effects of revisions to contract revenue and estimated completion costs are recorded in the accounting period in which the amounts become evident and can be reasonably estimated. These revisions can include such items as the effects of change orders and claims, warranty claims, liquidated damages or other contractual penalties, adjustments for audit findings on US government contracts and contract closeout settlements.

*Accounting for government contracts.* Most of the services provided to the United States government are governed by cost-reimbursable contracts. Generally, these contracts contain both a base fee (a fixed profit percentage applied to our actual costs to complete the work) and an award fee (a variable profit percentage applied to definitized costs, which is subject to our customer's discretion and tied to the specific performance measures defined in the contract, such as adherence to schedule, health and safety, quality of work, responsiveness, cost performance, and business management).

Revenue is recorded at the time services are performed, and such revenue includes base fees, actual direct project costs incurred and an allocation of indirect costs. Indirect costs are applied using rates approved by our government customers. The general, administrative, and overhead cost reimbursement rates are estimated periodically in accordance with government contract accounting regulations and may change based on actual costs incurred or based upon the volume of work performed. Revenue is reduced for our estimate of costs that either are in dispute with our customer or have been identified as potentially unallowable per the terms of the contract or the federal acquisition regulations.

Award fees are generally evaluated and granted periodically by our customer. For contracts entered into prior to June 30, 2003, award fees are recognized during the term of the contract based on our estimate of amounts to be awarded. Once award fees are granted and task orders underlying the work are definitized, we adjust our estimate of award fees to actual amounts earned. Our estimates are often based on our past award experience for similar types of work. We periodically receive LogCAP III award fee scores and, based on these actual amounts, we adjust our accrual rate for future awards, if necessary. The controversial nature of this contract may cause actual awards to vary significantly from past experience. As discussed further in Note 9 to our consolidated financial statements, we are currently unable to reliably estimate award fees as a result of our customer's unilateral decision to grant no award fees for certain performance periods.

For contracts containing multiple deliverables entered into subsequent to June 30, 2003, we analyze each activity within the contract to ensure that we adhere to the separation guidelines of FASB ASC 605 Revenue Recognition and FASB ASC 605-25 Multiple-Element Arrangements. For service-only contracts and service elements of multiple deliverable arrangements, award fees are recognized only when definitized and awarded by the customer. Award fees on government construction contracts are recognized during the term of the contract based on our estimate of the amount of fees to be awarded.

Similar to many cost-reimbursable contracts, these government contracts are typically subject to audit and adjustment by our customer. Each contract is unique; therefore, the level of confidence in our estimates for audit adjustments varies depending on how much historical data we have with a particular contract. KBR excludes from billings to the U.S. Government costs that are expressly unallowable, or mutually agreed to be unallowable, or not allocable to government

---

**Table of Contents**

contracts per applicable regulations. Revenue recorded for government contract work is reduced for our estimate of potentially refundable costs related to issues that may be categorized as disputed or unallowable as a result of cost overruns or the audit process. Our estimates of potentially unallowable costs are based upon, among other things, our internal analysis of the facts and circumstances, terms of the contracts and the applicable provisions of the FAR, quality of supporting documentation for costs incurred, and subcontract terms as applicable. From time to time, we engage outside counsel to advise us on certain matters in determining whether certain costs are allowable. We also review our analysis and findings with the ACO as appropriate. In some cases, we may not reach agreement with the DCAA or the ACO regarding potentially unallowable costs which may result in our filing of claims in various courts such as the Armed Services Board of Contract Appeals ( ASBCA ) or the United States Court of Federal Claims ( COFC ). We only include amounts in revenue related to disputed and potentially unallowable costs when we determine it is probable that such costs will result in revenue. We generally do not recognize additional revenue for disputed or potentially unallowable costs for which revenue has been previously reduced until we reach agreement with the DCAA and/or the ACO that such costs are allowable.

*Goodwill Impairment Testing.* Goodwill represents the excess of cost over the fair market value of net assets acquired in business combinations and, in accordance with FASB ASC 350 Intangibles – Goodwill and Other, we are required to test goodwill for impairment on an annual basis, and more frequently when negative conditions or other triggering events arise. Effective January 1, 2010, we elected to change our annual goodwill impairment testing to the fourth quarter of every year based on carrying values of our business units as of October 1 from our previous method of using our business unit carrying values as of September 30. An annual goodwill impairment test date of October 1 better aligns with our annual budget process which is completed during the fourth quarter of each year. In addition, performing our annual goodwill impairment test during the fourth quarter allows for a more thorough consideration of the valuations of our business units subsequent to the completion of our annual budget process but prior to our financial year end reporting date. As a result of this accounting change, there were no required adjustments to any of the financial statement line items in the accompanying financial statements. As of December 31, 2010, we had goodwill totaling \$947 million on our consolidated balance sheet.

In the first quarter of 2010, we reorganized our business units, each focused on a specific segment of the market with identifiable customers, business strategies, and sales and marketing capabilities. For segment reporting purposes, the business units are grouped into four reportable segments: Hydrocarbons; Infrastructure, Government & Power; Services; and Other. Within those reportable segments we operate eleven business units which are also our operating segments as defined by FASB ASC 280 – Segment Reporting and our reporting units as defined by FASB ASC 350. In accordance with FASB ASC 350, we conduct our goodwill impairment testing at the reporting unit level which consists of our eleven business units. The reporting units include Gas Monetization, Oil & Gas, Downstream, Technology, North American Government & Defense, International Government & Defense, Power & Industrial, Infrastructure & Minerals, Services, Ventures, and the AllStates staffing business.

The annual impairment test for goodwill is a two-step process that involves comparing the estimated fair value of each business unit to the unit's carrying value, including goodwill. If the fair value of a business unit exceeds its carrying amount, the goodwill of the business unit is not considered impaired; therefore, the second step of the impairment test is unnecessary. If the carrying amount of a business unit exceeds its fair value, we perform the second step of the goodwill impairment test to measure the amount of goodwill impairment loss to be recorded, as necessary.

Consistent with prior years, the fair values of reporting units in 2010 were determined using a combination of two methods, one based on market earnings multiples of peer companies identified for each business unit (the market approach), and the other based on discounted cash flow models with estimated cash flows based on internal forecasts of revenues and expenses over a four year period plus a terminal value period (the income approach).

The market approach estimates fair value by applying earnings and revenue market multiples to a reporting unit's operating performance for the trailing twelve-month period. The market multiples are derived from comparable publicly traded companies with operating and investment characteristics similar to those of each of our reporting units. The earnings multiples for the market approach ranged between 4.0 times and 11.0 times the earnings for each of our reporting units. The income approach estimates fair value by discounting each reporting unit's estimated future cash flows using a weighted-average cost of capital that reflects current market conditions and the risk profile of each reporting unit. The discount rates used under the income approach ranged from 13.2% to 17.5%. The fair value derived from the weighting of these two methods provided appropriate valuations that, in aggregate, reasonably reconciled to our market capitalization, taking into account observable control premiums.

We believe these two approaches are appropriate valuation techniques and we generally weight the two resulting values equally as an estimate of reporting unit fair value for the purposes of our impairment testing. However, we may weigh one value more heavily than the other when conditions merit doing so.



---

**Table of Contents**

In addition to the earnings multiples and the discount rates disclosed above, certain other judgments and estimates are used to prepare the goodwill impairment test. If market conditions change compared to those used in our market approach, or if actual future results of operations fall below the projections used in the income approach, our goodwill could become impaired in the future.

At October 1, 2010, our market capitalization exceeded the carrying value of our consolidated net assets by \$1.4 billion and the fair value of all our individual reporting units significantly exceeded their respective carrying amounts as of that date. However, the fair values for the Services, P&I and Allstates reporting units exceeded their respective carrying values based on projected growth rates and other market inputs to our impairment test models that are more sensitive to the risk of future variances due to competitive market conditions as well as business unit execution risks.

We review our projected growth rates and other market inputs used in our impairment test models, and changes in our business and other factors that could represent indicators of impairment. Subsequent to our October 1, 2010 annual impairment test, no such indicators of impairment were identified.

In the third quarter of 2009, we recognized a goodwill impairment charge of approximately \$6 million related to the AllStates staffing reporting unit in connection with our annual goodwill impairment test on September 30, 2009. The charge was primarily the result of a decline in the staffing market, the effect of the recession on the market, and our reduced forecasts of the sales, operating income and cash flows for this reporting unit that were identified through the course of our 2009 annual planning process. As of October 1, 2010, goodwill and intangibles for this reporting unit totaled approximately \$18 million, including goodwill of \$12 million.

*Deferred taxes and tax contingencies.* Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns. A current tax asset or liability is recognized for the estimated taxes payable or refundable on tax returns for the current year. A deferred tax asset or liability is recognized for the estimated future tax effects attributable to temporary differences between the financial reporting basis and the income tax basis of assets and liabilities. The measurement of current and deferred tax assets and liabilities is based on provisions of the enacted tax law, and the effects of potential future changes in tax laws or rates are not considered.

In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will not be realized. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Additionally, we use forecasts of certain tax elements such as taxable income and foreign tax credit utilization and the evaluation of tax planning strategies in making this assessment of realization. Given the inherent uncertainty involved with the use of such assumptions, there can be significant variation between anticipated and actual results. As of December 31, 2010, we had net deferred tax assets of \$116 million, which are net of deferred tax liabilities of \$262 million and a valuation allowance of \$32 million primarily related to certain foreign branch net operating losses. In 2010, we increased our valuation allowance by approximately \$2 million primarily due to net operating losses generated in tax jurisdictions where future taxable income is not expected to be sufficient for us to recognize a tax benefit.

We have operations in numerous countries other than the United States. Consequently, we are subject to the jurisdiction of a significant number of taxing authorities. The income earned in these various jurisdictions is taxed on differing bases, including income actually earned, income deemed earned, and revenue-based tax withholding. The final determination of our tax liabilities involves the interpretation of local tax laws, tax treaties, and related authorities in each jurisdiction. Changes in the operating environment, including changes in tax law and currency/repatriation controls, could impact the determination of our tax liabilities for a tax year.

We record estimated reserves for uncertain tax positions if the position does not meet a more-likely-than-not threshold to be sustained upon by review by taxing authorities. Income tax positions that previously failed to meet the more-likely-than-not threshold are recognized as benefits in the first subsequent financial reporting period in which that threshold is met. The company recognizes potential interest and penalties related to uncertain tax positions within the provision for income taxes.

Tax filings of our subsidiaries, unconsolidated affiliates, and related entities are routinely examined in the normal course of business by tax authorities. These examinations may result in assessments of additional taxes, which we work to resolve with the tax authorities and through the judicial process. Predicting the outcome of disputed assessments involves some uncertainty. Factors such as the availability of settlement procedures, willingness of tax authorities to negotiate, and the operation and impartiality of judicial systems vary across the different tax jurisdictions and may significantly influence the





---

**Table of Contents**

ultimate outcome. We review the facts for each assessment, and then utilize assumptions and estimates to determine the most likely outcome and provide taxes, interest, and penalties as needed based on this outcome.

*Legal and Investigation Matters.* As discussed in Notes 9 and 10 of our consolidated financial statements, as of December 31, 2010 and 2009, we have accrued an estimate of the probable and estimable costs for the resolution of some of our legal and investigation matters. For other matters for which the liability is not probable and reasonably estimable, we have not accrued any amounts. Attorneys in our legal department monitor and manage all claims filed against us and review all pending investigations. Generally, the estimate of probable costs related to these matters is developed in consultation with internal and outside legal counsel representing us. Our estimates are based upon an analysis of potential results, assuming a combination of litigation and settlement strategies. The precision of these estimates is impacted by the amount of due diligence we have been able to perform. We attempt to resolve these matters through settlements, mediation, and arbitration proceedings when possible. If the actual settlement costs, final judgments, or fines, after appeals, differ from our estimates, our future financial results may be materially and adversely affected. We record adjustments to our initial estimates of these types of contingencies in the periods when the change in estimate is identified.

*Pensions.* Our pension benefit obligations and expenses are calculated using actuarial models and methods, in accordance with FASB ASC 715 Compensation Retirement Benefits. Two of the more critical assumptions and estimates used in the actuarial calculations are the discount rate for determining the current value of plan benefits and the expected rate of return on plan assets. Other assumptions and estimates used in determining benefit obligations and plan expenses, including demographic factors such as retirement age, mortality, and turnover, are also evaluated periodically and updated accordingly to reflect our actual experience.

The discount rate was determined annually by reviewing yields on high-quality bonds that receive one of the two highest ratings given by a recognized rating agency and the expected duration of the obligations specific to the characteristics of the Company's plans. The overall expected long-term rate of return on assets was determined by reviewing targeted asset allocations and historical index performance of the applicable asset classes on a long-term basis of at least 15 years. Plan assets are comprised primarily of equity and debt securities. As we have both domestic and international plans, these assumptions differ based on varying factors specific to each particular country or economic environment.

The discount rate utilized to determine the projected benefit obligation at the measurement date for our U.S. pension plan decreased from 5.35% at December 31, 2009 to 4.84% at December 31, 2010. The discount rate utilized to determine the projected benefit obligation at the measurement date for our U.K. pension plans, which constitutes all of our international plans and 95% of all plans, decreased from 5.84% at December 31, 2009 to 5.45% at December 31, 2010. An additional future decrease in the discount rate of 25 basis points for our pension plans would increase our projected benefit obligation by an estimated \$2 million and \$50 million for the US and UK plans, respectively, while a similar increase in the discount rate would reduce our projected benefit obligation by an estimated \$2 million and \$48 million for the US and UK plans, respectively. Our expected long-term rates of return on plan assets utilized at the measurement date decreased from 7.63% to 7.00% for our U.S. pension plan and remained unchanged at 7.0% for our international plans.

Unrecognized actuarial gains and losses are generally being recognized over a period of 10 to 15 years, which represents the expected remaining service life of the employee group. Our unrecognized actuarial gains and losses arise from several factors, including experience and assumptions changes in the obligations and the difference between expected returns and actual returns on plan assets. The difference between actual and expected returns is deferred as an unrecognized actuarial gain or loss and is recognized as future pension expense. Our unrecognized actuarial loss at December 31, 2010 was \$538 million, of which \$20 million is expected to be recognized as a component of our expected 2011 pension expense. Lower than expected long-term rates of return on our plan assets and the previous curtailment of our existing pension plans could increase our future pension costs and contributions over historical levels. During 2010, we made contributions to fund our defined benefit plans of \$20 million. We currently expect to make contributions in 2011 of approximately \$68 million.

The actuarial assumptions used in determining our pension benefits may differ materially from actual results due to changing market and economic conditions, higher or lower withdrawal rates, and longer or shorter life spans of participants. While we believe that the assumptions used are appropriate, differences in actual experience or changes in assumptions may materially affect our financial position or results of operations. Our actuarial estimates of pension benefit expense and expected pension returns of plan assets are discussed in Note 17 in the accompanying financial statements.

**Table of Contents**

*Variable Interest Entities.* We account for variable interest entities ( VIEs ) in accordance with FASB ASC 810 Consolidation which requires the consolidation of VIEs in which a company has both the power to direct the activities of the VIE that most significantly impact the VIE s economic performance and the obligation to absorb losses or the right to receive the benefits from the VIE that could potentially be significant to the VIE. If a reporting enterprise meets these conditions then it has a controlling financial interest and is the primary beneficiary of the VIE. We have applied the requirements of FASB ASC 810 on a prospective basis from January 1, 2010.

We assess all newly created entities and those with which we become involved to determine whether such entities are VIEs and, if so, whether or not we are their primary beneficiary. Most of the entities we assess are incorporated or unincorporated joint ventures formed by us and our partner(s) for the purpose of executing a project or program for a customer, such as a governmental agency or a commercial enterprise, and are generally dissolved upon completion of the project or program. Many of our long-term energy-related construction projects in our Hydrocarbons business segment are executed through such joint ventures. Typically, these joint ventures are funded by advances from the project owner, and accordingly, require little or no equity investment by the joint venture partners but may require subordinated financial support from the joint venture partners such as letters of credit, performance and financial guarantees or obligations to fund losses incurred by the joint venture. Other joint ventures, such as privately financed initiatives in our Ventures business unit, generally require the partners to invest equity and take an ownership position in an entity that manages and operates an asset post construction.

As required by ASC 810, we perform a qualitative assessment to determine whether we are the primary beneficiary once an entity is identified as a VIE. A qualitative assessment begins with an understanding of the nature of the risks in the entity as well as the nature of the entity s activities including terms of the contracts entered into by the entity, ownership interests issued by the entity and how they were marketed, and the parties involved in the design of the entity. We then identify all of the variable interests held by parties involved with the VIE including, among other things, equity investments, subordinated debt financing, letters of credit, and financial and performance guarantees, and contracted service providers. Once we identify the variable interests, we determine those activities which are most significant to the economic performance of the entity and which variable interest holder has the power to direct those activities. Though infrequent, some of our VIE s have no primary beneficiary because the power to direct the most significant activities that impact the economic performance is held equally by two or more variable interest holders who are required to provide their consent prior to the execution of their decisions. Most of the VIEs with which we are involved have relatively few variable interests and are primarily related to our equity investment, significant service contracts, and other subordinated financial support.

**Table of Contents****Results of Operations**

We analyze the financial results for each of our four segments including the related business units within Hydrocarbons and IGP. The business segments presented are consistent with our reportable segments discussed in Note 5 to our consolidated financial statements. While certain of the business units and product service lines presented below do not meet the criteria for reportable segments in accordance with FASB ASC 280 Segment Reporting, we believe this supplemental information is relevant and meaningful to our investors.

In millions	Years Ended December 31,						
	2010	2009	Dollar Change	Percentage Change	2008	Dollar Change	Percentage Change
<b>Revenue (1)</b>							
<b>Hydrocarbons:</b>							
Gas Monetization	\$ 2,829	\$ 2,755	\$ 74	3%	\$ 2,156	\$ 599	28%
Oil & Gas	426	576	(150)	(26)%	526	50	10%
Downstream	584	478	106	22%	484	(6)	(1)%
Technology	130	97	33	34%	84	13	15%
<b>Total Hydrocarbons</b>	<b>3,969</b>	<b>3,906</b>	<b>63</b>	<b>2%</b>	<b>3,250</b>	<b>656</b>	<b>20%</b>
<b>Infrastructure, Government and Power ( IGP ):</b>							
North America Government and Defense	3,307	5,189	(1,882)	(36)%	6,027	(838)	(14)%
International Government and Defence	369	288	81	28%	421	(133)	(32)%
Infrastructure and Minerals	271	337	(66)	(20)%	431	(94)	(22)%
Power and Industrial	352	474	(122)	(26)%	244	230	94%
<b>Total IGP</b>	<b>4,299</b>	<b>6,288</b>	<b>(1,989)</b>	<b>(32)%</b>	<b>7,123</b>	<b>(835)</b>	<b>(12)%</b>
<b>Services</b>	<b>1,755</b>	<b>1,863</b>	<b>(108)</b>	<b>(6)%</b>	<b>1,188</b>	<b>675</b>	<b>57%</b>
Ventures	55	21	34	162%	(2)	23	1,150%
Other	21	27	(6)	(22)%	22	5	23%
<b>Total revenue</b>	<b>\$ 10,099</b>	<b>\$ 12,105</b>	<b>\$ (2,006)</b>	<b>(17)%</b>	<b>\$ 11,581</b>	<b>\$ 524</b>	<b>5%</b>

- (1) Our revenue includes both equity in the earnings of unconsolidated affiliates and revenue from the sales of services into the joint ventures. We often participate on larger projects as a joint venture partner and also provide services to the venture as a subcontractor. The amount included in our revenue represents our share of total project revenue, including equity in the earnings (loss) from joint ventures and revenue from services provided to joint ventures.

**Table of Contents**

For purposes of reviewing the results of operations, business unit income is calculated as revenue less cost of services managed and reported by the business unit and are directly attributable to the business unit. Business unit income excludes corporate general and administrative expenses and other non-operating income and expense items.

In millions	Years Ending December 31,						
	2010	2009	Dollar Change	Percentage Change	2008	Dollar Change	Percentage Change
<b>Business unit income (loss):</b>							
Hydrocarbons:							
Gas Monetization	\$ 252	\$ 178	\$ 74	42%	\$ 165	\$ 13	8%
Oil & Gas	90	274	(184)	(67)%	141	133	94%
Downstream	117	59	58	98%	72	(13)	(18)%
Technology	55	49	6	12%	41	8	20%
Total job income	514	560	(46)	(8)%	419	141	34%
Impairment of long-lived assets	(4)		(4)				
Divisional overhead	(110)	(96)	(14)	(15)%	(87)	(9)	(10)%
Total Hydrocarbons	400	464	(64)	(14)%	332	132	40%
Infrastructure, Government and Power ( IGP ):							
North America Government and Defense	230	113	117	104%	260	(147)	(57)%
International Government and Defence	88	71	17	24%	88	(17)	(19)%
Infrastructure and Minerals	62	87	(25)	(29)%	91	(4)	(4)%
Power and Industrial	37	68	(31)	(46)%	21	47	224%
Total job income	417	339	78	23%	460	(121)	(26)%
Divisional overhead	(145)	(151)	6	4%	(119)	(32)	(27)%
Total IGP	272	188	84	45%	341	(153)	(45)%
Services:							
Job income	172	167	5	3%	139	28	20%
Gain (loss) on sale of assets	(1)		(1)		1	(1)	(100)%
Divisional overhead	(69)	(71)	2	3%	(39)	(32)	(82)%
Total Services	102	96	6	6%	101	(5)	(5)%
Ventures:							
Job income (loss)	33	19	14	74%	(4)	23	575%
Gain on sale of assets	3	2	1	50%	1	1	100%
Divisional overhead	(3)	(2)	(1)	(50)%	(2)		%
Total Ventures	33	19	14	74%	(5)	24	480%
Other:							
Job income	12	9	3	33%	7	2	29%
Impairment of long-lived assets	(1)		(1)				
Impairment of goodwill		(6)	6	100%		(6)	
Gain (loss) on sale of assets	(2)		(2)		1	(1)	(100)%

Edgar Filing: KBR, INC. - Form 10-K

Divisional overhead	(7)	(6)	(1)	(17)%	(5)	(1)	(20)%
<b>Total Other</b>	<b>2</b>	<b>(3)</b>	<b>5</b>	<b>167%</b>	<b>3</b>	<b>(6)</b>	<b>(200)%</b>
<b>Total business unit income</b>	<b>809</b>	<b>764</b>	<b>45</b>	<b>6%</b>	<b>772</b>	<b>(8)</b>	<b>(1)%</b>
<b>Unallocated amounts:</b>							
Labor cost absorption (1)	12	(11)	23	209%	(8)	(3)	(38)%
Corporate general and administrative	(212)	(217)	5	2%	(223)	6	3%
<b>Total operating income</b>	<b>\$ 609</b>	<b>\$ 536</b>	<b>\$ 73</b>	<b>14%</b>	<b>\$ 541</b>	<b>\$ (5)</b>	<b>(1)%</b>

(1) Labor cost absorption represents costs incurred by our central labor and resource groups (above) or under the amounts charged to the operating business units.

***Hydrocarbons Business Segment***

*Gas Monetization.* Revenue from Gas Monetization increased in 2010 by \$74 million primarily due to increased activity from the Gorgon LNG and several other LNG projects. Revenue from these projects increased \$442 million in the aggregate compared to 2009 primarily as a result of the transition from the FEED to the EPCM portion of the Gorgon project as well as absence of losses in 2009 from two joint ventures executing LNG projects that were substantially completed in 2010. Partially offsetting these increases in revenue was a decline in revenue of approximately \$360 million due to lower procurement and subcontractor activity on the Skikda LNG projects and lower progress on the Pearl GTL project as well as projects that were completed in 2009.

Gas Monetization job income increased approximately \$74 million in 2010 compared to the same period of the prior year. Job income increased \$117 million as a result of increased activity on the EPCM portion of the Gorgon LNG project as

**Table of Contents**

well as change orders on an LNG project executed through a joint venture which is substantially completed. Additionally, job income increased due to the absence of a charge of \$30 million in 2009 on an LNG project resulting from schedule delays, subcontractor claims and equipment failures. Partially offsetting the increases in job income were decreases of approximately \$60 million in the aggregate on the Escravos and Pearl GTL projects and lower activity on another LNG project that was completed in 2009. Additionally, primarily due to actions and inactions on the part of the customer, we identified increases in the estimated cost to complete an LNG project due to a schedule delay which resulted in a non-cash charge of approximately \$42 million to job income in the third quarter of 2010. We are evaluating our legal entitlement under the contract with our customer and will vigorously pursue all other available remedies which may reduce our exposure to the estimated project cost increases in future periods.

During 2010, we negotiated a final settlement agreement with one of our commercial agents who provided services to various Gas Monetization projects which resulted in a non-cash increase to Gas Monetization job income of approximately \$42 million in the third quarter of 2010. Prior to the settlement, the agent was reviewed and approved under our policies on business conduct.

Revenue for 2009 in Gas Monetization increased by \$599 million primarily due to increased activity from several projects including the Escravos GTL, Gorgon LNG and Skikda LNG projects. Revenue from these projects increased an aggregate \$784 million in 2009. Our Escravos GTL and Skikda LNG project revenues increased primarily due to higher volumes of material procurement activity compared to the prior year. Revenue on our Gorgon LNG project increased as a result of the transition from the FEED to the EPCM portion of the project which was awarded in the third quarter of 2009. Partially offsetting the 2009 increases in Gas Monetization revenue were declines in revenue of approximately \$228 million due to lower activity on the Pearl GTL project as well as increases in project costs due to schedule delays, subcontractor claims and equipment failures on other LNG projects that are nearing completion.

Job income increased \$63 million in the aggregate on the Escravos GTL and Gorgon LNG projects in 2009. We recognized higher incentive fees on the Escravos GTL project in 2009 than in the prior year and increased activity on the Gorgon LNG project due to the award of the EPCM portion of the project contributed to the increase in job income for 2009. Also, in 2008 we recognized a \$20 million charge related to the settlement of the FCPA and bidding practices investigation in Nigeria which did not recur in 2009 further contributing to the increase in Gas Monetization job income in 2009. Partially offsetting these 2009 increases in Gas Monetization job income were increases in project costs on other LNG projects due to schedule delays, subcontractor claims and equipment failures as these projects near completion.

*Oil & Gas.* Revenue in Oil & Gas decreased by \$150 million and job income decreased by \$184 million in 2010 over the prior year. The decrease in revenue and job income is primarily due to favorable arbitration award on the EPC 1 project performed for PEMEX which contributed approximately \$183 million to revenues in 2009. Increased revenue and job income related to new project awards and higher progress on existing projects in 2010 partially offset the impact of the EPC1 award recognized in 2009. Additional legal costs related to the Barracuda arbitration and lower margins for the Jack St Malo and Kashagan projects in 2010 also contributed to the decline in job income.

Revenue from Oil & Gas in 2009 increased largely as a result of the favorable arbitration award on the EPC 1 project performed for PEMEX which contributed approximately \$183 million to the increase in 2009 revenues. Partially offsetting the increase in Oil & Gas revenues were decreases due to the slower progress on a number of offshore projects that were either completed or were nearing completion in 2009 including the AIOC project in Kazakhstan and Woodside North Rankin project in Australia. Job income in our Oil & Gas for 2009 increased primarily due to the \$351 million favorable arbitration award on the EPC 1 project performed for PEMEX which resulted in \$183 million of job income. Oil & Gas job income in 2008 included a \$51 million gain related to a settlement with PEMEX on the EPC 28 project that did not recur in 2009.

*Downstream.* Downstream revenue in 2010 increased by \$106 million primarily due to increases on the Sonangol refining job in Africa and petrochemical projects in the Middle East including Shaybah, Ras Tanura and Yanbu, which increased approximately \$207 million in the aggregate as a result of increased activity over the prior year. These increases in revenue were partially offset by lower revenues of \$24 million on the Saudi Kayan project and \$61 million on other projects nearing completion.

Downstream job income in 2010 increased by approximately \$58 million as compared to the same period of the prior year. The increase was primarily driven by increased activity on the Sonangol, Saudi Kayan, Ras Tanura and Yanbu projects which resulted in an increase in job income of \$66 million in 2010. Additionally, Downstream job income in 2009 included \$17 million in charges on our EBIC ammonia project due to additional costs related to the commissioning and start up of the plant which did not recur in 2010. Partially offsetting these increases in job income was a charge of approximately \$9 million related to an account receivable reserve adjustment recorded in the second quarter of 2010 as well as decreases on

**Table of Contents**

several projects that were completed or nearing completion.

Downstream revenue decreased by \$6 million in 2009. Downstream was awarded with a number of refining projects in late 2008, including the Sonagol FEED project which increased revenue in 2009. Additionally, projects acquired in the July 1, 2008 acquisition of BE&K further increased revenue as a result of having a full years worth of activity in 2009. However, these increases were more than offset by the completion of several refining projects in 2009 as well as a significant decrease in activity on the EBIC ammonia plant project as it neared completion. Downstream job income in 2009 decreased primarily due to a \$23 million reduction in profit on the EBIC ammonia plant project. As this project neared completion, we incurred additional costs associated with a delay in completing the plant's reliability test which was successfully completed and formally accepted by the client in the third quarter of 2009. Partially offsetting this decrease was an aggregate increase in job income of \$7 million in our refining operations primarily due to the increased activity of new refining projects awarded in late 2008.

*Technology.* Technology revenue and job income in 2010 increased \$33 and \$6 million, respectively, primarily due to the progress achieved on a number of new projects including several grassroots ammonia and urea projects in Brazil, Turkmenistan and India, as well as petrochemical plants in China. These new projects contributed approximately \$57 million to the increase in Technology revenue and approximately \$29 million to the increase in Technology job income in 2010. Partially offsetting these increases were decreases in revenue and job income associated with the completion of engineering services on several ammonia projects located in Venezuela, Trinidad, and India, and other refining projects in Spain and Russia.

Technology revenue and job income in 2009 increased by \$13 million and \$8 million, respectively. Revenue increased primarily due to the progress achieved on several ammonia projects including grassroots ammonia projects in Brazil and Trinidad and an ammonia plant revamp in India and new refining projects in India, Angola, and Indonesia which contributed approximately \$34 million to the increase. These increases were partially offset by the completion of engineering services on several ammonia projects located in China and South America as well as several other projects that were completed in 2008. Technology job income for 2009 increased by \$8 million primarily due to our grassroots ammonia projects in Venezuela and Trinidad and the ammonia plant revamp in India which contributed \$17 million to the increase. Additionally, job income increased by approximately \$6 million on our refining projects in India, Angola and Indonesia. These increases were partially offset by lower activity on our ammonia projects in China and South America and other projects that were completed in 2008 and early 2009.

***Infrastructure, Government and Power ( IGP ) Business Segment***

*North America Government and Defense ( NAGD ).* Revenue from NAGD decreased approximately \$1.9 billion in 2010. The decrease in NAGD revenue includes a \$2 billion decline resulting from an overall reduction in volume for U.S. military support activities primarily in Iraq under our LogCAP III contract. The lower volume is primarily due to the continued reductions in staff and personnel on the project as military bases have closed and combat troop levels declined. We expect to continue providing services on certain task orders through 2011. Although the decreases in revenue on the LogCAP III project have been partially offset by an increase in revenue of \$246 million on a task order under the LogCAP IV contract, we expect our overall volume of work to continue to decrease in Iraq throughout the remainder of 2011. Also contributing to the decrease in NAGD revenue is \$130 million less revenue as a result of lower volumes of work under the CENTCOM project.

Job income from NAGD increased by approximately \$117 million primarily due to the net impact of the charge related to the write-off of award fees in 2009 on the LogCAP III contract previously accrued in 2008 and recognition of award fees in 2010 for periods of performance from May 2008 through May 2010 awarded to us in the second and third quarters of 2010. The net impact of this award fee activity resulted in an increase to job income of approximately \$159 in 2010. The increases in NAGD job income due to the award fees were partially offset by lower volume of activity on our LogCAP III contract as a result of the overall reduction in volume of U.S. military support activities in 2010 primarily in Iraq which resulted in a decrease to job income of \$74 million. Additionally, job income on the LogCAP III contract decreased due to the absence of a gain of \$17 million in 2009 related to the billing of costs incurred in previous periods related to the litigation with one our LogCAP III subcontractors and a charge recorded in 2010 of \$23 million associated with potentially unallowable costs.

Revenue from NAGD decreased by \$838 million in 2009 largely as a result of the overall reduction in volume of activity on our LogCAP III contract in Iraq. Revenue from the LogCAP III contract decreased \$664 million in 2009 which was primarily driven by declines in troop levels throughout the year. Additionally, the U.S. Army was in the process of transitioning services in Kuwait and Afghanistan from the LogCAP III contract to the LogCAP IV contract which further

---

**Table of Contents**

contributed to the decrease in revenues for 2009. Additionally, revenue from NAGD decreased in 2009 as a result of the reduction in activity on the Los Alamos project and other domestic cost-reimbursable U.S. government projects. Revenue on these projects decreased approximately \$189 million in the aggregate.

Job income from NAGD was lower in 2009 by approximately \$147 million primarily due to the net charge taken in 2009 as a result of reversing our award fee accruals for the performance period January 2008 through December 2009 which resulted in a decrease of \$130 million to job income, as well as lower volume of activity on our LogCAP III contract. On February 19, 2010, we were notified by the U.S. Army's Iraq Award Fee Evaluation Board for the LogCAP III project that KBR would not receive any award fees for the performance period from January 1, 2008 through April 30, 2008, for which we had previously accrued \$20 million. As a result, we re-evaluated our assumptions used in the estimation process related to the remainder of the open performance periods from May 1, 2008 through December 31, 2009, that were based on our historic experience, and in light of the discretionary actions of the Award Fee Determining Official ( AFDO ) in February 2010, and our inability to obtain assurances to the contrary, we concluded that we were no longer able to estimate the fees to be awarded. Accordingly, we reversed the remaining balance of the accrued award fees. See Note 1 to our consolidated financial statements for further discussion of our award fee accruals. Additionally, we recognized a \$19 million charge in 2009 as a result of an unfavorable judgment against us in litigation with one of our LogCAP III subcontractors and additional charges totaling \$17 million related to the correction of errors primarily associated with legal fees on various U.S. government related matters. These decreases were partially offset by \$17 million of charges recorded in 2008 related to the ASCO litigation and the revenue that was subsequently recognized in 2009 related to our recovery of these charges through billings to our customer. In addition, our charges for potentially unallowable costs in 2009 were lower than 2008.

*International Government and Defence ( IGD )*. Revenue from IGD increased approximately \$81 million and job income increased \$17 million in 2010 compared to the prior year. The increase in revenue was primarily related to the ongoing presence of troops in Afghanistan where we provide contingency logistics, operations and maintenance and other services to the U.K. MoD and NATO under the TDA and NAMSA projects. Job income in the third quarter of 2010 increased due to higher construction margins on the Allenby & Connaught project due to increased volumes of construction activity as well as contingency releases related to warranty expirations on other projects.

Revenues from our International Operations decreased in 2009 largely due to reduced levels of work volumes on U.K. MoD projects including the Tier 3 Basra project in Iraq and the Temporary Deployable Accommodations project. Job income from our International Operations decreased in 2009 primarily due to the Allenby & Connaught joint venture resulting from lower interest rate returns on project investments and strengthening of the U.S. Dollar to the British pound as well as lower volumes of activity on other projects for the U.K. MoD.

*Infrastructure and Minerals ( I&M )*. Revenue from I&M decreased approximately \$66 million in 2010 over the prior year due to lower overall activity on several projects. The projects were either completed in 2010 or scaled down as a result of the global economic conditions. Additionally, new project awards have been either delayed or canceled further contributing to the decrease. Job income from I&M decreased in 2010 by approximately \$25 million primarily as a result of the overall decrease in project activity primarily in Australia and fewer project awards.

Revenue from I&M decreased approximately \$94 million in 2009 over the prior year due to lower overall activity across the market sectors and in particular due to a number of large projects being at maximum capacity in the prior year. Job income from I&M declined slightly by approximately \$4 million in 2009.

*Power and Industrial ( P&I )*. Revenue from P&I decreased approximately \$122 million in 2010 over the prior year largely as a result of the completion of fieldwork on projects in early 2010 and reduced workload on projects as they near completion. These decreases were partially offset by increased volume on a new waste-to-energy refurbishment project in Florida and increased scope on other existing projects. Job income from P&I decreased by \$31 million in 2010 primarily as a result of completion of the Georgia Power and Procter & Gamble projects, lower profits on the Red River project that is nearing completion, and the effect of a non-recurring \$9 million gain in 2009 from collection of a fully-reserved project receivable. These declines were partially offset by improved job income of \$10 million related to construction mobilization on the waste-to-energy refurbishment project in Florida.

Revenue and job income from P&I increased approximately \$230 million and \$47 million, respectively, in 2009 compared to 2008 primarily as a result of the BE&K acquisition in July 2008. The improvement in job income was also driven by increased progress on certain projects and by a non-recurring \$9 million gain in 2009 from the collection of a fully-reserved project receivable.



---

**Table of Contents**
**Services Segment**

Services revenue in 2010 decreased by \$108 million as compared to 2009. Revenue declined \$95 million in our U.S. Construction Group and a combined \$93 million in our Building group and Canada operations. The primary driver for the declines was the completion several projects or projects being near completion and the lack of new project awards. These declines were partially offset by an increase in revenue of \$82 million from our Industrial Services group primarily as a result of increased construction maintenance and services under a new multi-site contract for DuPont throughout the Eastern and Gulf Coast regions of the U.S., the Atlanta Public Schools project, as well as the increased levels of turnaround work based in Canada.

Job income increased by approximately \$5 million in 2010 over 2009. The increase in job income resulted from the increased activity on the multi-site DuPont project, the Atlanta Public Schools and the Hunt Refining projects as well as favorable change orders on a power plant contract. These increases were partially offset by the lower profits on projects in our Canadian and US Construction operations that are nearing completion.

Services revenue in 2009 increased by \$675 million primarily as a result of the business we obtained through the acquisition of BE&K on July 1, 2008, which contributed approximately \$545 million to the increase. The increase in revenue from the BE&K acquisition was largely driven by the increased progress on the Hunt Refining project. Revenue from our Services legacy operations also increased as a result of continued growth in our North American Construction and Canadian operations. North American Construction revenue in 2009 increased approximately \$67 million over 2008 due to increased progress on the Borger and Exxon Mobil Flare Gas projects in Texas. Revenue from our Canadian operations increased approximately \$57 million due to the ramp up in field work on the Shell AOSP project and project mobilization on the Syncrude ESP project in late 2008.

Job income increased by \$28 million in 2009 largely due to the business we obtained through the acquisition of BE&K which contributed approximately \$44 million to the increase. Additionally, job income increased \$7 million in 2009 as a result of higher utilization of marine vessel support services provided through our MMM joint venture in the Gulf of Mexico. Partially offsetting these increases were reductions of approximately \$21 million in job income primarily in our Canadian operations due to a transition in that nature of the work performed from fabrication of modules to direct hire field construction which generally is performed at lower profit margins.

**Ventures Business Unit**

Our Venture s operations consist of investments in joint ventures accounted for under the equity method of accounting, net of tax. Ventures revenue was \$55 million and job income was \$33 million in 2010 as compared to revenue of \$21 million and job income of \$19 million in 2009. The increase in revenue is primarily attributable to the consolidation of Fasttrax Limited which was consolidated upon the adoption of ASC 810 in the first quarter of 2010. Fasttrax Limited is the primary contracting entity with the U.K. MoD in a project that owns and operates heavy equipment transport vehicles for the U.K. military. This variable interest entity, in which we have a 50% ownership interest, was previously accounted for using the equity method of accounting. Ventures job income increased during 2010 primarily due to the consolidation of Fasttrax Ltd. as well as improved performance of the EBIC ammonia plant project which became operational in 2009. The EBIC ammonia plant performance benefitted from a full year of operation in 2010, which resulted in increased sales volume and higher ammonia prices compared to 2009. In addition, job income from the Aspire Defence project improved in 2010 compared to 2009 resulting from the increase in the number of assets being accepted into service and lower maintenance costs.

Ventures 2009 job income of \$19 million increased \$23 million from a job loss of \$4 million compared to 2008. This job income increase of \$23 million in 2009 was primarily due to the adoption by two of our U.K. road project joint ventures of a favorable U.K. tax ruling related to the tax depreciation of certain assets which resulted in an increase to Equity earnings from unconsolidated affiliates of approximately \$8 million. This favorable U.K. tax ruling enabled Ventures to also recognize an additional \$2 million of gain on a prior disposal of pre-emption share rights relating to these roads which was contingent upon this tax ruling. In addition, as a result of lower inflation in the U.K., certain Ventures investments benefitted from significantly lower indexed linked bond interest cost in 2009. Job income increased approximately \$3 million in 2009 on the Aspire Defence project as a result of higher progress and lower maintenance costs offset by significantly lower interest income due lower interest rates in the UK than the previous year. In addition, the EBIC ammonia plant was completed during the year and made its first shipment of ammonia in May 2009. The EBIC ammonia plant operations contributed an additional \$3 million to the increase in Ventures job income in 2009.

**Table of Contents****Unallocated amounts**

**Labor cost absorption.** Labor cost absorption income was \$12 million in 2010 compared to labor cost absorption expense of \$11 million in 2009 and \$8 million in 2008. Labor cost absorption represents costs incurred by our central labor and resource groups net of the amounts charged to the operating business units. Labor cost absorption income improved in 2010 primarily due to higher chargeability and utilization in several of our engineering offices as well as a significantly higher headcount in the labor resource pool. Labor cost absorption expense in 2009 was primarily due to lower chargeability and utilization in several of our engineering offices as well as higher incentive compensation which was partially offset by lower headcount. Labor cost absorption expense in 2008 was primarily due to lower chargeability and utilization, partially offset by a \$6 million charge recorded in 2008 related to the impact of Hurricane Ike in Houston, Texas.

**General and Administrative expense.** General and administrative expense was \$212 million, \$217 million and \$223 million for the years ended December 31, 2010, 2009 and 2008, respectively. General and administrative expense declined in 2010 due to lower incentive compensation costs, lower legal costs and reductions associated with other cost containment measures. Additionally, in 2009 we wrote-off costs associated with our contemplated West Houston campus project which did not recur in 2010. Partially offsetting these reductions were higher G&A costs associated with corporate development activities, higher U.K. pension costs driven by unfavorable changes in assumptions that impacted 2010 expense and other risk and benefit programs. General and administrative expense declined slightly in 2009 primarily due to 2008 charges related to Hurricane Ike along with lower costs from Halliburton for access to their HR Payroll system and lower state tax audit adjustments. Offsetting these reductions were increases in legal expenses related to both litigation and the FCPA monitor preparation; the write off of approximately \$4 million in costs associated with our contemplated West Houston campus project after a decision to maintain our current area location; and higher incentive compensation related to the third year of our long-term incentive plans.

**Services Segment Revenues by Market Sector**

The Services business segment provides construction management and maintenance services to clients in a number of markets that are also served by our other business units. Customer focus, attention to highly productive delivery, and a diverse market presence we believe are the keys to our success in delivering construction and maintenance services. Accordingly, the Services business segment focuses on these key success factors. The analysis below is supplementally provided to present the revenue generated by the Services segment based on the markets served, some of which are the same sectors served by our other business segments. The perspective highlights the markets served by our Services segment.

<i>(in millions)</i>	Year Ending December 31, 2010		
	Business Unit Revenue	Services Revenue	Total Revenue by Market Sectors
<b>Hydrocarbons business segment:</b>			
Gas Monetization	\$ 2,829	\$	\$ 2,829
Oil & Gas	426	297	723
Downstream	584	534	1,118
Technology	130		130
Total Hydrocarbons business segment revenue	3,969	831	4,800
<b>Infrastructure, Government and Power ( IGP ):</b>			
North America Government and Defense	3,307	97	3,404
International Government and Defence	369		369
Infrastructure and Minerals	271		271
Power and Industrial	352	827	1,179
Total IGP business segment revenue	4,299	924	5,223

Edgar Filing: KBR, INC. - Form 10-K

Services	1,755	(1,755)	
Other	76		76
<b>Total KBR Revenue</b>	<b>\$ 10,099</b>	<b>\$</b>	<b>\$ 10,099</b>

**Table of Contents**

<i>(in millions)</i>	Year Ending December 31, 2009		
	Business		Total
	Unit	Services	Revenue by
	Revenue	Revenue	Market
			Sectors
<b>Hydrocarbons business segment:</b>			
Gas Monetization	\$ 2,755	\$	\$ 2,755
Oil & Gas	576	337	913
Downstream	478	538	1,016
Technology	97		97
Total Hydrocarbons business segment revenue	3,906	875	4,781
<b>Infrastructure, Government and Power ( IGP ):</b>			
North America Government and Defense	5,189	59	5,248
International Government and Defence	288		288
Infrastructure and Minerals	337		337
Power and Industrial	474	929	1,403
Total IGP business segment revenue	6,288	988	7,276
Services	1,863	(1,863)	
Other	48		48
<b>Total KBR Revenue</b>	<b>\$ 12,105</b>	<b>\$</b>	<b>\$ 12,105</b>

<i>(in millions)</i>	Year Ending December 31, 2008		
	Business		Total
	Unit	Services	Revenue by
	Revenue	Revenue	Market
			Sectors
<b>Hydrocarbons business segment:</b>			
Gas Monetization	\$ 2,156	\$	\$ 2,156
Oil & Gas	526	206	732
Downstream	484	323	807
Technology	84		84
Total Hydrocarbons business segment revenue	3,250	529	3,779
<b>Infrastructure, Government and Power ( IGP ):</b>			
North America Government and Defense	6,027	53	6,080
International Government and Defence	421		421
Infrastructure and Minerals	431		431
Power and Industrial	244	606	850
Total IGP business segment revenue	7,123	659	7,782

Edgar Filing: KBR, INC. - Form 10-K

Services	1,188	(1,188)	
Other	20		20
<b>Total KBR Revenue</b>	\$ 11,581	\$	\$ 11,581

*Non-operating items*

Net interest expense was \$17 million and \$1 million for the year ended December 31, 2010 and 2009, respectively. Net interest income was \$35 million for the year ended December 31, 2008. Gross interest expense was \$23 million in 2010, \$5 million in 2009 and \$2 million in 2008. Interest expense increased in 2010 primarily as a result of increased commitment fees paid under the terms of our new credit facility, increased rates associated with outstanding performance-related and financial-related issued letters of credit, and fees paid to Halliburton for guarantees provided to us for various financial commitments. Additionally, interest expense recognized in 2010 on non-recourse project-finance debt was \$7 million higher due to the consolidation of Fasttrax Limited effective January 1, 2010.

The significant decline in interest income in 2009 was a result of the decrease in our average interest rates earned and our average cash and equivalents balance. Average interest rates earned on our invested cash declined as a result of the

**Table of Contents**

current economic recession that began in late 2008 combined with a decline in our cash and equivalents which is generally invested in either time deposits with commercial banks or money market funds. The decrease in our average cash and equivalents balance from 2008 to 2009 is attributable to the acquisition of BE&K on July 1, 2008 with a purchase price of approximately \$559 million, the use of cash in joint venture projects and a contract in progress, working capital requirements for our Iraq related work and total cumulative stock repurchases.

Provision for income taxes was \$191 million, \$168 million, and \$212 million for the years ended December 31, 2010, 2009, and 2008, respectively. Our effective tax rate was 32.6%, 31.5%, and 37% for the years ended December 31, 2010, 2009, and 2008, respectively. Our U.S. statutory tax rate for all years is 35%. Our effective tax rate for the year ended December 31, 2010 was lower than our statutory rate of 35% primarily due to favorable rate differentials on foreign earnings, benefits associated with income from unincorporated joint ventures and several favorable discrete tax items including the true-up of prior year U.S. income taxes and utilization of additional U.S. foreign tax credits during 2010. Our effective tax rate for 2009 was lower than our statutory rate of 35% primarily due to favorable rate differentials on foreign earnings compared to the U.S. tax rate, the favorable final determination of previously estimated 2008 domestic and foreign taxable income made in connection with the preparation and filing of our 2008 consolidated tax returns and the benefit associated with income on unincorporated joint ventures. Our effective tax rate for 2008 exceeded our statutory rate primarily due to certain dividends from foreign affiliates, the non-deductible fine resulting from our settlement of the FCPA investigation in Nigeria and domestic state taxes. For the year ended December 31, 2008, our valuation allowance was reduced from \$33 million to \$19 million primarily as a result of utilizing foreign branch net operating losses for which a valuation allowance had been previously established in prior years.

Income from discontinued operations was zero for the years ended December 31, 2010 and 2009, and \$11 million for the year ended December 31, 2008. Discontinued operations primarily represent revenues and gain on the sale of our 51% interest in DML in June 2007. In 2008, we recognized a tax benefit of \$11 million related to foreign tax credits upon completion of a tax pool study related to DML.

**Backlog**

Backlog represents the dollar amount of revenue we expect to realize in the future as a result of performing work on contracts awarded and in progress. We generally include total expected revenue in backlog when a contract is awarded and/or the scope is definitized. For long-term contracts, the amount included in backlog is limited to five years. In many instances, arrangements included in backlog are complex, nonrepetitive in nature, and may fluctuate depending on expected revenue and timing. Where contract duration is indefinite, projects included in backlog are limited to the estimated amount of expected revenue within the following twelve months. Certain contracts provide maximum dollar limits, with actual authorization to perform work under the contract being agreed upon on a periodic basis with the customer. In these arrangements, only the amounts authorized are included in backlog. For projects where we act solely in a project management capacity, we only include our management fee revenue of each project in backlog.

For our projects related to unconsolidated joint ventures, we have included in the table below our percentage ownership of the joint ventures revenue in backlog. However, because these projects are accounted for under the equity method, only our share of future earnings from these projects will be recorded in our revenue. Our backlog for projects related to unconsolidated joint ventures totaled \$1.7 billion at December 31, 2010 and \$2.1 billion at December 31, 2009. We also consolidate joint ventures which are majority-owned and controlled or are variable interest entities in which we are the primary beneficiary. Our backlog included in the table below for projects related to consolidated joint ventures with noncontrolling interests includes 100% of the backlog associated with those joint ventures and totaled \$4.4 billion at December 31, 2010 and \$4.6 billion at December 31, 2009.

**Table of Contents****Backlog (1)**

(in millions)	December 31,	
	2010	2009
<b>Hydrocarbons:</b>		
Gas Monetization	\$ 5,509	\$ 6,976
Oil & Gas	325	109
Downstream	525	535
Technology	201	154
<b>Total Hydrocarbons backlog</b>	<b>\$ 6,560</b>	<b>\$ 7,774</b>
<b>Infrastructure, Government and Power ( IGP ):</b>		
North America Government and Defense	1,043	1,341
International Government and Defence	1,223	1,427
Infrastructure and Minerals	446	167
Power and Industrial	177	338
<b>Total IGP backlog</b>	<b>\$ 2,889</b>	<b>\$ 3,273</b>
<b>Services</b>	<b>1,771</b>	<b>2,302</b>
<b>Ventures</b>	<b>821</b>	<b>749</b>
<b>Total backlog for continuing operations</b>	<b>\$ 12,041</b>	<b>\$ 14,098</b>

(1) All backlog is attributable to firm orders as of December 31, 2010 and 2009. Backlog attributable to unfunded government orders was \$137 million at December 31, 2010 and \$326 million as of December 31, 2009.

We estimate that as of December 31, 2010, 55% of our backlog will be executed within one year. As of December 31, 2010, 21% of our backlog was attributable to fixed-price contracts and 79% was attributable to cost-reimbursable contracts. For contracts that contain both fixed-price and cost-reimbursable components, we classify the components as either fixed-price or cost-reimbursable according to the composition of the contract except for smaller contracts where we characterize the entire contract based on the predominant component.

Hydrocarbons backlog declined approximately \$1.2 billion primarily because of a decline in Gas Monetization backlog of approximately \$1.5 billion due to work performed on the Gorgon LNG, Skikda LNG, Pearl GTL and other projects and with no new significant awards in 2010. These declines were partially offset by new awards of \$495 million in our Oil & Gas and Technology business unit which was partially offset by \$232 million of work performed on existing projects in our Oil & Gas business unit as well as certain ammonia and refining projects in our Technology business unit.

IGP Backlog decreased by \$384 million primarily as a result of work performed on existing projects of approximately \$1 billion which were partially offset by new awards of \$654 million primarily in North America Government and Defense and International Government and Defense as well as the acquisition of Roberts & Schafer which contributed approximately \$214 million to the increase in I&M backlog. Work performed in our North America Government and Defense was approximately \$485 million in 2010, primarily related to our LogCAP III and other support projects partially offset by new awards of \$187 million on our LogCAP IV and other projects. International Government and Defence work performed totaled \$433 million primarily related to Allenby and Connaught, CONLOG, Afghanistan ISP and TDA projects, which was partially offset by new awards in 2010, primarily from the NAMSAs projects for the U.K. MoD.

Services backlog declined \$531 million primarily due to work performed of approximately \$1.1 billion on various construction projects in the U.S. and Canada. These declines were partially offset by new awards of approximately \$593 million which include major awards in our Building Group and Industrial Services product lines.





## Table of Contents

### **Liquidity and Capital Resources**

Our operating cash flow can vary significantly from year to year and are affected by the mix, terms and percentage of completion of our engineering and construction projects. We often receive cash through advanced billings to our customers on our larger engineering and construction projects and those of our consolidated joint ventures. Joint venture cash balances are limited to joint venture activities and are not available for use on other projects, general cash needs or distributions to us without approval of the board of directors of the respective joint ventures. As client cash advances are used in execution of the project, they are recovered through regular or milestone billings to the customer. To the extent our net investment in the operating assets of a project is greater than available project cash balance, we may utilize other cash on hand or availability under our Revolving Credit Facility to satisfy any periodic operating cash requirements.

Engineering and construction projects generally require us to provide credit enhancements to our customers including letters of credit, surety bonds or guarantees. Our ability to obtain new project awards in the future may be dependent on our ability to maintain our letter of credit and surety bonding capacity and the timely release of existing letters of credit and surety bonds. As the need arises, future projects will be supported by letters of credit issued under our Revolving Credit Facility or arranged with our banks on a bilateral basis. We believe we have adequate letter of credit capacity under our existing Revolving Credit Facility and bilateral lines of credit to support our operations for the next twelve months. Additionally, we believe our current surety bond capacity is adequate to support our current backlog of projects for the next twelve months.

Cash and equivalents totaled \$786 million at December 31, 2010 and \$941 million at December 31, 2009, which included \$136 million and \$236 million, respectively, of cash held by our joint ventures that we consolidate for accounting purposes. Joint venture cash balances are limited to joint venture activities and are not available for use on other projects, general cash needs or distributions to us without approval of the board of directors of the respective joint ventures and we expect to use the cash to pay project costs.

As of December 31, 2010, we had restricted cash of \$21 million related to the amounts held in deposit with certain banks to collateralize standby letters of credit, of which \$11 million is included in Other current assets and \$10 million is included in Other assets in the accompanying consolidated financial statements.

Our excess cash is generally invested in either time deposits with commercial banks with an Individual Rating of B or better by Fitch or money market funds governed under rule 2a-7 of the U.S. Investment Company Act of 1940 and rated AAA by Standard & Poor's or Aaa by Moody's Investors Service, respectively. As of December 31, 2010, substantially all of our excess cash is held in time deposits with commercial banks with the primary objectives of preserving capital and maintaining liquidity.

We generally do not provide U.S. federal and state income taxes on the accumulated but undistributed earnings of non-United States subsidiaries except for certain entities in Mexico and certain other joint ventures. Taxes are provided as necessary with respect to earnings that are considered not permanently reinvested. For all other non-U.S. subsidiaries, no U.S. taxes are provided because such earnings are intended to be reinvested indefinitely to finance foreign activities. These accumulated but undistributed foreign earnings could be subject to additional tax if remitted, or deemed remitted, as a dividend. Determination of the amount of unrecognized deferred U.S. income tax liability is not practicable; however, the potential foreign tax credit associated with the deferred income would be available to reduce the resulting U.S. tax liabilities.

#### *Revolving Credit Facility*

On November 3, 2009, we entered into a syndicated, unsecured \$1.1 billion three-year revolving credit agreement (the Revolving Credit Facility), with Citibank, N.A., as agent, and a group of banks and institutional lenders replacing the Prior Revolving Credit Facility, which was terminated at the same time as the closing of the Revolving Credit Facility. The Revolving Credit Facility is used for working capital and letters of credit for general corporate purposes and expires in November 2012. While there is no sub-limit for letters of credit under this facility, letters of credit fronting commitments at December 31, 2009 totaled \$830 million and was expanded in January 2010 to \$880 million, which we would seek to expand if necessary. Amounts drawn under the Revolving Credit Facility bear interest at variable rates based either on the London interbank offered rate (LIBOR) plus 3%, or a base rate plus 2%, with the base rate being equal to the highest of reference bank's publicly announced base rate, the Federal Funds Rate plus 0.5%, or LIBOR plus 1%. The Revolving Credit Facility provides for fees on the letters of credit issued under the Revolving Credit Facility of 1.5% for performance and commercial letters of credit and 3% for all others. We are also charged an issuance fee of 0.05% for the issuance of letters of credit, a per annum commitment fee of 0.625% for any unused portion of the credit line, and a per annum fronting commitment fee of 0.25%. As of December 31, 2010, there were no outstanding borrowings/cash drawings and \$278 million in letters of credit

---

**Table of Contents**

issued and outstanding under the Revolving Credit Facility.

The Revolving Credit Facility includes financial covenants requiring maintenance of a ratio of consolidated debt to consolidated EBITDA of 3.5 to 1 and a minimum consolidated net worth of \$2 billion plus 50% of consolidated net income for each quarter ending after September 30, 2009 plus 100% of any increase in shareholders' equity attributable to the sale of equity securities. At December 31, 2010, we were in compliance with these ratios and other covenants mentioned below.

The Revolving Credit Facility contains a number of covenants restricting, among other things, our ability to incur additional liens and sales of our assets, as well as limiting the amount of investments we can make. The Revolving Credit Facility also permits us, among other things, to declare and pay shareholder dividends and/or engage in equity repurchases not to exceed \$400 million in the aggregate during the term of the facility and to incur indebtedness in respect of purchase money obligations, capitalized leases and refinancing or renewals secured by liens upon or in property acquired, constructed or improved in an aggregate principal amount not to exceed \$200 million. Our subsidiaries may incur unsecured indebtedness not to exceed \$100 million in aggregate outstanding principal amount at any time.

*Nonrecourse Project Finance Debt*

Fastrax Limited, a joint venture in which we indirectly own a 50% equity interest with an unrelated partner, was awarded a contract in 2001 with the U.K. MoD to provide a fleet of 92 heavy equipment transporters ( HETs ) to the British Army. Under the terms of the arrangement, Fastrax Limited operates and maintains the HET fleet for a term of 22 years. The purchase of the HETs by the joint venture was financed through a series of bonds secured by the assets of Fastrax Limited totaling approximately £84.9 million and are non-recourse to KBR and its partner of which £12.2 million provided equity bridge financing. The bridge financing was replaced in 2005 with combined equity capital contributions and subordinated loans from the joint venture partners. The bonds are guaranteed by Ambac Assurance UK Ltd under a policy that guarantees the schedule of the principle and interest payments to the bond trustee in the event of non-payment by Fastrax Limited.

The guaranteed secured bonds were issued in two classes consisting of Class A 3.5% Index Linked Bonds in the amount of £56 million and Class B 5.9% Fixed Rate Bonds in the amount of £16.7 million. Payments on both classes of bonds commenced in March 2005 and are due in semi-annual installments over the term of the bonds which end in 2021. Subordinated notes payable to our 50% partner initially bear interest at 11.25% increasing to 16% over the term of the note through 2025. Payments on the subordinated debt commenced in March 2006 and are due in semi-annual installments over the term of the note.

The combined principal installments for both classes of bonds and subordinated notes, including inflation adjusted bond indexation, due for the years ended December 31, 2010, 2011 and 2012 and thereafter total approximately £6 million, £6 million, £6 million and £61 million, respectively. For additional information see Note 15 of our consolidated financial statements.

Since the inception of the project, we accounted for our investment in the project entity using the equity method of accounting. As a result of the adoption of Accounting Standards Update No. 2009-17 Consolidation (Topic 810) Improvements to Financial Reporting by Enterprises with Variable Interest Entities, effective January 1, 2010 we concluded that we are the primary beneficiary of Fastrax Limited because we control the activities that most significantly impact the economic performance of the entity. We applied the requirements of FASB ASC 810 on a prospective basis from the date of adoption. As such, our consolidated financial statements for 2010 include the accounts of Fastrax Limited and accordingly, the cash and equivalents, property, plant and equipment, and the non-recourse project financing debt. The secured bonds are an obligation of Fastrax Limited and will never be a debt obligation of KBR because they are non-recourse to the joint venture partners. Accordingly, in the event of a default on the term loan, the lenders may only look to the resources of Fastrax Limited for repayment.

**Table of Contents***Cash flow activities summary*

Cash flow activities	Years Ended December 31,		
	2010	2009	2008
	(In millions)		
Cash flows provided by (used in) operating activities	\$ 549	\$ (36)	\$ 124
Cash flows used in investing activities	(397)	(9)	(556)
Cash flows used in financing activities	(336)	(166)	(244)
Effect of exchange rate changes on cash	7	7	(40)
Decrease in cash and equivalents	(177)	(204)	(716)
Cash increase due to consolidation of a variable interest entity	22		
Net decrease in cash and equivalents	\$ (155)	\$ (204)	\$ (716)

*Operating activities.* Cash provided by operations totaled \$549 million in 2010, compared to cash used by operations of \$36 million in 2009. Of this, approximately \$93 million represented distributions of earnings from our unconsolidated joint ventures and \$116 million represented advances from our clients. Cash provided by operating activities during 2010 was primarily driven by strong overall earnings, cash cycle improvements, and active management of working capital to support project execution activities. On a consolidated basis, working capital, excluding cash, decreased by approximately \$280 million during the year, which included a \$180 million current obligation payable to JGC for its 44.94% interest in MWKL. Cash held by joint ventures that we consolidate for accounting purposes decreased by approximately \$100 million.

Cash used in operating activities was \$36 million in 2009, compared to cash provided by operating activities of \$124 million in 2008. Net income in 2009 included a non-cash gain of approximately \$117 million, net of tax, related to the favorable award on the EPC 1 project arbitration.

Cash provided by operating activities of \$124 million for the year ended December 31, 2008 included payments from PEMEX related to the EPC 22 and EPC 28 arbitration awards totaling \$185 million and \$121 million in dividends from unconsolidated joint ventures. In addition, working capital requirements for our Iraq-related work decreased from \$239 at December 31, 2007 to \$76 at December 31, 2008, generating cash of approximately \$163 million. Offsetting these cash increases were decreases in cash of approximately \$342 million on our consolidated joint venture projects and a contract in progress. We also made contributions to our international and domestic pension plans of \$74 million during 2008.

*Investing activities.* Cash used in investing activities for 2010 totaled \$397 million compared to \$9 million during 2009. Cash used in investing activities was primarily related to the net cash paid of approximately \$299 million for the acquisition of R&S and Energo Engineering. Capital expenditures were \$66 million in 2010. During 2010, we paid \$20 million for the exclusive right to certain technology under a 25-year licensing arrangement. We also made investments totaling \$12 million in several equity method joint ventures.

Cash used in investing activities for 2009 totaled \$9 million compared to \$556 million during 2008. The decline in cash used in investing activities was due to lower business acquisition activity in 2009 compared to 2008. We acquired BE&K in July 2008 for \$494 million, net of cash acquired and post closing purchase price adjustments. In 2008, we also acquired TGI, Catalyst Interactive and Wabi Development Corporation for a combined purchase price of approximately \$32 million, net of cash received. Capital expenditures were \$41 million and \$37 million for the years ended December 31, 2009 and 2008 respectively. In 2009, we received proceeds of approximately \$32 million primarily from one of our joint ventures that executed a pro-rata share repurchase transaction, which partially offset our 2009 capital expenditures.

*Financing activities.* Cash used in financing activities for 2010 totaled \$336 million and included \$233 million of payments to repurchase approximately 10 million shares of our common stock, \$91 million related to distributions to noncontrolling interests of several of our consolidated joint ventures, and \$32 million related to dividend payments to shareholders. These payments were partially offset by return of cash used to collateralize standby letters of credit of approximately \$28 million.

## Edgar Filing: KBR, INC. - Form 10-K

Cash used in financing activities was \$166 million for the year ended December 31, 2009 and included \$54 million for distributions to noncontrolling interests of several of our consolidated joint ventures, \$32 million related to dividend payments to our shareholders and \$31 million for payments to reacquire 2 million shares of our common stock. Additionally, our financing activities included \$44 million related to the net cash collateralization of our standby letters of credit in accordance with certain agreements.

Cash used in financing activities for the year ended December 31, 2008 totaled \$244 million which was almost entirely

---

**Table of Contents**

related to \$196 million of payments to reacquire 8.4 million shares of our common stock and \$53 million related to dividend payments to our shareholders and to minority shareholders of several of our consolidated joint ventures.

*Future sources of cash.* Future sources of cash include cash flows from operations, including cash advances from our clients and cash derived from further cash cycle improvements, and advances under our Revolving Credit Facility.

*Future uses of cash.* Future uses of cash will primarily relate to working capital requirements and acquisitions. In addition, we will use cash to fund capital expenditures, pension obligations, operating leases, cash dividends, share repurchases and various other obligations as they arise. Our capital expenditures will be focused primarily on information technology, real estate and equipment/facilities. See *Off balance sheet arrangements commitments and other contractual obligations* below for a schedule of contractual obligations and other long-term liabilities that will require the use of cash.

***Off balance sheet arrangements***

*Letters of credit, surety bonds and bank guarantees.* In connection with certain projects, we are required to provide letters of credit or surety bonds to our customers. Letters of credit are provided to customers in the ordinary course of business to guarantee advance payments from certain customers, support future joint venture funding commitments and to provide performance and completion guarantees on engineering and construction contracts. We have \$1.9 billion in committed and uncommitted lines of credit to support letters of credit and as of December 31, 2010, and we had utilized \$623 million of our credit capacity, including \$37 million in letters of credit issued and outstanding under various facilities that are irrevocably and unconditionally guaranteed by Halliburton. Surety bonds are also posted under the terms of certain contracts primarily related to state and local government projects to guarantee our performance.

The \$623 million in letters of credit outstanding on KBR lines of credit was comprised of \$278 million issued under our Revolving Credit Facility and \$345 million issued under uncommitted bank lines at December 31, 2010. Of the total letters of credit outstanding, \$274 relate to our joint venture operations and \$22 million of the letters of credit have terms that could entitle a bank to require additional cash collateralization on demand. Approximately \$182 million of the \$278 million letters of credit issued under our Revolving Credit Facility have expiry dates close to or beyond the maturity date of the facility. Under the terms of the Revolving Credit Facility, if the original maturity date of November 2, 2012 is not extended then the issuing banks may require that we provide cash collateral for these extended letters of credit no later than 95 days prior to the original maturity date. As the need arises, future projects will be supported by letters of credit issued under our Revolving Credit Facility or arranged on a bilateral basis. We believe we have adequate letter of credit capacity under our existing Revolving Credit Facility and bilateral lines of credit to support our operations for the next twelve months.

Halliburton has guaranteed certain letters of credit and surety bonds and provided parent company guarantees primarily related to the performance and financial commitments on the Allenby and Connaught project. We expect to cancel these letters of credit and surety bonds as we complete the underlying projects. Since the separation from Halliburton, we have arranged lines with multiple surety companies for our own standalone capacity. Since the arrangement of this stand alone capacity, we have been sourcing surety bonds from our own capacity without additional Halliburton credit support.

We agreed to pay Halliburton a quarterly carry charge, which has increased in accordance with our extension provisions, for its guarantees of our outstanding letters of credit and surety bonds and agreed to indemnify Halliburton for all losses in connection with the outstanding credit support instruments and any new credit support instruments relating to our business for which Halliburton may become obligated. In 2010, we reduced the amount of letters of credit outstanding under Halliburton facilities from \$289 million to \$37 million primarily through transfers to existing uncommitted bank lines of KBR. During 2009 we paid an annual fee to Halliburton calculated at 0.40% of the outstanding performance-related letters of credit, 0.80% of the outstanding financial-related letters of credit guaranteed by Halliburton and 0.25% of the outstanding guaranteed surety bonds. Effective January 1, 2010, the annual fee increased to 0.90%, 1.65% and 0.50% of the outstanding performance-related and financial-related outstanding issued letters of credit and the outstanding guaranteed surety bonds, respectively.

The current capacity of our Revolving Credit Facility is adequate for us to issue letters of credit necessary to replace all outstanding letters of credit issued under the various Halliburton facilities or those guaranteed by Halliburton and issue letters of credit for projects that we are currently pursuing should they be awarded to us.

**Table of Contents**

*Commitments and other contractual obligations.* The following table summarizes our significant contractual obligations and other long-term liabilities as of December 31, 2010:

<i>Millions of dollars</i>	Payments Due						Total
	2011	2012	2013	2014	2015	Thereafter	
Obligation to former noncontrolling interest (a)	\$180	\$	\$	\$	\$	\$	\$180
Operating leases	69	59	55	53	51	508	795
Purchase obligations(b)	49	14	13	7			83
Pension funding obligation (c)	68	24	20	19	19	140	290
<b>Total (d)</b>	<b>\$366</b>	<b>\$97</b>	<b>\$88</b>	<b>\$79</b>	<b>\$70</b>	<b>\$648</b>	<b>\$1,348</b>

- (a) Represents our obligation to a former noncontrolling interest for the acquisition of the remaining 44.94% interest in MWKL.
- (b) The purchase obligations disclosed above do not include purchase obligations that we enter into with vendors in the normal course of business that support existing contracting arrangements with our customers. The purchase obligations with our vendors can span several years depending on the duration of the projects. In general, the costs associated with those purchase obligations are expensed to correspond with the revenue earned on the related projects.
- (c) The pension funding obligation comprised of payments related to our agreement with the trustees of one of our international plans to contribute £34 million over a 10-year period beginning in 2010 at an annual rate of approximately £5.5 million during the first three years and £2.5 million thereafter. In addition, during the fourth quarter of 2010, we agreed with the trustees of another international plan to contribute £25 million by January 31, 2011, and £130 million over a 13-year period beginning in 2011 at an annual rate of £10 million. The foreign pension funding obligations were converted to U.S. dollars using the conversion rate as of December 31, 2010.
- (d) Uncertain tax positions recorded pursuant to FASB ASC 740 Income Taxes were \$95 million, excluding \$23 million in interest and penalties. The ultimate timing of when these obligations will be settled cannot be determined with reasonable assurance and have been excluded from the table above. Refer to Note 11 in our consolidated financial statements.

The table above does not include our consolidated non-recourse project-finance debt of a VIE of \$101 million. See Note 15 for additional information.

*Lease obligations.* In February 2010, we executed two lease amendments for office space in two separate high-rise office buildings in Houston, Texas for the purpose of significantly expanding our current leased office space and to extend the original term of these leases to June 30, 2030. In the third quarter of 2010, we executed an additional lease agreement for office space located in an office building in Houston, Texas for the purpose of expanding our leased office space. The non-cancelable lease term expires on December 31, 2018.

*Other obligations.* We had commitments to provide funds to our privately financed projects of \$33 million as of December 31, 2010 primarily related to future equity funding on our Allenby and Connaught project. Our commitments to fund our privately financed projects are supported by letters of credit as described above. At December 31, 2010, approximately \$17 million of the \$33 million in commitments will become due within one year.

We have an obligation to fund estimated losses on our uncompleted contracts which totaled \$26 million at December 31, 2010. Approximately \$24 million of this amount relates to our Escravos project, the majority of which is expected to be funded in 2011.

*Other factors affecting liquidity*

*Government claims.* Included in receivables in our balance sheets are unapproved claims for costs incurred under various government contracts totaling \$163 million at December 31, 2010 of which \$125 million is included in Account receivable and \$38 million is included in Unbilled receivables on uncompleted contracts. Unapproved claims relate to contracts where our costs have exceeded the customer's funded value of the task order. The unapproved claims at December 31, 2010 include approximately \$123 million resulting from the de-obligation of 2004 and 2005 funding on certain task orders that were also subject to Form 1 notices relating to certain DCAA audit issues discussed above. This balance includes \$71 million that was de-obligated in 2010 which consists of funds nearing the 5-year expiration date. We believe such

---

## **Table of Contents**

disputed costs will be resolved in our favor at which time the customer will be required to obligate funds from appropriations for the year in which resolution occurs. The remaining unapproved claims balance of approximately \$40 million represents primarily costs for which incremental funding is pending in the normal course of business. The majority of costs in this category are normally funded within several months after the costs are incurred. The unapproved claims outstanding at December 31, 2010 are considered to be probable of collection and have been previously recognized as revenue.

*Liquidated damages.* Many of our engineering and construction contracts have milestone due dates that must be met or we may be subject to penalties for liquidated damages if claims are asserted and we were responsible for the delays. These generally relate to specified activities that must be met within a project by a set contractual date or achievement of a specified level of output or throughput of a plant we construct. Each contract defines the conditions under which a customer may make a claim for liquidated damages. However, in many instances, liquidated damages are not asserted by the customer, but the potential to do so is used in negotiating claims and closing out the contract.

Based upon our evaluation of our performance and other legal analysis, we have not accrued for possible liquidated damages related to several projects, totaling \$20 million at December 31, 2010 (including amounts related to our share of unconsolidated subsidiaries), that we could incur based upon completing the projects as currently forecasted.

*Halliburton indemnities.* Halliburton has agreed to indemnify us and certain of our greater than 50%-owned subsidiaries for fines or other monetary penalties or direct monetary damages, including disgorgement, as a result of claims made or assessed against us by U.S. and certain foreign governmental authorities or a settlement thereof, relating to investigations under the FCPA or analogous applicable foreign statutes related investigations with respect to the construction and subsequent expansion by TSKJ of a natural gas liquefaction complex in Nigeria. Halliburton has also agreed to indemnify us for out-of-pocket cash costs and expenses, or cash settlement or cash arbitration awards in lieu thereof, we may incur as a result of the replacement of certain subsea flow-line bolts installed in connection with the Barracuda-Caratinga project. See Note 10 to our Condensed Consolidated Financial Statements for further discussion.

In February 2009, one of our subsidiaries pled guilty to violating and conspiring to violate the FCPA arising from the intent to bribe various Nigerian officials through commissions paid to agents working on behalf of TSKJ. The terms of the plea agreement with the DOJ called for the payment of a criminal penalty of \$402 million, of which Halliburton was obligated to pay \$382 million under the terms of the indemnity while we were obligated to pay \$20 million in quarterly payments over a two-year period ending October 2010. We also agreed to a judgment by the SEC requiring, Halliburton and us, jointly and severally, to make payments totaling \$177 million, all of which were paid by Halliburton under the terms of the indemnity. As of December 31, 2010 Halliburton has paid all installments to the DOJ and SEC, and such payments totaled \$559 million. Of the \$559 million in total payments, Halliburton paid \$142 million in 2010 and \$417 million in 2009, which have been reflected in the accompanying statement of cash flows as noncash operating activities. On October 1, 2010, we made the final payment to the DOJ related to our portion of the settlement agreement.

### **Financial Instruments Market Risk**

We invest excess cash and equivalents in short-term securities, primarily overnight time deposits, which carry a fixed rate of return per a given tenor. Additionally, a substantial portion of our cash balances are maintained in foreign countries.

We have foreign currency exchange rate risk resulting from our international operations. We do not comprehensively hedge the exposure to currency rate changes; however, we selectively manage these exposures through the use of derivative instruments to mitigate our market risk from these exposures. The objective of our risk management program is to protect our cash flows related to sales or purchases of goods and services from market fluctuations in currency rates. We do not use derivative instruments for speculative trading purposes. We generally utilize currency options and forward exchange contracts to hedge foreign currency transactions entered into in the ordinary course of business. As of December 31, 2010, we had forward foreign exchange contracts of up to 41 months in duration to exchange major world currencies. The total gross notional amount of these contracts at December 31, 2010, 2009 and 2008 was \$403 million, \$406 million, and \$274 million, respectively. These contracts had fair value asset of \$6 million and \$3 million at December 31, 2010 and 2009, and fair value liability of approximately \$1 million at December 31, 2008.



## Table of Contents

### Transactions with Former Parent

In connection with our initial public offering in November 2006 and the separation of our business from Halliburton, we entered into various agreements, including, among others, a master separation agreement, transition services agreements and a tax sharing agreement. Pursuant to our master separation agreement, we agreed to indemnify Halliburton for, among other matters, all past, present and future liabilities related to our business and operations. We agreed to indemnify Halliburton for liabilities under various outstanding and certain additional credit support instruments relating to our businesses and for liabilities under litigation matters related to our business. Halliburton agreed to indemnify us for, among other things, liabilities unrelated to our business, for certain other agreed matters relating to the investigation of FCPA and related corruption allegations and the Barracuda-Caratinga project and for other litigation matters related to Halliburton's business. See *MD&A Legal Proceedings* for further discussion of matters related to the investigation of FCPA and related corruption allegations and the Barracuda-Caratinga project arbitration. Under the transition services agreements, Halliburton provided various interim corporate support services to us and we provided various interim corporate support services to Halliburton. The tax sharing agreement provides for certain allocations of U.S. income tax liabilities and other agreements between us and Halliburton with respect to tax matters.

At December 31, 2010 and 2009, KBR had a \$43 million and a \$53 million balance payable to Halliburton, respectively, which consists of amounts KBR owes Halliburton primarily for estimated outstanding income taxes under the tax sharing agreement. See Note 11 for further discussion of amounts outstanding under the tax sharing agreement.

### Transactions with Joint Ventures

We perform many of our projects through incorporated and unincorporated joint ventures. In addition to participating as a joint venture partner, we often provide engineering, procurement, construction, operations or maintenance services to the joint venture as a subcontractor. Where we provide services to a joint venture that we control and therefore consolidate for financial reporting purposes, we eliminate intercompany revenues and expenses on such transactions. In situations where we account for our interest in the joint venture under the equity method of accounting, we do not eliminate any portion of our revenues or expenses. We recognize the profit on our services provided to joint ventures that we consolidate and joint ventures that we record under the equity method of accounting primarily using the percentage-of-completion method.

Our total revenue and profit from services provided to our unconsolidated joint ventures recorded in our consolidated statements of income is presented in the table below:

<i>Millions of dollars</i>	December 31,		
	2010	2009	2008
Revenue from services provided to unconsolidated joint ventures	\$ 145	\$ 166	\$ 202
Profit from services provided to unconsolidated joint ventures	\$ 12	\$ 1	\$ 28

### Recent Accounting Pronouncements

Information related to new accounting standards is described in Note 18 to the condensed consolidated financial statements.

---

## **Table of Contents**

### **U.S. Government Matters**

#### *Award fees*

In accordance with the provisions of the LogCAP III contract, we earn profits on our services rendered based on a combination of a fixed fee plus award fees granted by our customer. Both fees are measured as a percentage rate applied to estimated and negotiated costs. Our customer is contractually obligated to periodically convene Award-Fee Boards, which are comprised of individuals who have been designated to assist the Award Fee Determining Official ( AFDO ) in making award fee determinations. Award fees are based on evaluations of our performance using criteria set forth in the contract, which include non-binding monthly evaluations made by our customers in the field of operations. Although these criteria have historically been used by the Award-Fee Boards in reaching their recommendations, the amounts of award fees are determined at the sole discretion of the AFDO.

On February 19, 2010, KBR was notified by the AFDO that a determination had been made regarding the Company's performance for the period January 2008 to April 2008 in Iraq. The notice stated that based on information received from various Department of Defense individuals and organizations after the date of the evaluation board held in June 2008, the AFDO made a unilateral decision to grant no award fees for the period of performance from January 2008 to April 2008.

As a result of the AFDO's adverse determination, in the fourth quarter of 2009, we reversed award fees that had previously been estimated as earned and recognized as revenue. Until we are able to reliably estimate fees to be awarded in the future, we will recognize award fees on the LogCAP III contract in the period they are awarded. In May 2010, we recognized an award fee of approximately \$60 million representing approximately 47% of the available award fee pool for the period of performance from May 2008 through August 2009 which we recorded as an increase to revenue in the second quarter of 2010. In September 2010, we recognized an award fee of approximately \$34 million representing approximately 66% of the available award fee pool for the period of performance from September 2009 through February 2010 on task orders in Iraq and from September 2009 through May 2010 on task orders in Afghanistan, which we recorded as an increase to revenue in the third quarter of 2010. We expect to receive award notifications for the subsequent performance periods through August 2010 in the first quarter of 2011.

Prior to the fourth quarter of 2009, we recognized award fees on the LogCAP III contract using an estimated accrual of the amounts to be awarded. Once task orders underlying the work are definitized and award fees are granted, we adjusted our estimate of award fees to the actual amounts earned. We used 72% as our accrual rate through the third quarter of 2009.

#### *Government Compliance Matters*

The negotiation, administration, and settlement of our contracts with the U.S. Government, consisting primarily of Department of Defense contracts, are subject to audit by the Defense Contract Audit Agency ( DCAA ), which serves in an advisory role to the Defense Contract Management Agency ( DCMA ) which is responsible for the administration of our contracts. The scope of these audits include, among other things, the allowability, allocability, and reasonableness of incurred costs, approval of annual overhead rates, compliance with the Federal Acquisition Regulation ( FAR ) and Cost Accounting Standard ( CAS ) Regulations, compliance with certain unique contract clauses, and audits of certain aspects of our internal control systems. Issues identified during these audits are typically discussed and reviewed with us, and certain matters are included in audit reports issued by the DCAA, with its recommendations to our customer's administrative contracting officer. We attempt to resolve all issues identified in audit reports by working directly with the DCAA and the administrative contracting officer ( ACO ). When agreement cannot be reached, DCAA may issue a Form 1, Notice of Contract Costs Suspended and/or Disapproved, which recommends withholding the previously paid amounts or it may issue an advisory report to the ACO. KBR is permitted to respond to these documents and provide additional support. At December 31, 2010, we had open Form 1's from the DCAA recommending suspension of payments totaling approximately \$319 million associated with our contract costs incurred in prior years, of which approximately \$160 million has been withheld from our current billings. As a consequence, for certain of these matters, we have withheld approximately \$81 million from our subcontractors under the payment terms of those contracts. In addition, we have outstanding demand letters received from our customer requesting that we remit a total of \$84 million of disapproved costs for which we currently do not intend to pay. We continue to work with our ACO's, the DCAA and our subcontractors to resolve these issues. However, for certain of these matters, we have filed claims with the Armed Services Board of Contract Appeals or the United States Court of Federal Claims.

KBR excludes from billings to the U.S. Government costs that are expressly unallowable, or mutually agreed to be unallowable, or not allocable to government contracts per applicable regulations. Revenue recorded for government contract work is reduced for our estimate of potentially refundable costs related to issues that may be categorized as disputed or



---

**Table of Contents**

unallowable as a result of cost overruns or the audit process. Our estimates of potentially unallowable costs are based upon, among other things, our internal analysis of the facts and circumstances, terms of the contracts and the applicable provisions of the FAR, quality of supporting documentation for costs incurred, and subcontract terms as applicable. From time to time, we engage outside counsel to advise us on certain matters in determining whether certain costs are allowable. We also review our analysis and findings with the ACO as appropriate. In some cases, we may not reach agreement with the DCAA or the ACO regarding potentially unallowable costs which may result in our filing of claims in various courts such as the Armed Services Board of Contract Appeals ( ASBCA ) or the United States Court of Federal Claims ( COFC ). We only include amounts in revenue related to disputed and potentially unallowable costs when we determine it is probable that such costs will result in revenue. We generally do not recognize additional revenue for disputed or potentially unallowable costs for which revenue has been previously reduced until we reach agreement with the DCAA and/or the ACO that such costs are allowable.

Certain issues raised as a result of contract audits and other investigations are discussed below.

**Private Security.** In February 2007, we received a Form 1 notice from the Department of the Army informing us of their intent to adjust payments under the LogCAP III contract associated with the cost incurred for the years 2003 through 2006 by certain of our subcontractors to provide security to their employees. Based on that notice, the Army withheld its initial assessment of \$20 million. The Army based its initial assessment on one subcontract wherein, based on communications with the subcontractor, the Army estimated 6% of the total subcontract cost related to the private security costs. The Army previously indicated that not all task orders and subcontracts have been reviewed and that they may make additional adjustments. In August 2009, we received a Form 1 notice from the DCAA disapproving an additional \$83 million of costs incurred by us and our subcontractors to provide security during the same periods. Since that time, the Army withheld an additional \$24 million in payments from us bringing the total payments withheld to approximately \$44 million as of December 31, 2010 out of the Form 1 notices issued to date of \$103 million.

The Army indicated that they believe our LogCAP III contract prohibits us and our subcontractors from billing costs of privately acquired security. We believe that, while the LogCAP III contract anticipates that the Army will provide force protection to KBR employees, it does not prohibit us or any of our subcontractors from using private security services to provide force protection to KBR or subcontractor personnel. In addition, a significant portion of our subcontracts are competitively bid fixed price subcontracts. As a result, we do not receive details of the subcontractors' cost estimate nor are we legally entitled to it. Further, we have not paid our subcontractors any additional compensation for security services. Accordingly, we believe that we are entitled to reimbursement by the Army for the cost of services provided by us or our subcontractors, even if they incurred costs for private force protection services. Therefore, we believe that the Army's position that such costs are unallowable and that they are entitled to withhold amounts incurred for such costs is wrong as a matter of law.

In 2007, we provided the Army's request information that addresses the use of armed security either directly or indirectly charged to LogCAP III. In October 2007, we filed a claim to recover the original \$20 million that was withheld which was deemed denied as a result of no response from the contracting officer. To date, we have filed appeals to the ASBCA to recover \$44 million of the amounts withheld from us which is currently in the early stages of discovery. We believe these sums were properly billed under our contract with the Army. At this time, we believe the likelihood that a loss related to this matter has been incurred is remote. We have not adjusted our revenues or accrued any amounts related to this matter. This matter is also the subject of a separate claim filed by the Department of Justice ( DOJ ) for alleged violation of the False Claims Act as discussed further below under the heading Investigations, Qui Tams and Litigation.

**Containers.** In June 2005, the DCAA recommended withholding certain costs associated with providing containerized housing for soldiers and supporting civilian personnel in Iraq. The DCMA agreed that the costs be withheld pending receipt of additional explanation or documentation to support the subcontract costs. We have not received a final determination by the DCMA and, as requested, we continue to provide information to the DCMA. As of December 31, 2010, approximately \$26 million of costs have been suspended under Form 1 notices and withheld from us by our customer related to this matter of which \$30 million has been withheld by us from our subcontractor. In April 2008, we filed a counterclaim in arbitration against our LogCAP III subcontractor, First Kuwaiti Trading Company, to recover approximately \$51 million paid to the subcontractor for containerized housing as further described under the caption First Kuwaiti Trading Company arbitration below. We will continue working with the government and our subcontractor to resolve the remaining amounts. We believe that the costs incurred associated with providing containerized housing are reasonable and we intend to vigorously defend ourselves in this matter. We do not believe that we face a risk of significant loss from any disallowance of these costs in excess of the amounts we have withheld from subcontractors and the loss accruals we have recorded. At this time, the likelihood that a loss in excess of the amount accrued for this matter is remote.

---

## **Table of Contents**

***Dining facilities.*** In 2006, the DCAA raised questions regarding our billings and price reasonableness of costs related to dining facilities in Iraq. We responded to the DCMA that our costs are reasonable. As of December 31, 2010, we have outstanding Form 1 notices from the DCAA disapproving \$165 million in costs related to these dining facilities until such time we provide documentation to support the price reasonableness of the rates negotiated with our subcontractor and demonstrate that the amounts billed were in accordance with the contract terms. We believe the prices obtained for these services were reasonable and intend to vigorously defend ourselves on this matter. We filed claims in the U.S. COFC to recover \$58 million of the \$80 million withheld from us by the customer. The claims proceedings are in the discovery process and no trial date has been set but is expected to occur in 2011. With respect to questions raised regarding billing in accordance with contract terms, as of December 31, 2010, we believe it is reasonably possible that we could incur losses in excess of the amount accrued for possible subcontractor costs billed to the customer that were possibly not in accordance with contract terms. However, we are unable to estimate an amount of possible loss or range of possible loss in excess of the amount accrued related to any costs billed to the customer that were not in accordance with the contract terms. We believe the prices obtained for these services were reasonable, we intend to vigorously defend ourselves in this matter and we do not believe we face a risk of significant loss from any disallowance of these costs in excess of amounts withheld from subcontractors. As of December 31, 2010, we had withheld \$41 million in payments from our subcontractors pending the resolution of these matters with our customer.

Additionally, one of our subcontractors, Tamimi, filed for arbitration to recover approximately \$35 million for payments we have withheld from them pending the resolution of the Form 1 notices with our customer. In December 2010, the arbitration panel ruled that the subcontract terms were not sufficient to hold retention from Tamimi for price reasonableness matters and awarded the subcontractor \$35 million plus interest thereon and certain legal costs. As a result of the arbitration award, we recorded an additional charge of \$5 million in the fourth quarter of 2010 associated with the interest due on the accrued retention payable to Tamimi and other costs awarded. We also have a claim pending in the U.S. COFC to recover the \$35 million from the U.S. government and we believe it is probable that we will recover such amount.

***Transportation costs.*** The DCAA, in performing its audit activities under the LogCAP III contract, raised a question about our compliance with the provisions of the Fly America Act. Subject to certain exceptions, the Fly America Act requires Federal employees and others performing U.S. Government-financed foreign air travel to travel by U.S. flag air carriers. There are times when we transported personnel in connection with our services for the U.S. military where we may not have been in compliance with the Fly America Act and its interpretations through the Federal Acquisition Regulations and the Comptroller General. As of December 31, 2010, we have accrued an estimate of the cost incurred for these potentially non-compliant flights with a corresponding reduction to revenue. The DCAA may consider additional flights to be noncompliant resulting in potential larger amounts of disallowed costs than the amount we have accrued. At this time, we cannot estimate a range of reasonably possible losses that may have been incurred, if any, in excess of the amount accrued. We will continue to work with our customer to resolve this matter.

***Construction services.*** As of December 31, 2010, we have outstanding Form 1 notices from the DCAA disapproving approximately \$25 million in costs related to work performed under our CONCAP III contract with the U.S. Navy to provide emergency construction services primarily to Government facilities damaged by Hurricanes Katrina and Wilma. The DCAA claims the costs billed to the U.S. Navy primarily related to subcontract costs that were either inappropriately bid, included unallowable profit markup or were unreasonable. In April 2010, we met with the U.S. Navy in an attempt to settle the potentially unallowable costs. As a result of the meeting, approximately \$7 million of the potentially unallowable costs was agreed in principle to be allowable and approximately \$1 million unallowable. We are working with the ACO to finalize a settlement of this position. Settlement of the remaining disputed amounts is pending further discussions with the customer regarding the applicable provisions of the FAR and interpretations thereof, as well as providing additional supporting documentation to the customer. As of December 31, 2010, the U.S. Navy has withheld approximately \$10 million from us. We believe we undertook adequate and reasonable steps to ensure that proper bidding procedures were followed and the amounts billed to the customer were reasonable and not in violation of the FAR. As of December 31, 2010, we have accrued our estimate of probable loss related to this matter; however, it is reasonably possible we could incur additional losses.

### ***Investigations, Qui Tams and Litigation***

The following matters relate to ongoing litigation or investigations involving U.S. government contracts.

***McBride Qui Tam suit.*** In September 2006, we became aware of a qui tam action filed against us by a former employee alleging various wrongdoings in the form of overbillings of our customer on the LogCAP III contract. This case was originally filed pending the government's decision whether or not to participate in the suit. In June 2006, the government formally declined to participate. The principal allegations are that our compensation for the provision of Morale, Welfare and Recreation ( MWR ) facilities under LogCAP III is based on the volume of usage of those facilities and that we



---

**Table of Contents**

deliberately overstated that usage. In accordance with the contract, we charged our customer based on actual cost, not based on the number of users. It was also alleged that, during the period from November 2004 into mid-December 2004, we continued to bill the customer for lunches, although the dining facility was closed and not serving lunches. There are also allegations regarding housing containers and our provision of services to our employees and contractors. On July 5, 2007, the court granted our motion to dismiss the qui tam claims and to compel arbitration of employment claims including a claim that the plaintiff was unlawfully discharged. The majority of the plaintiff's claims were dismissed but the plaintiff was allowed to pursue limited claims pending discovery and future motions. Substantially all employment claims were sent to arbitration under the Company's dispute resolution program and were subsequently resolved in our favor. In January 2009, the relator filed an amended complaint which is nearing completion of the discovery process. Trial for this matter is expected in 2011. We believe the relator's claim is without merit and that the likelihood that a loss has been incurred is remote. As of December 31, 2010, no amounts have been accrued.

**First Kuwaiti Trading Company arbitration.** In April 2008, First Kuwaiti Trading Company, one of our LogCAP III subcontractors, filed for arbitration of a subcontract under which KBR had leased vehicles related to work performed on our LogCAP III contract. First Kuwaiti alleged that we did not return or pay rent for many of the vehicles and seeks damages in the amount of \$134 million. We filed a counterclaim to recover amounts which may ultimately be determined due to the Government for the \$51 million in suspended costs as discussed in the preceding section of this footnote titled Containers. Three arbitration hearings took place in 2010 in Washington, D.C. primarily related to claims involving unpaid rents and damages on lost or unreturned vehicles totaling approximately \$77 million for which the arbitration panel awarded \$7 million to FKTC plus an unquantified amount for repair costs on certain vehicles, damages suffered as a result of late vehicle returns, and interest thereon, to be determined at a later date. No payments are expected to occur until all claims are arbitrated and awards finalized. The next arbitration hearing is scheduled to occur in May 2011 and we believe any damages ultimately awarded to First Kuwaiti will be billable under the LogCAP III contract. Accordingly, we have accrued amounts payable and a related unbilled receivable for the amounts awarded to First Kuwaiti pursuant to the terms of the contract.

**Paul Morell, Inc. d/b/a The Event Source vs. KBR, Inc.** TES is a former LogCAP III subcontractor who provided DFAC services at six sites in Iraq from mid-2003 to early 2004. TES sued KBR in Federal Court in Virginia for breach of contract and tortious interference with TES's subcontractors by awarding subsequent DFAC contracts to the subcontractors. In addition, the Government withheld funds from KBR that KBR had submitted for reimbursement of TES invoices, and at that time, TES agreed that it was not entitled to payment until KBR was paid by the Government. Eventually KBR and the Government settled the dispute, and in turn KBR and TES agreed that TES would accept, as payment in full with a release of all other claims, the amount the Government paid to KBR for TES's services. TES filed a suit to overturn that settlement and release, claiming that KBR misrepresented the facts. The trial was completed in June 2009 and in January 2010, the Federal Court issued an order against us in favor of TES in the amount of \$15 million in actual damages and interest and \$4 million in punitive damages relating to the settlement and release entered into by the parties in May 2005. As of December 31, 2010, we have recorded un-reimbursable expenses and a liability of \$20 million for the full amount of the awarded damages. We have filed a notice of appeal with the Court.

**Electrocution litigation.** During 2008, a lawsuit was filed against KBR alleging that the Company was responsible for an electrical incident which resulted in the death of a soldier. This incident occurred at the Radwaniyah Palace Complex. It is alleged in the suit that the electrocution incident was caused by improper electrical maintenance or other electrical work. We intend to vigorously defend this matter. KBR denies that its conduct was the cause of the event and denies legal responsibility. The case was removed to Federal Court where motion to dismiss was filed. The court issued a stay in the discovery of the case, pending an appeal of certain pre-trial motions to dismiss that were previously denied. In August 2010, the Court of Appeal dismissed our appeal concluding it did not have jurisdiction. The case is currently proceeding with the discovery process. We are unable to determine the likely outcome nor can we estimate a range of potential loss, if any, related to this matter at this time. As of December 31, 2010, no amounts have been accrued.

**Burn Pit litigation.** KBR has been served with over 50 lawsuits in various states alleging exposure to toxic materials resulting from the operation of burn pits in Iraq or Afghanistan in connection with services provided by KBR under the LogCAP III contract. Each lawsuit has multiple named plaintiffs who purport to represent a large class of unnamed persons. The lawsuits primarily allege negligence, willful and wanton conduct, battery, intentional infliction of emotional harm, personal injury and failure to warn of dangerous and toxic exposures which has resulted in alleged illnesses for contractors and soldiers living and working in the bases where the pits are operated. All of the pending cases have been removed to Federal Court, the majority of which have been consolidated for multi-district litigation treatment. In the second quarter of 2010, we filed various motions including a motion to strike an amended consolidated petition filed by the plaintiffs and a motion to dismiss which the court has taken under advisement. In the September 2010, our motion to dismiss was denied. However, our motion to strike an amended consolidated petition filed by the plaintiffs was granted. The Court directed the parties to propose a plan for limited jurisdictional discovery. In December 2010, the Court stayed virtually all proceedings

---

## **Table of Contents**

pending a decision from the Fourth Circuit Court of Appeals on three other cases involving the Political Question Doctrine and other jurisdictional issues. We intend to vigorously defend these matters. Due to the inherent uncertainties of litigation and because the litigation is at a preliminary stage, we cannot at this time accurately predict the ultimate outcome nor can we estimate a range of potential loss, if any, related to this matter at this time. Accordingly, as of December 31, 2010, no amounts have been accrued.

***Convoy Ambush Litigation.*** In April 2004, a fuel convoy in route from Camp Anaconda to Baghdad International Airport for the U.S. Army under our LogCAP III contract was ambushed resulting in deaths and severe injuries to truck drivers hired by KBR. In 2005, survivors of the drivers killed and those that were injured in the convoy, filed suit in state court in Houston, Texas against KBR and several of its affiliates, claiming KBR deliberately intended that the drivers in the convoy would be attacked and wounded or killed. The suit also alleges KBR committed fraud in its hiring practices by failing to disclose the dangers associated with working in the Iraq combat zone. In September 2006, the case was dismissed based upon the court's ruling that it lacked jurisdiction because the case presented a non-justiciable political question. Subsequently, three additional suits were filed, arising out of insurgent attacks on other convoys that occurred in 2004 and were likewise dismissed as non-justiciable under the Political Question Doctrine.

The plaintiffs in all cases appealed the dismissals to the Fifth Circuit Court of Appeals which reversed and remanded the remaining cases to trial court. In July 2008, the trial court directed substantive discovery to commence including the re-submittal of dispositive motions on various grounds including the Defense Base Act and Political Question Doctrine. In February 2010, the trial court ruled in favor of the plaintiffs, denying two of our motions to dismiss the case. In March 2010, the trial court granted in part and denied in part our third motion to dismiss the case. We filed appeals on all issues with the Fifth Circuit Court of Appeals and have moved to stay all proceedings in the trial court pending the resolution of these appeals. The cases were removed from the trial docket and the Fifth Circuit Court of Appeals has heard all previous motions filed by both parties. In September 2010, the DOJ filed a brief in support of KBR's position that the cases should be dismissed in their entirety based upon the exclusive provisions in the Defense Base Act. We are unable to determine the likely outcome of these cases at this time. As of December 31, 2010, no amounts have been accrued nor can we estimate the amount of potential loss, if any.

***DOJ False Claims Act complaint.*** On April 1, 2010, the DOJ filed a complaint in the U.S. District Court in the District of Columbia alleging certain violations of the False Claims Act related to the use of private security firms. The complaint alleges, among other things, that we made false or fraudulent claims for payment under the LogCAP III contract because we allegedly knew that they contained costs of services for or that included improper use of private security. We believe these sums were properly billed under our contract with the Army and that the use of private security was not prohibited under LogCAP III. We have filed motions to dismiss the complaint which are currently pending. We have not adjusted our revenues or accrued any amounts related to this matter.

## **Legal Proceedings**

### ***Foreign Corrupt Practices Act investigations***

On February 11, 2009 KBR LLC, entered a guilty plea related to the Bonny Island investigation in the United States District Court, Southern District of Texas, Houston Division (the Court). KBR LLC pled guilty to one count of conspiring to violate the FCPA and four counts of violating the FCPA, all arising from the intent to bribe various Nigerian officials through commissions paid to agents working on behalf of TSKJ on the Bonny Island project. The plea agreement reached with the DOJ resolves all criminal charges in the DOJ's investigation into the conduct of KBR LLC relating to the Bonny Island project, so long as the conduct was disclosed or known to DOJ before the settlement, including previously disclosed allegations of coordinated bidding. The plea agreement called for the payment of a criminal penalty of \$402 million, of which Halliburton was obligated to pay \$382 million under the terms of the indemnity in the master separation agreement, while we were obligated to pay \$20 million. We also agreed to a period of organizational probation of three years, during which we retain a monitor who assesses our compliance with the plea agreement and evaluate our FCPA compliance program over the three year period, with periodic reports to the DOJ.

On the same date, the SEC filed a complaint and we consented to the filing of a final judgment against us in the Court. The complaint and the judgment were filed as part of a settled civil enforcement action by the SEC, to resolve the civil portion of the government's investigation of the Bonny Island project. The complaint alleges civil violations of the FCPA's antibribery and books-and-records provisions related to the Bonny Island project. The complaint enjoins us from violating the FCPA's antibribery, books-and-records, and internal-controls provisions and requires Halliburton and KBR, jointly and severally, to make payments totaling \$177 million, all of which has been paid by Halliburton pursuant to the indemnification under the master separation agreement. The judgment also requires us to retain an independent monitor on the same terms as



**Table of Contents**

the plea agreement with the DOJ.

Under both the plea agreement and judgment, we have agreed to cooperate with the SEC and DOJ in their investigations of other parties involved in TSKJ and the Bonny Island project.

As a result of the settlement, in the fourth quarter 2008 we recorded the \$402 million obligation to the DOJ and, accordingly, recorded a receivable from Halliburton for the \$382 million that Halliburton was obligated to pay to the DOJ on our behalf. The resulting charge of \$20 million to KBR was recorded in cost of sales of our Hydrocarbons business segment in the fourth quarter of 2008. Likewise, we recorded an obligation to the SEC in the amount of \$177 million and a receivable from Halliburton in the same amount. As of December 31, 2010, Halliburton has paid all installments to the DOJ and SEC, and such payments totaled \$559 million. Of the payments mentioned above, Halliburton paid \$142 million in 2010 and \$417 million in 2009, which have been reflected in the accompanying statement of cash flows as noncash operating activities. On October 1, 2010, we made the final payment to the DOJ related to our portion of the settlement agreement.

As part of the settlement of the FCPA matters, we agreed to the appointment of a corporate monitor for a period of up to three years. We proposed the appointment of a corporate monitor and received approval from the DOJ in the third quarter of 2009. We are responsible for paying the fees and expenses related to the monitor's review and oversight of our policies and activities relating to compliance with applicable anti-corruption laws and regulations.

Because of the guilty plea by KBR LLC, we are subject to possible suspension or debarment of our ability to contract with governmental agencies of the United States and of foreign countries. We received written confirmation from the U.S. Department of the Army stating that it does not intend to suspend or debar KBR from DoD contracting as a result of the guilty plea by KBR LLC. The U.K. Ministry of Defence ( MoD ) has indicated that it does not have any grounds to debar the KBR subsidiary with which it contracts under its public procurement regulations. Although there has been a threat to challenge the MOD's decision not to debar KBR, no formal proceedings have been issued since the threat was made. Therefore, we believe the risk of being debarred from contracting with the MOD is low. Although we do not believe we will be suspended or debarred of our ability to contract with other governmental agencies of the United States or any other foreign countries, suspension or debarment from the government contracts business would have a material adverse effect on our business, results of operations, and cash flow.

Under the terms of the MSA, Halliburton has agreed to indemnify us, and any of our greater than 50%-owned subsidiaries, for our share of fines or other monetary penalties or direct monetary damages, including disgorgement, as a result of claims made or assessed by a governmental authority of the United States, the United Kingdom, France, Nigeria, Switzerland or Algeria or a settlement thereof relating to FCPA and related corruption allegations, which could involve Halliburton and us through The M. W. Kellogg Company, M. W. Kellogg Limited ( MWKL ), or their or our joint ventures in projects both in and outside of Nigeria, including the Bonny Island, Nigeria project. Halliburton's indemnity will not apply to any other losses, claims, liabilities or damages assessed against us as a result of or relating to FCPA matters and related corruption allegations or to any fines or other monetary penalties or direct monetary damages, including disgorgement, assessed by governmental authorities in jurisdictions other than the United States, the United Kingdom, France, Nigeria, Switzerland or Algeria, or a settlement thereof, or assessed against entities such as TSKJ, in which we do not have an interest greater than 50%. As of December 31, 2010, we are not aware of any uncertainties related to the indemnity from Halliburton or any material limitations on our ability to recover amounts due to us for matters covered by the indemnity from Halliburton.

The U.K. Serious Fraud Office ( SFO ) conducted an investigation of activities by current and former employees of MWKL regarding the Bonny Island project. During the investigation process, MWKL self-reported to the SFO its corporate liability for corruption-related offenses arising out of the Bonny Island project and entered into a plea negotiation process under the Attorney General's Guidelines on Plea Discussions in Cases of Serious and Complex Fraud issued by the Attorney General for England and Wales. In February 2011, MWKL reached a settlement with the SFO in which the SFO accepted that MWKL was not party to any unlawful conduct and assessed a civil penalty of approximately \$11 million including interest and reimbursement of certain costs of the investigation. The settlement terms included a full release of all claims against MWKL, its current and former parent companies, subsidiaries and other related parties including their respective current or former officers, directors and employees with respect to the Bonny Island project. As of December 31, 2010, we recorded a liability to the SFO of \$11 million included in Other current liabilities in our consolidated balance sheet. Due to the indemnity from Halliburton under the MSA, we recognized a receivable from Halliburton of approximately \$6 million in Due to former parent, net in our consolidated balance sheet.

In 2010, we learned that charges were filed in Nigeria against various parties including Halliburton, KBR and TSKJ Nigeria Limited based on the facts associated with our settlement of the DOJ's FCPA investigation of the Bonny Island project. Prior to KBR being served with a suit, Halliburton negotiated a settlement with the Federal Government of Nigeria without any



---

## **Table of Contents**

admission of liability or financial impact to KBR. With the settlement of this matter, all known investigations into the Bonny Island project have been concluded.

### ***Commercial Agent Fees***

We have both before and after the separation from our former parent used commercial agents on some of our large-scale international projects to assist in understanding customer needs, local content requirements, vendor selection criteria and processes and in communicating information from us regarding our services and pricing. Prior to separation, it was identified by our former parent in performing its investigation of anti-corruption activities that certain of these agents may have engaged in activities that were in violation of anti-corruption laws at that time and the terms of their agent agreements with us. Accordingly, we have ceased the receipt of services from and payment of fees to these agents. Fees for these agents are included in the total estimated cost for these projects at their completion. In connection with actions taken by U.S. Government authorities, we have removed certain unpaid agent fees from the total estimated costs in the period that we obtained sufficient evidence to conclude such agents clearly violated the terms of their contracts with us. In the first and third quarters of 2009, we reduced project cost estimates by \$16 million and \$5 million, respectively, as a result of making such determinations. In September 2010, we executed a final settlement agreement with one of our agents in question after the agent was reviewed and approved under our policies on business conduct. Under the terms of the settlement agreement, the agent had, among other things, confirmed their understanding of and compliance with KBR's policies on business conduct and represented that they have complied with anti-corruption laws as they relate to prior services provided to KBR. We negotiated final payment for fees to this agent on several projects in our Hydrocarbons segment resulting in an overall reduction of estimated project costs of approximately \$60 million of which \$42 million was recognized as a charge in the third quarter of 2010 and the remaining amount will be recognized over the remaining term of the project. As of December 31, 2010, the remaining unpaid agent fees of approximately \$8 million are included in the estimated costs related to a completed project.

### ***Barracuda-Caratinga Project Arbitration***

In June 2000, we entered into a contract with Barracuda & Caratinga Leasing Company B.V., the project owner, to develop the Barracuda and Caratinga crude oilfields, which are located off the coast of Brazil. Petrobras is a contractual representative that controls the project owner. In November 2007, we executed a settlement agreement with the project owner to settle all outstanding project issues except for the bolts arbitration discussed below.

At Petrobras' direction, we replaced certain bolts located on the subsea flowlines that failed through mid-November 2005, and we understand that additional bolts failed thereafter, which were replaced by Petrobras. These failed bolts were identified by Petrobras when it conducted inspections of the bolts. In March 2006, Petrobras notified us they submitted this matter to arbitration claiming \$220 million plus interest for the cost of monitoring and replacing the defective stud bolts and, in addition, all of the costs and expenses of the arbitration including the cost of attorneys' fees. The arbitration is being conducted in New York under the guidelines of the United Nations Commission on International Trade Law (UNCITRAL). Petrobras contends that all of the bolts installed on the project are defective and must be replaced.

During the time that we addressed outstanding project issues and during the conduct of the arbitration, KBR believed the original design specification for the bolts was issued by Petrobras, and as such, the cost resulting from any replacement would not be our responsibility. A hearing on legal and factual issues relating to liability with the arbitration panel was held in April 2008. In June 2009, we received an unfavorable ruling from the arbitration panel on the legal and factual issues as the panel decided the original design specification for the bolts originated with KBR and its subcontractors. The ruling concluded that KBR's express warranties in the contract regarding the fitness for use of the design specifications for the bolts took precedence over any implied warranties provided by the project owner. Our potential exposure would include the costs of the bolts replaced to date by Petrobras, any incremental monitoring costs incurred by Petrobras and damages for any other bolts that are subsequently found to be defective. We believe that it is probable that we have incurred some liability in connection with the replacement of bolts that have failed during the contract warranty period which expired June 30, 2006. In May 2010, the arbitration tribunal heard arguments from both parties regarding various damage scenarios and estimates of the amount of KBR's overall liability in this matter. The final arbitration arguments were made in August of 2010. Based on the damage estimates presented at this hearing, we estimate our minimum exposure, excluding interest, to be approximately \$12 million representing our estimate for replacement of bolts that failed during the warranty period and were not replaced. As of December 31, 2010, we have a liability of \$12 million and an indemnification receivable from Halliburton of \$12 million. The amount of any remaining liability will be dependent upon the legal and factual issues to be determined by the arbitration tribunal in the final arbitration hearings. For the remaining bolts at dispute, we cannot determine that we have liability nor determine the amount of any such liability and no additional amounts have been accrued.

**Table of Contents**

Any liability incurred by us in connection with the replacement of bolts that have failed to date or related to the remaining bolts at dispute in the bolt arbitration is covered by an indemnity from our former parent Halliburton. Under the MSA, Halliburton has agreed to indemnify us and any of our greater than 50%-owned subsidiaries as of November 2006, for all out-of-pocket cash costs and expenses (except for ongoing legal costs), or cash settlements or cash arbitration awards in lieu thereof, we may incur after the effective date of the master separation agreement as a result of the replacement of the subsea flowline bolts installed in connection with the Barracuda-Caratinga project. As of December 31, 2010, we are not aware of any uncertainties related to the indemnity from Halliburton or any material limitations on our ability to recover amounts due to us for matters covered by the indemnity from Halliburton. We do not believe any outcome of this matter will have a material adverse impact to our operating results or financial position.

**Item 7A. Quantitative and Qualitative Discussion about Market Risk**

Information relating to market risk is included in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations under the caption Financial Instrument Market Risk and Note 14 of our consolidated financial statements and the information discussed therein is incorporated by reference into this Item 7A.

**Item 8. Financial Statements and Supplementary Data**

	<b>Page No.</b>
<u>Report of Independent Registered Public Accounting Firm</u>	59
<u>Consolidated Statements of Income for years ended December 31, 2010, 2009, and 2008</u>	60
<u>Consolidated Balance Sheets at December 31, 2010 and 2009</u>	61
<u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2010, 2009, and 2008</u>	62
<u>Consolidated Statements of Shareholders' Equity for the years ended December 31, 2010, 2009, and 2008</u>	63
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009, and 2008</u>	64
<u>Notes to Consolidated Financial Statements</u>	65

The related financial statement schedules are included under Part IV, Item 15 of this annual report.

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders

KBR, Inc.:

We have audited the accompanying consolidated balance sheets of KBR, Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of KBR, Inc. and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

As discussed in Notes 1 and 15 to the consolidated financial statements, the Company changed its method of accounting for variable interest entities on a prospective basis as of January 1, 2010.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), KBR, Inc.'s internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 23, 2011 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Houston, Texas

February 23, 2011

**Table of Contents****KBR, Inc.****Consolidated Statements of Income**

(In millions, except for per share data)

	Years ended December 31		
	2010	2009	2008
<b>Revenue:</b>			
Services	\$ 9,962	\$ 12,060	\$ 11,493
Equity in earnings of unconsolidated affiliates, net	137	45	88
Total revenue	10,099	12,105	11,581
<b>Operating costs and expenses:</b>			
Cost of services	9,273	11,348	10,820
General and administrative	212	217	223
Impairment of long-lived assets	5		
Impairment of goodwill		6	
Gain on disposition of assets, net		(2)	(3)
Total operating costs and expenses	9,490	11,569	11,040
<b>Operating income</b>	<b>609</b>	<b>536</b>	<b>541</b>
Interest income (expense), net	(17)	(1)	35
Foreign currency losses, net	(4)		(8)
Other non-operating expense	(2)	(3)	
<b>Income from continuing operations before income taxes and noncontrolling interests</b>	<b>586</b>	<b>532</b>	<b>568</b>
Less: Provision for income taxes	191	168	212
<b>Income from continuing operations, net of tax</b>	<b>395</b>	<b>364</b>	<b>356</b>
Income from discontinued operations, net of tax benefit of \$11			11
<b>Net income</b>	<b>395</b>	<b>364</b>	<b>367</b>
Less: Net income attributable to noncontrolling interests	68	74	48
<b>Net income attributable to KBR</b>	<b>\$ 327</b>	<b>\$ 290</b>	<b>\$ 319</b>
<b>Reconciliation of net income attributable to KBR common shareholders:</b>			
Continuing operations	\$ 327	\$ 290	\$ 308
Discontinued operations, net			11
<b>Net income attributable to KBR</b>	<b>\$ 327</b>	<b>\$ 290</b>	<b>\$ 319</b>
<b>Basic income per share (1):</b>			
Continuing operations Basic	\$ 2.08	\$ 1.80	\$ 1.84
Discontinued operations, net Basic			0.07

Edgar Filing: KBR, INC. - Form 10-K

<b>Net income attributable to KBR per share</b>	<b>Basic</b>	\$ 2.08	\$ 1.80	\$ 1.91
<b>Diluted income per share (1):</b>				
Continuing operations - Diluted		\$ 2.07	\$ 1.79	\$ 1.84
Discontinued operations, net	Diluted			0.07
<b>Net income attributable to KBR per share</b>	<b>Diluted</b>	\$ 2.07	\$ 1.79	\$ 1.90
<b>Basic weighted average common shares outstanding</b>				
		156	160	166
<b>Diluted weighted average common shares outstanding</b>				
		157	161	167
<b>Cash dividends declared per share</b>				
		\$ 0.15	\$ 0.20	\$ 0.25

(1) Due to the effect of rounding, the sum of the individual per share amounts may not equal the total shown.  
See accompanying notes to consolidated financial statements.

**Table of Contents****KBR, Inc.****Consolidated Balance Sheets****(In millions except share data)**

	<b>December 31</b>	
	<b>2010</b>	<b>2009</b>
<b>Assets</b>		
<b>Current assets:</b>		
Cash and equivalents	\$ 786	\$ 941
Receivables:		
Accounts receivable, net of allowance for bad debts of \$27 and \$26	1,455	1,243
Unbilled receivables on uncompleted contracts	428	657
<b>Total receivables</b>	<b>1,883</b>	<b>1,900</b>
Deferred income taxes	199	192
Other current assets	394	608
<b>Total current assets</b>	<b>3,262</b>	<b>3,641</b>
Property, plant, and equipment, net of accumulated depreciation of \$334 and \$264 (including \$80 and \$0, net, owned by a variable interest entity - see Note 15)	355	251
Goodwill	947	691
Intangible assets, net	127	58
Equity in and advances to related companies	219	164
Noncurrent deferred income taxes	103	120
Noncurrent unbilled receivables on uncompleted contracts	320	321
Other assets	84	81
<b>Total assets</b>	<b>\$ 5,417</b>	<b>\$ 5,327</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 921	\$ 1,045
Due to former parent, net	43	53
Obligation to former noncontrolling interest (Note 3)	180	
Advance billings on uncompleted contracts	498	407
Reserve for estimated losses on uncompleted contracts	26	40
Employee compensation and benefits	200	191
Current non-recourse project-finance debt of a variable interest entity (Note 15)	9	
Other current liabilities	470	552
Current liabilities related to discontinued operations, net		3
<b>Total current liabilities</b>	<b>2,347</b>	<b>2,291</b>
Noncurrent employee compensation and benefits	397	469
Noncurrent non-recourse project-finance debt of a variable interest entity (Note 15)	92	
Other noncurrent liabilities	132	106
Noncurrent income tax payable	128	43
Noncurrent deferred tax liability	117	122
<b>Total liabilities</b>	<b>3,213</b>	<b>3,031</b>



Edgar Filing: KBR, INC. - Form 10-K

<b>KBR Shareholders equity:</b>		
Preferred stock, \$0.001 par value, 50,000,000 shares authorized, 0 shares issued and outstanding		
Common stock, \$0.001 par value, 300,000,000 shares authorized, 171,448,067 and 170,686,531 shares issued, and 151,132,049 and 160,363,830 shares outstanding		
Paid-in capital in excess of par	1,981	2,103
Accumulated other comprehensive loss	(438)	(444)
Retained earnings	1,157	854
Treasury stock, 20,316,018 shares and 10,322,701 shares, at cost	(454)	(225)
<b>Total KBR shareholders equity</b>	<b>2,246</b>	<b>2,288</b>
Noncontrolling interests	(42)	8
<b>Total shareholders equity</b>	<b>2,204</b>	<b>2,296</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 5,417</b>	<b>\$ 5,327</b>

See accompanying notes to consolidated financial statements.

**Table of Contents****KBR, Inc.****Consolidated Statements of Comprehensive Income****(In millions)**

	Years ended December 31		
	2010	2009	2008
Net income	395	364	367
Other comprehensive income (loss), net of tax benefit (provision):			
Net cumulative translation adjustments	5	18	(117)
Pension liability adjustments, net of taxes of \$4, \$(5) and \$(85)	24	(15)	(226)
Other comprehensive gains (losses) on derivatives:			
Unrealized gains (losses) on derivatives	2	(3)	(1)
Reclassification adjustments to net income	(1)	1	(1)
Income tax benefit (provision) on derivatives	(1)		1
<b>Comprehensive income</b>	<b>424</b>	<b>365</b>	<b>23</b>
Less: Comprehensive income attributable to noncontrolling interests	(72)	(80)	(21)
<b>Comprehensive income attributable to KBR</b>	<b>352</b>	<b>285</b>	<b>2</b>

See accompanying notes to consolidated financial statements.

**Table of Contents****KBR, Inc.****Consolidated Statements of Shareholders' Equity****(In millions)**

	2010	December 31 2009	2008
<b>Balance at January 1,</b>	\$ 2,296	\$ 2,034	\$ 2,235
Stock-based compensation	17	17	16
Common stock issued upon exercise of stock options	5	2	3
Tax benefit increase (decrease) related to stock-based plans		(7)	2
Dividends declared to shareholders	(23)	(32)	(41)
Adjustments pursuant to tax sharing agreement with former parent	(8)		
Repurchases of common stock	(233)	(31)	(196)
Issuance of ESPP shares	3	2	
Distributions to noncontrolling interests	(108)	(66)	(21)
Investments from noncontrolling interests	17	12	
Acquisition of noncontrolling interests	(181)		2
Consolidation of Fasttrax Limited	(4)		
Tax adjustments to noncontrolling interests			12
Other noncontrolling partner activity	(1)		
Cumulative effect of initial adoption of accounting for defined benefit pension and other postretirement plans			(1)
Comprehensive income	424	365	23
<b>Balance at December 31,</b>	<b>\$ 2,204</b>	<b>\$ 2,296</b>	<b>\$ 2,034</b>

See accompanying notes to consolidated financial statements.

**Table of Contents****KBR, Inc.****Consolidated Statements of Cash Flows****(In millions)**

	Years ended December 31		
	2010	2009	2008
<b>Cash flows from operating activities:</b>			
Net income	\$ 395	\$ 364	\$ 367
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	62	55	49
Equity in earnings of unconsolidated affiliates	(137)	(45)	(88)
Deferred income taxes	14	65	88
Impairment of long-lived assets	5		
Impairment of goodwill		6	
Other	30	14	28
Changes in operating assets and liabilities:			
Receivables	(182)	107	(124)
Unbilled receivables on uncompleted contracts	223	156	(45)
Accounts payable	(177)	(355)	214
Advance billings on uncompleted contracts	116	(98)	(315)
Accrued employee compensation and benefits	9	(129)	(40)
Reserve for loss on uncompleted contracts	(13)	(37)	(41)
Collection (repayment) of advances from (to) unconsolidated affiliates, net	(16)	(18)	68
Distributions of earnings from unconsolidated affiliates	93	54	121
Other assets	6	(264)	(149)
Other liabilities	121	89	(9)
<b>Total cash flows provided by (used in) operating activities</b>	<b>549</b>	<b>(36)</b>	<b>124</b>
<b>Cash flows from investing activities:</b>			
Acquisition of businesses, net of cash acquired	(299)		(526)
Capital expenditures	(66)	(41)	(37)
Investment in equity method joint ventures	(12)		
Investment in licensing arrangement	(20)		
Sales of property, plant and equipment			7
Proceeds from sale of investments		32	
<b>Total cash flows used in investing activities</b>	<b>(397)</b>	<b>(9)</b>	<b>(556)</b>
<b>Cash flows from financing activities:</b>			
Payments to reacquire common stock	(233)	(31)	(196)
Distributions to noncontrolling interests, net	(91)	(54)	(28)
Payments of dividends to shareholders	(32)	(32)	(25)
Net proceeds from issuance of stock	5	2	3
Excess tax benefits from stock-based compensation		(7)	2
Payments on short-term and long-term borrowings	(13)		
Return (funding) of cash collateral on letters of credit, net	28	(44)	
<b>Total cash flows used in financing activities</b>	<b>(336)</b>	<b>(166)</b>	<b>(244)</b>

Edgar Filing: KBR, INC. - Form 10-K

Effect of exchange rate changes on cash	7	7	(40)
Decrease in cash and equivalents	(177)	(204)	(716)
Cash increase due to consolidation of a variable interest entity	22		
Cash and equivalents at beginning of period	941	1,145	1,861
<b>Cash and equivalents at end of period</b>	<b>\$ 786</b>	<b>\$ 941</b>	<b>\$ 1,145</b>

**Supplemental disclosure of cash flow information:**

Cash paid for interest	\$ 16	\$ 7	\$ 5
Cash paid for income taxes (net of refunds)	\$ 64	\$ 166	\$ 200
<b>Noncash operating activities</b>			
Other assets (Note 10)	\$ 130	\$ 417	\$ (559)
Other liabilities (Note 10)	\$ (130)	\$ (417)	\$ 579
<b>Noncash investing activities</b>			
Purchase of computer software	\$ (19)	\$	\$
<b>Noncash financing activities</b>			
Obligation to former noncontrolling interest (Note 3)	\$ 180	\$	\$

See accompanying notes to consolidated financial statements.

---

**Table of Contents**

**KBR, Inc.**

**Notes to Consolidated Financial Statements**

**Note 1. Description of Company and Significant Accounting Policies**

KBR, Inc., a Delaware corporation, was formed on March 21, 2006. KBR, Inc. and its subsidiaries (collectively, KBR) is a global engineering, construction and services company supporting the energy, petrochemicals, government services, industrial and civil infrastructure sectors. Headquartered in Houston, Texas, we offer a wide range of services through our Hydrocarbons, Infrastructure, Government and Power (IGP), Services and Other business segments. See Note 5 for additional financial information about our reportable business segments.

***Principles of consolidation***

Our consolidated financial statements include the financial position, results of operations and cash flows of KBR and our majority-owned, controlled subsidiaries and variable interest entities where we are the primary beneficiary (see Note 15). The equity method is used to account for investments in affiliates in which we have the ability to exert significant influence over the affiliates' operating and financial policies. The cost method is used when we do not have the ability to exert significant influence. All intercompany accounts and transactions are eliminated in consolidation.

Our revenue includes both equity in the earnings of unconsolidated affiliates and revenue from sales of services to joint ventures. We often participate on larger projects as a joint venture partner and also provide services to the joint venture as a subcontractor. The amount included in our revenue represents total project revenue, including equity in the earnings from joint ventures, impairments of equity investments in joint ventures, if any, and revenue from services provided to joint ventures.

***Use of estimates***

Our financial statements are prepared in conformity with accounting principles generally accepted in the United States, requiring us to make estimates and assumptions that affect the reported amounts of assets and liabilities and related disclosures at the balance sheet dates, and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

***Engineering and construction contracts***

Revenue from contracts to provide construction, engineering, design or similar services is reported on the percentage-of-completion method of accounting. Progress is generally measured based upon physical progress, man-hours, or costs incurred, depending on the type of job. Physical progress is determined as a combination of input and output measures as deemed appropriate by the circumstances. All known or anticipated losses on contracts are provided for in the period they become evident. Claims and change orders that are in the process of being negotiated with customers for extra work or changes in the scope of work are included in contract value when collection is deemed probable. Our contracts often require us to pay liquidated damages should we not meet certain performance requirements, including completion of the project in accordance with a scheduled time. We include an estimate of liquidated damages in contract costs when it is deemed probable that they will be paid.

***Accounting for government contracts***

Most of the services provided to the United States government are governed by cost-reimbursable contracts. Generally, these contracts contain both a base fee (a fixed profit percentage applied to our actual costs to complete the work) and an award fee (a variable profit percentage applied to definitized costs, which is subject to our customer's discretion and tied to the specific performance measures defined in the contract, such as adherence to schedule, health and safety, quality of work, responsiveness, cost performance and business management).

Revenue is recorded at the time services are performed, and such revenues include base fees, actual direct project costs incurred and an allocation of indirect costs. Indirect costs are applied using rates approved by our government customers. The general, administrative, and overhead cost reimbursement rates are estimated periodically in accordance with government contract accounting regulations and may change based on actual costs incurred or based upon the volume of work performed. Revenue is reduced for our estimate of costs that either are in dispute with our customer or have been identified as potentially unallowable per the terms of the contract or the federal acquisition regulations.



## **Table of Contents**

We generally recognize award fees on the LogCAP III contract using an estimated accrual of the amounts to be awarded. Once task orders underlying the work are definitized and award fees are granted, we adjust our estimate of award fees to the actual amounts earned. However, as further discussed in Note 9, we are currently unable to reliably estimate award fees as a result of our customer's unilateral decision to grant no award fees for certain performance periods. In accordance with the provisions of the LogCAP III contract, we earn profits on our services rendered based on a combination of a fixed fee plus award fees granted by our customer. Both fees are measured as a percentage rate applied to estimated and negotiated costs. The LogCAP III customer is contractually obligated to periodically convene Award-Fee Boards, which are comprised of individuals who have been designated to assist the Award Fee Determining Official ( AFDO ) in making award fee determinations. Award fees are based on evaluations of our performance using criteria set forth in the contract, which include non-binding monthly evaluations made by our customers in the field of operations. Although these criteria have historically been used by the Award-Fee Boards in reaching their recommendations, the amounts of award fees are determined at the sole discretion of the AFDO.

For contracts containing multiple deliverables entered into subsequent to June 30, 2003, we analyze each activity within the contract to ensure that we adhere to the separation guidelines for revenue arrangements with multiple deliverables in accordance with FASB ASC 605 - Revenue Recognition. For service-only contracts and service elements of multiple deliverable arrangements, award fees are recognized only when definitized and awarded by the customer. The LogCAP IV contract is an example of a contract in which award fees are recognized only when definitized and awarded by the Customer because the initial task orders awarded to date have included only service-related deliverables. Under this contract and for all similar future contracts we will continue to accrue base fees as costs are incurred and will recognize award fees only when they have been awarded.

### ***Accounting for pre-contract costs***

Pre-contract costs incurred in anticipation of a specific contract award are deferred only if the costs can be directly associated with a specific anticipated contract and their recoverability from that contract is probable. Pre-contract costs related to unsuccessful bids are written off no later than the period we are informed that we are not awarded the specific contract. Costs related to one-time activities such as introducing a new product or service, conducting business in a new territory, conducting business with a new class of customer, or commencing new operations are expensed when incurred.

### ***Legal expenses***

We expense legal costs in the period in which such costs are incurred.

### ***Cash and equivalents***

We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents. Cash and equivalents include cash related to contracts in progress as well as cash held by our joint ventures that we consolidate for accounting purposes. Joint venture cash balances are limited to joint venture activities and are not available for other projects, general cash needs or distribution to us without approval of the board of directors of the respective joint ventures. Cash held by our joint ventures that we consolidate for accounting purposes totaled approximately \$136 million and \$236 million at December 31, 2010 and 2009, respectively. We expect to use the cash on these projects to pay project costs.

Restricted cash consists of amounts held in deposit with certain banks to collateralize standby letters of credit. Our current restricted cash is included in Other current assets and our non-current restricted cash is included in Other assets on our consolidated financial statements. Our restricted cash balances are presented in the table below:

<i>Millions of dollars</i>	At December 31,	
	2010	2009
Current restricted cash	\$ 11	\$ 35
Non-current restricted cash	10	11
<b>Total restricted cash</b>	<b>\$ 21</b>	<b>\$ 46</b>



*Allowance for bad debts*

We establish an allowance for bad debts through a review of several factors including historical collection experience, current aging status of the customer accounts, financial condition of our customers, and whether the receivables involve retentions.

---

**Table of Contents**

***Goodwill and other intangibles***

Goodwill represents the excess of cost over the fair market value of net assets acquired in business combinations and, in accordance with FASB ASC 350 Intangibles – Goodwill and Other, we are required to test goodwill for impairment on an annual basis, and more frequently when negative conditions or other triggering events arise. Effective January 1, 2010, we elected to change our annual goodwill impairment testing to the fourth quarter of every year based on carrying values of our business units as of October 1 from our previous method of using our business unit carrying values as of September 30. An annual goodwill impairment test date of October 1 better aligns with our annual budget process which is completed during the fourth quarter of each year. In addition, performing our annual goodwill impairment test during the fourth quarter allows for a more thorough consideration of the valuations of our business units subsequent to the completion of our annual budget process but prior to our financial year end reporting date. As a result of this accounting change, there were no required adjustments to any of the financial statement line items in the accompanying financial statements.

The annual impairment test for goodwill is a two-step process that involves comparing the estimated fair value of each business unit to the unit's carrying value, including goodwill. If the fair value of a business unit exceeds its carrying amount, the goodwill of the business unit is not considered impaired; therefore, the second step of the impairment test is unnecessary. If the carrying amount of a business unit exceeds its fair value, we perform the second step of the goodwill impairment test to measure the amount of goodwill impairment loss to be recorded, as necessary.

Consistent with prior years, the fair values of reporting units in 2010 were determined using a combination of two methods, one based on market earnings multiples of peer companies identified for each business unit (the market approach), and the other based on discounted cash flow models with estimated cash flows based on internal forecasts of revenues and expenses over a four year period plus a terminal value period (the income approach).

The market approach estimates fair value by applying earnings and revenue market multiples to a reporting unit's operating performance for the trailing twelve-month period. The market multiples are derived from comparable publicly traded companies with operating and investment characteristics similar to those of each of our reporting units. The earnings multiples for the market approach ranged between 4.0 times and 11.0 times the earnings for each of our reporting units. The income approach estimates fair value by discounting each reporting unit's estimated future cash flows using a weighted-average cost of capital that reflects current market conditions and the risk profile of each reporting unit. The discount rates used under the income approach ranged from 13.2% to 17.5%. The fair value derived from the weighting of these two methods provided appropriate valuations that, in aggregate, reasonably reconciled to our market capitalization, taking into account observable control premiums.

We believe these two approaches are appropriate valuation techniques and we generally weight the two resulting values equally as an estimate of reporting unit fair value for the purposes of our impairment testing. However, we may weigh one value more heavily than the other when conditions merit doing so.

In addition to the earnings multiples and the discount rates disclosed above, certain other judgments and estimates are used to prepare the goodwill impairment test. If market conditions change compared to those used in our market approach, or if actual future results of operations fall below the projections used in the income approach, our goodwill could become impaired in the future.

At October 1, 2010, our market capitalization exceeded the carrying value of our consolidated net assets by \$1.4 billion and the fair value of all our individual reporting units significantly exceeded their respective carrying amounts as of that date. However, the fair values for the Services, P&I and Allstates reporting units exceeded their respective carrying values based on projected growth rates and other market inputs to our impairment test models that are more sensitive to the risk of future variances due to competitive market conditions as well as business unit execution risks.

We review our projected growth rates and other market inputs used in our impairment test models, and changes in our business and other factors that could represent indicators of impairment. Subsequent to our October 1, 2010 annual impairment test, no such indicators of impairment were identified.

---

**Table of Contents**
***Impairment of long-lived assets***

When events or changes in circumstances indicate that long-lived assets other than goodwill may be impaired, an evaluation is performed. For an asset classified as held for use, the estimated future undiscounted cash flow associated with the asset are compared to the asset's carrying amount to determine if a write-down to fair value is required. When an asset is classified as held for sale, the asset's book value is evaluated and adjusted to the lower of its carrying amount or fair value less cost to sell. Depreciation or amortization is ceased when an asset is classified as held for sale.

We evaluate equity method investments for impairment when events or changes in circumstances indicate, in management's judgment, that the carrying value of such investment may have experienced an other-than-temporary decline in value. When evidence of loss in value has occurred, management compares the estimated fair value of the investment to the carrying value of the investment to determine whether an impairment has occurred. Management assesses the fair value of its equity method investment using commonly accepted techniques, and may use more than one method, including, but not limited to, recent third party comparable sales, internally developed discounted cash flow analysis and analysis from outside advisors. If the estimated fair value is less than the carrying value and management considers the decline in value to be other than temporary, the excess of the carrying value over the estimated fair value is recognized in the financial statements as an impairment.

***Income taxes***

Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will not be realized. In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, we believe it is more likely than not that we will realize the benefits of these deductible differences, net of the existing valuation allowances.

We record estimated reserves for uncertain tax positions if the position does not meet a more-likely-than-not threshold to be sustained upon by review by taxing authorities. Income tax positions that previously failed to meet the more-likely-than-not threshold are recognized as benefits in the first subsequent financial reporting period in which that threshold is met. The company recognizes potential interest and penalties related to uncertain tax positions within the provision for income taxes.

***Derivative instruments***

At times, we enter into derivative financial transactions to hedge existing or projected exposures to changing foreign currency exchange rates. We do not enter into derivative transactions for speculative or trading purposes. We recognize all derivatives on the balance sheet at fair value. Derivatives that are not accounted for as hedges under FASB ASC 815 – Derivatives and Hedging, are adjusted to fair value and such changes are reflected through the results of operations. If the derivative is designated as a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings.

The ineffective portion of a derivative's change in fair value is recognized in earnings. Recognized gains or losses on derivatives entered into to manage foreign exchange risk are included in foreign currency gains and losses in the consolidated statements of income.

***Concentration of credit risk***

We have revenues and receivables from transactions with external customers that amount to 10% or more of our revenues. A significant portion of our revenue from services is generated from transactions with the United States government, which was derived almost entirely from our IGP segment. Additionally, a considerable percentage of revenue from services is generated from transactions with the Chevron Corporation (Chevron), which was derived almost entirely from our Hydrocarbons segment. No other customers represented 10% or more of consolidated revenues in any of the periods presented. In addition, our receivables are generally not collateralized. The information in the following tables has summarized data related to our transactions with the U.S. government and Chevron.

**Table of Contents****Revenues from major customers:**

<i>Millions of dollars, except percentage amounts</i>	<b>Years ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
U.S. government revenue	\$ 3,277	\$ 5,195	\$ 6,180
Chevron revenue	\$ 1,783	\$ 1,375	\$ 1,058

**Percentages of revenues and accounts receivable from major customers:**

<i>Millions of dollars, except percentage amounts</i>	<b>Years ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
U.S. government revenue percentage	32%	43%	53%
Chevron revenues percentage	18%	11%	9%
U.S. government receivables percentage	33%	44%	45%
Chevron receivables percentage	11%	7%	8%

**Noncontrolling interest**

Noncontrolling interest in consolidated subsidiaries in our consolidated balance sheets principally represents noncontrolling shareholders proportionate share of the equity in our consolidated subsidiaries. Noncontrolling interest in consolidated subsidiaries is adjusted each period to reflect the noncontrolling shareholders' allocation of income or the absorption of losses by noncontrolling shareholders on certain majority-owned, controlled investments.

**Foreign currency translation**

We determine the functional currency of our foreign entities based upon the currency of the primary environment in which they operate. Where the functional currency is not the U.S. dollar, translation of assets and liabilities to U.S. dollars is based on exchange rates at the balance sheet date. Translation of revenue and expenses to U.S. dollars is based on the average rate during the period. Translation gains or losses, net of income tax effects, are reported as a component of other comprehensive income (loss). Gains or losses from foreign currency transactions are included in results of operations, with the exception of intercompany foreign transactions that are of a long-term investment nature, which are recorded in Other comprehensive income on our consolidated balance sheets.

**Variable Interest Entities**

We account for variable interest entities ( VIEs ) in accordance with FASB ASC 810 Consolidation which requires the consolidation of VIEs in which a company has both the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses or the right to receive the benefits from the VIE that could potentially be significant to the VIE. If a reporting enterprise meets these conditions then it has a controlling financial interest and is the primary beneficiary of the VIE. We have applied the requirements of FASB ASC 810 on a prospective basis from the date of adoption. The adoption of FASB ASC 810 resulted in the consolidation of the Fasttrax Limited VIE which is discussed below under the caption Fasttrax Limited Project.

We assess all newly created entities and those with which we become involved to determine whether such entities are VIEs and, if so, whether or not we are their primary beneficiary. Most of the entities we assess are incorporated or unincorporated joint ventures formed by us and our partner(s) for the purpose of executing a project or program for a customer, such as a governmental agency or a commercial enterprise, and are generally dissolved upon completion of the project or program. Many of our long-term energy-related construction projects in our Hydrocarbons business segment are executed through such joint ventures. Typically, these joint ventures are funded by advances from the project owner, and accordingly, require little or no equity investment by the joint venture partners but may require subordinated financial support from the joint venture partners such as letters of credit, performance and financial guarantees or obligations to fund losses incurred by the joint venture. Other joint ventures, such as privately financed initiatives in our Ventures business unit, generally require the partners to invest equity and take an ownership position in an entity that manages and operates an asset post construction.

## Edgar Filing: KBR, INC. - Form 10-K

As required by ASC 810-10, we perform a qualitative assessment to determine whether we are the primary beneficiary once an entity is identified as a VIE. A qualitative assessment begins with an understanding of the nature of the risks in the entity as well as the nature of the entity's activities including terms of the contracts entered into by the entity, ownership interests issued by the entity and how they were marketed, and the parties involved in the design of the entity. We then identify all of the variable interests held by parties involved with the VIE including, among other things, equity investments,

**Table of Contents**

subordinated debt financing, letters of credit, and financial and performance guarantees, and contracted service providers. Once we identify the variable interests, we determine those activities which are most significant to the economic performance of the entity and which variable interest holder has the power to direct those activities. Though infrequent, some of our VIEs have no primary beneficiary because the power to direct the most significant activities that impact the economic performance is held equally by two or more variable interest holders who are required to provide their consent prior to the execution of their decisions. Most of the VIEs with which we are involved have relatively few variable interests and are primarily related to our equity investment, significant service contracts, and other subordinated financial support.

**Stock-based compensation**

We apply the fair value recognition provisions of FASB ASC 718-10 for share-based payments to account for and report equity-based compensation. FASB ASC 718-10 requires equity-based compensation expense to be measured based on the grant-date fair value of the award. For performance-based awards, compensation expense is measured based on the grant-date fair value of the award and the fair value of that award is remeasured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period or the vesting period are recognized as compensation cost on a straight line basis over that period. See Note 13 for detailed information on stock-based compensation and incentive plans.

**Additional Balance Sheet Information**

Included in Other current assets on our consolidated balance sheets are Advances to subcontractors and included in Other current liabilities on our consolidated balance sheets are Retainage payables to subcontractors. Our Advances to subcontractors and Retainage payables to subcontractors for the years ended December 31, 2010 and 2009 is presented below:

<i>Millions of dollars</i>	At December 31,	
	2010	2009
Advances to subcontractors	\$ 176	\$ 200
Retainage payables to subcontractors	\$ 226	\$ 217

**Note 2. Income per Share**

Basic income per share is based upon the weighted average number of common shares outstanding during the period. Dilutive income per share includes additional common shares that would have been outstanding if potential common shares with a dilutive effect had been issued, using the treasury stock method. A reconciliation of the number of shares used for the basic and diluted income per share calculations is as follows:

<i>Millions of Shares</i>	Years ended December 31,		
	2010	2009	2008
Basic weighted average common shares outstanding	156	160	166
Stock options and restricted shares	1	1	1
Diluted weighted average common shares outstanding	157	161	167

For purposes of applying the two-class method in computing earnings per share, net earnings allocated to participating securities was approximately \$2 million, or \$0.01 per share, for the fiscal years 2010, 2009, and 2008. The diluted earnings per share calculation did not include 1.1 million, 2.0 million, and 0.8 million antidilutive weighted average shares for the years ended December 31, 2010, 2009, and 2008, respectively.



**Table of Contents****Note 3. Business Combinations and Other Transactions****Business Combinations**

**ENI Holdings, Inc. (the Roberts & Schaefer Company)**. On December 21, 2010, we completed the acquisition of 100% of the outstanding common shares of ENI Holdings, Inc. ( ENI ). ENI is the parent to the Roberts & Schaefer Company ( R&S ), a privately held, EPC services company for material handling and processing systems. Headquartered in Chicago, Illinois, R&S provides services and associated processing infrastructure to customers in the mining and minerals, power, industrial, refining, aggregates, precious and base metals industries.

The purchase price was \$280 million plus preliminary net working capital of \$17 million which included cash acquired of \$8 million. The total net cash paid at closing of \$289 million is subject to post-closing adjustments to be determined in the first quarter of 2011. The purchase price is subject to an escrowed holdback amount of \$43 million to secure post closing working capital adjustments, indemnifications obligations of the sellers and other contingent obligations related to the operations of the business. R&S will be integrated into our IGP segment. We expensed approximately \$1 million related to the acquisition of R&S in 2010 primarily related to legal fees, consultation fees, travel and other miscellaneous expenses.

In accordance with Accounting Standards Codification 805, Business Combinations, ( ASC 805 ), the purchase of R&S was accounted for using the acquisition method which requires an acquirer to recognize and measure the identifiable assets acquired and the liabilities assumed at their fair values as of the acquisition date. The following presents the preliminary allocation of the purchase price to ENI's identifiable assets acquired and liabilities assumed based on the estimates of their fair values at the acquisition date.

**Preliminary allocation of purchase price:**

<i>Millions of dollars, except years</i>	Amount	Estimated Useful Life
<b>Net tangible assets:</b>		
Cash and equivalents	\$ 8	
Notes and accounts receivable	34	
Unbilled receivables	16	
Other assets	3	
Accounts payable and advanced billings	(35)	
Advanced billings on uncompleted contracts	(6)	
Deferred tax liabilities	(22)	
Other current liabilities	(7)	
Total net tangible assets	(9)	
<b>Identifiable intangible assets:</b>		
Customer relationships and backlog	35	2-10 years
Tradenames	17	8-10 years
Other	4	1.5-10 years
Total amount allocated to identifiable intangible assets	56	
Goodwill	250	
<b>Total purchase price</b>	<b>\$ 297</b>	

Goodwill represents the excess of the purchase price over the fair value of the underlying net tangible and intangible assets. Goodwill was recognized primarily as a result of acquiring an assembled workforce, expertise and capabilities in the material handling and processing systems market, cost saving opportunities and other synergies. The acquisition generated goodwill of approximately \$250 million none of which is expected to be deductible for income tax purposes.



## Edgar Filing: KBR, INC. - Form 10-K

Of the total purchase price, \$56 million has been allocated to customer relationships, trade names and other intangibles. Customer relationships represent existing contracts and the underlying customer relationships and backlog and will be amortized on a straight-lined basis over the period in which the economic benefits are expected to be realized. Tradename intangibles include the Roberts & Schaefer's and Soros brands and will be amortized on a straight-lined basis over an estimated useful life of 8-10 years. The fair value of acquired intangible assets is provisional pending receipt of the final valuation for these assets.

---

**Table of Contents**

**Energco.** On April 5, 2010, we acquired 100% of the outstanding common stock of Houston-based Energco Engineering ( Energco ) for approximately \$16 million in cash, subject to an escrowed holdback amount of \$6 million to secure working capital adjustments, indemnification obligations of the sellers, and other contingent obligations related to the operation of the business. As a result of the acquisition, we recognized goodwill of \$6 million and other intangible assets of \$3 million. Energco provides Integrity Management (IM) and advanced structural engineering services to the offshore oil and gas industry. Energco's results of operations were integrated into our Hydrocarbons segment.

**BE&K, Inc.** On July 1, 2008, we acquired 100% of the outstanding common shares of BE&K, Inc., ( BE&K ) a privately held, Birmingham, Alabama-based engineering, construction and maintenance services company. The acquisition of BE&K enhances our ability to provide contractor and maintenance services in North America. The agreed-upon purchase price was \$550 million in cash subject to certain indemnifications and stockholder's equity adjustments as defined in the stock purchase agreement. BE&K and its acquired divisions have been integrated into our Services, Hydrocarbons and IGP segments based upon the nature of the underlying projects acquired.

The purchase consideration paid was approximately \$559 million, which included \$550 million in cash paid at closing, \$7 million in cash paid related to stockholder's equity based purchase price adjustments and \$2 million of direct transaction costs. Long-lived assets largely reflect a value of replacing the assets, which takes into account changes in technology, usage, and relative obsolescence and depreciation of the assets. In addition, assets that would not normally be recorded in ordinary operations (i.e., customer relationships and other intangibles) were recorded at their estimated fair values. The excess of preliminary purchase price over the estimated fair values of the net assets acquired was recorded as goodwill.

Our allocation of the purchase price to the fair value of the major assets acquired and liabilities assumed at the date of acquisition has been adjusted to reflect the agreed upon stockholder's equity and final asset valuation adjustments. Adjustments primarily related to the estimates used in the opening balance sheet valuation for certain intangibles, accounts receivables, accounts payables and other assets and liabilities, as well as the settlement of escrow obligations. In 2009, we decreased goodwill related to BE&K by approximately \$7 million due to an impairment charge of \$6 million and purchase price allocation adjustments of \$1 million related to the completion of our BE&K asset valuation.

**Turnaround Group of Texas, Inc.** In April 2008, we acquired 100% of the outstanding common stock of Turnaround Group of Texas, Inc. ( TGI ). TGI is a Houston-based turnaround management and consulting company that specializes in the planning and execution of turnarounds and outages in the petrochemical, power, and pulp & paper industries. The total purchase consideration for this stock purchase transaction was approximately \$7 million. As a result of the acquisition, we recognized goodwill of \$5 million and other intangible assets of \$2 million. Beginning in April 2008, TGI's results of operations were included in our Services segment.

**Catalyst Interactive.** In April 2008, we acquired 100% of the outstanding common stock of Catalyst Interactive, an Australian e-learning and training solution provider that specializes in the defense, government and industry training sectors. The total purchase consideration for this stock purchase transaction was approximately \$5 million. As a result of the acquisition, we recognized goodwill of approximately \$3 million and other intangible assets of approximately \$2 million. Beginning in April 2008, Catalyst Interactive's results of operations were included in our IGP segment.

**Wabi Development Corporation.** In October 2008, we acquired 100% of the outstanding common stock of Wabi Development Corporation ( Wabi ) for approximately \$20 million in cash. As a result of the acquisition, we recognized goodwill of \$5 million and other intangible assets of \$5 million. Wabi is a privately held Canada-based general contractor, which provides services for the energy, forestry and mining industries. Wabi provides maintenance, fabrication, construction and construction management services to a variety of clients in Canada and Mexico. The integration of Wabi into our

## Table of Contents

Services segment provides additional growth opportunities for our heavy hydrocarbon, forest products, oil sand, general industrial and maintenance services business.

### *Other Transactions*

**M.W. Kellogg Limited ( MWKL ).** On December 31, 2010, we obtained control of the remaining 44.94% interest in our MWKL subsidiary located in the U.K for approximately \$165 million (£107 million) subject to certain post-closing adjustments to be determined during the first quarter of 2011. Under the terms of the purchase agreement, the \$165 million initial purchase price was paid on January 5, 2011 and recorded as Obligation to former noncontrolling interest in our consolidated balance sheet. In addition, we agreed to pay the former noncontrolling interest 44.94% of future proceeds collected on certain receivables owed to MWKL. Furthermore, the former noncontrolling interest agreed to indemnify us for 44.94% of certain MWKL liabilities to be settled and paid in the future. As a result, we recognized an additional \$15 million net liability recorded as Obligation to former noncontrolling interest. The acquisition was recorded as an equity transaction that reduced noncontrolling interests, accumulated other comprehensive income ( AOCI ) and additional paid-in capital by \$180 million. We recognized direct transaction costs associated with the acquisition of approximately \$1 million as a direct charge to additional paid in capital.

**Technology License Agreement.** Effective December 24, 2009, we entered into a collaboration agreement with BP p.l.c. to market and license certain technology. In conjunction with this arrangement, we acquired a license granting us the exclusive right to the technology. In January 2010, as partial consideration for the license, we paid an initial fee of \$20 million, which will be amortized on a straight-line basis over the shorter of its estimated useful life or the 25-year life of the arrangement. We currently estimate the useful life to be 25 years.

### **Note 4. Percentage-of-Completion Contracts**

Revenue from contracts to provide construction, engineering, design, or similar services is reported on the percentage-of-completion method of accounting using measurements of progress toward completion appropriate for the work performed. Commonly used measurements are physical progress, man-hours, and costs incurred.

Billing practices for these projects are governed by the contract terms of each project based upon costs incurred, achievement of milestones, or pre-agreed schedules. Billings do not necessarily correlate with revenue recognized using the percentage-of-completion method of accounting. Billings in excess of recognized revenue are recorded in Advance billings on uncompleted contracts. When billings are less than recognized revenue, the difference is recorded in Unbilled receivables on uncompleted contracts. With the exception of claims and change orders that are in the process of being negotiated with customers, unbilled receivables are usually billed during normal billing processes following achievement of the contractual requirements.

Recording of profits and losses on percentage-of-completion contracts requires an estimate of the total profit or loss over the life of each contract. This estimate requires consideration of contract value, change orders and claims reduced by costs incurred and estimated costs to complete. Anticipated losses on contracts are recorded in full in the period they become evident. Except in a limited number of projects that have significant uncertainties in the estimation of costs, we do not delay income recognition until projects have reached a specified percentage of completion. Generally, profits are recorded from the commencement date of the contract based upon the total estimated contract profit multiplied by the current percentage complete for the contract.

When calculating the amount of total profit or loss on a percentage-of-completion contract, we include unapproved claims in total estimated contract value when the collection is deemed probable based upon the four criteria for recognizing unapproved claims in accordance with FASB ASC 605-35 related to accounting for performance of construction-type and certain production-type contracts. Including unapproved claims in this calculation increases the operating income (or reduces the operating loss) that would otherwise be recorded without consideration of the probable unapproved claims. Probable unapproved claims are recorded to the extent of costs incurred and include no profit element. In all cases, the probable unapproved claims included in determining contract profit or loss are less than the actual claim that will be or has been presented to the customer.

When recording the revenue and the associated unbilled receivable for unapproved claims, we only accrue an amount equal to the costs incurred related to probable unapproved claims. The amounts of unapproved claims and change orders included in determining the profit or loss on contracts and recorded in current and non-current unbilled receivables on uncompleted contracts are as follows:

Millions of dollars	Years ended December 31,	
	2010	2009

## Edgar Filing: KBR, INC. - Form 10-K

Probable unapproved claims	\$	19	\$	33
Probable unapproved change orders		10		61
Probable unapproved change orders related to unconsolidated subsidiaries		3		2

As of December 31, 2010, the probable unapproved claims related to a completed project. See Note 9 for a discussion of U.S. government contract claims, which are not included in the table above.

Included in the table above are contracts with probable unapproved claims that will likely not be settled within one year totaling \$19 million and \$20 million at December 31, 2010 and 2009, respectively, which are reflected as a non-current asset in Noncurrent unbilled receivables on uncompleted contracts on the condensed consolidated balance sheets. Other probable unapproved claims and change orders that we believe will be settled within one year, have been recorded as a current asset in Unbilled receivables on uncompleted contracts on the condensed consolidated balance sheets.

**PEMEX Arbitration.** In 1997 and 1998 we entered into three contracts with PEMEX, the project owner, to build offshore platforms, pipelines and related structures in the Bay of Campeche offshore Mexico. The three contracts were known as EPC 1, EPC 22 and EPC 28. All three projects encountered significant schedule delays and increased costs due to problems with design work, late delivery and defects in equipment, increases in scope and other changes. PEMEX took

---

## **Table of Contents**

possession of the offshore facilities of EPC 1 in March 2004 after having achieved oil production but prior to our completion of our scope of work pursuant to the contract.

We filed for arbitration with the International Chamber of Commerce ( ICC ) in 2004 claiming recovery of damages of \$323 million for EPC 1 and PEMEX subsequently filed counterclaims totaling \$157 million. The EPC 1 arbitration hearings were held in November 2007. In December 2009, the ICC ruled in our favor and we were awarded a total of approximately \$351 million including legal and administrative recovery fees as well as interest. PEMEX was awarded approximately \$6 million on counterclaims, plus interest on a portion of that sum. The amount of the award exceeded the book value of our claim receivable resulting in our recognition of a \$183 million of operating income and \$117 million of net income in the fourth quarter of 2009. The arbitration award is legally binding and we filed a proceeding in U.S. Federal Court to recognize the award pursuant to which hearings were held in July 2010. The Court entered judgment on November 2, 2010 in our favor. The judgment included an award of approximately \$356 million in our favor as of October 5, 2010, plus interest thereon until paid. PEMEX initiated an appeal and a stay related to the enforcement of the judgment which was granted by the Lower District Court and PEMEX was required to post collateral of \$395 million with the court registry.

PEMEX has attempted to nullify the award in Mexican court. The Mexican trial court rejected PEMEX's nullification petition. PEMEX has filed additional appeals in the Mexican Courts. We will respond to further efforts by PEMEX to nullify our award as may be required. Although it is possible we could resolve and collect the amounts due from PEMEX in the next 12 months, we believe the timing of the collection of the award is uncertain and therefore, we have continued to classify the amount due from PEMEX as a long term receivable included in Noncurrent unbilled receivable on uncompleted contracts as of December 31, 2010. No adjustments have been made to our receivable balance since recognition of the initial award in the fourth quarter of 2009. Depending on the timing and amount ultimately settled with PEMEX, we could recognize an additional gain upon collection of the award.

### **Note 5. Business Segment Information**

We provide a wide range of services, but the management of our business is heavily focused on major projects within each of our reportable segments. At any given time, a relatively few number of projects and joint ventures represent a substantial part of our operations. Our equity in earnings and losses of unconsolidated affiliates that are accounted for using the equity method of accounting is included in revenue of the applicable segment.

#### *Business Reorganization*

Our reportable segments are consistent with the financial information that our chief executive officer ( CEO ), who is our chief operating decision maker, reviews to evaluate operating performance and make resource allocation decisions. In the first quarter of 2010, we reorganized our business into discrete engineering and construction business units, each focused on a specific segment of the market with identifiable customers, business strategies, and sales and marketing capabilities. The reorganization includes the realignment of certain underlying projects among our existing business units as well as the transfer of certain projects to several newly formed business units as further described below. Certain realigned business units are reported under the newly formed Hydrocarbons and Infrastructure, Government & Power ( IGP ) business segments which are reportable segments as defined by the criteria in Financial Accounting Standard Board ( FASB ) Accounting Standard Codification ( ASC ) 280 Segment Reporting. Each business segment is led by a business segment president who reports directly to our chief operating decision maker. Our Services segment continues to operate as a stand-alone reportable segment reporting directly to our chief operating decision maker. Our Ventures business unit was not impacted by the reorganization. We have revised our segment reporting to represent how we now manage our business, restating prior periods to conform to the current segment presentation.

The following is a description of our reportable segments:

**Hydrocarbons.** Our Hydrocarbons business segment serves the Hydrocarbon industry by providing services ranging from prefeasibility studies to designing, and construction to commissioning of process facilities in remote locations around the world. We are involved in hydrocarbon processing which includes constructing liquefied natural gas ( LNG ) plants in several countries. Our global teams of engineers also execute and provide solutions for projects in the biofuel, carbon capture, oil and gas, olefins and petrochemical markets. The Hydrocarbons business segment includes the Gas Monetization, Oil & Gas, Downstream, and Technology business units. Prior to the 2010 business reorganization, the Downstream and Technology business units were reported as part of the Other segment and our Gas Monetization and Oil & Gas business units were collectively reported as the Upstream segment.

Our Gas Monetization business unit designs and constructs facilities that enable our customers to monetize their



## Table of Contents

natural gas resources. We design and build LNG and gas-to-liquids ( GTL ) facilities that allow for the economical development and transportation of resources from locations across the globe. Additionally, we make significant contributions in gas processing development, equipment design and innovative construction methods. Our Oil & Gas business unit delivers onshore and offshore oil and natural gas production facilities which include platforms, floating production and subsea facilities, and pipelines. We also implement the infrastructure needed to make intricate projects feasible by managing projects ranging from deepwater through landfalls, to onshore environments, in remote desert regions, tropical rain forests, and major river crossings. Our Downstream business unit provides a complete range of engineering, procurement, construction and construction services ( EPC-CS ) services, as well as program and project management, consulting, front-end engineering and design ( FEED ) for refineries, petrochemical and other plants. Our Technology business unit provides expertise related to differentiated process technologies for the coal monetization, petrochemical, refining and syngas markets.

**Infrastructure, Government & Power.** Our IGP business segment serves the Infrastructure, Government & Power industries delivering effective solutions to defense and governmental agencies worldwide, providing base operations, facilities management, border security, engineering, procurement and construction ( EPC ) services, and logistics support. We also deliver project management support and services for an array of complex initiatives and provide project management for the airfield design and construction program, runway expansion and widening, bridges, new cargo infrastructure and drainage improvements. For the industrial manufacturing sector, we provide a full range of EPC services to a variety of heavy industrial and advanced manufacturing markets, frequently employing our clients' proprietary knowledge and technologies in strategically critical projects. For the power market, we use our full-scope EPC expertise to execute projects which play a distinctive role in increasing the world's power generation capacity from multiple fuel sources and in enhancing the efficiency and environmental compliance of existing power facilities. The IGP business segment includes the North American Government and Defense ( NAGD ), International Government and Defence ( IGD ), Infrastructure and Minerals ( I&M ), and the Power and Industrial ( P&I ) business units. On December 21, 2010, we completed the acquisition of 100% of the outstanding common shares of ENI Holdings, Inc. ( ENI ). ENI is the parent to the Roberts & Schaefer Company ( R&S ), a privately held, EPC services company for material handling and processing systems. R&S provides services and associated processing infrastructure to customers in the mining and minerals, power, industrial, refining, aggregates, precious and base metals industries. R&S will be integrated into our Infrastructure, Government and Power segment.

**Services.** Our Services segment delivers full-scope construction, construction management, fabrication, operations/maintenance, commissioning/startup and turnaround expertise to customers worldwide to a broad variety of markets including oil and gas, petrochemicals and hydrocarbon processing, power, alternate energy, pulp and paper, industrial and manufacturing, and consumer product industries. Specifically, Services is organized around four major product lines; U.S. Construction, Industrial Services, Building Group and Canada. Our U.S. Construction product line delivers direct hire construction, construction management for construction only projects to a variety of markets and works closely with the Hydrocarbons group and Power and Industrial business unit to provide construction execution support on all domestic EPC projects. Our Industrial Services product line is a diversified maintenance organization operating on a global basis providing maintenance, on-call construction, turnaround and specialty services to a variety of markets. This group works with all of our other operating units to identify potential for pull through opportunities and to identify upcoming EPC projects at one of the 80 plus locations where we have embedded KBR personnel. Our Building Group product line provides general commercial contractor-related services to education, food and beverage, health care, hospitality and entertainment, life science and technology, and mixed-use building clients. Our Canada product line is a diversified construction and fabrication operation providing direct hire construction, module assembly, fabrication and maintenance services to our Canadian customers. This product line serves a number of markets including oil and gas customers operating in the oil sands, pulp and paper, mining and industrial markets.

Certain of our business units meet the definition of operating segments contained in FASB ASC 280 Segment Reporting, but individually do not meet the quantitative thresholds as a reportable segment, nor do they share a majority of the aggregation criteria with another operating segment. These operating segments are reported on a combined basis as Other and include our Ventures and Allstates business units as well as corporate expenses not included in the operating segments' results. Our segment information has been prepared in accordance with FASB ASC 280 Segment Reporting.

Our reportable segments follow the same accounting policies as those described in Note 2 (Significant Accounting Policies). Our equity in pretax earnings and losses of unconsolidated affiliates that are accounted for using the equity method of accounting is included in revenue and operating income of the applicable segment.

Reportable segment performance is evaluated by our chief operating decision maker using operating segment income which is defined as operating segment revenue less the cost of services and segment overhead directly attributable to the

**Table of Contents**

operating segment. Reportable segment income excludes certain cost of services and general and administrative expenses directly attributable to the operating segment that is managed and reported at the corporate level, and corporate general and administrative expenses. We believe this is the most accurate measure of the ongoing profitability of our operating segments.

Labor cost absorption in the following table represents costs incurred by our central service labor and resource groups (above) or under the amounts charged to the operating segments. Additionally, in the following table depreciation and amortization associated with corporate assets is allocated to our operating segments for determining operating income or loss.

The tables below present information on our reportable segments.

**Operations by Reportable Segment**

Millions of dollars	Years ended December 31,		
	2010	2009	2008
<b>Revenue:</b>			
Hydrocarbons	\$ 3,969	\$ 3,906	\$ 3,250
Infrastructure, Government and Power	4,299	6,288	7,123
Services	1,755	1,863	1,188
Other	76	48	20
Total revenue	\$ 10,099	\$ 12,105	\$ 11,581
<b>Operating segment income:</b>			
Hydrocarbons	\$ 400	\$ 464	\$ 332
Infrastructure, Government and Power	272	188	341
Services	102	96	101
Other	35	16	(2)
Operating segment income	809	764	772
Unallocated amounts:			
Labor cost absorption	12	(11)	(8)
Corporate general and administrative	(212)	(217)	(223)
Total operating income	\$ 609	\$ 536	\$ 541
<b>Capital Expenditures:</b>			
Hydrocarbons	\$ 1	\$ 2	\$ 1
Infrastructure, Government and Power	8	9	12
Services	2	4	3
Other	55	26	21
Total	\$ 66	\$ 41	\$ 37
<b>Equity in earnings (losses) of unconsolidated affiliates, net:</b>			
Hydrocarbons	\$ 40	\$ (30)	\$ 25
Infrastructure, Government and Power	40	27	46



Edgar Filing: KBR, INC. - Form 10-K

Services	33	28	20
Other	24	20	(3)
Total	\$ 137	\$ 45	\$ 88

**Depreciation and amortization:**

Hydrocarbons	\$ 3	\$ 3	\$ 4
Infrastructure, Government and Power	6	5	6
Services	12	19	9
Other	41	28	30
Total	\$ 62	\$ 55	\$ 49

**Table of Contents**

Within KBR, not all assets are associated with specific segments. Those assets specific to segments include receivables, inventories, certain identified property, plant and equipment and equity in and advances to related companies, and goodwill. The remaining assets, such as cash and the remaining property, plant and equipment, are considered to be shared among the segments and are therefore reported as General corporate assets.

**Balance Sheet Information by Operating Segment**

Millions of dollars	December 31,	
	2010	2009
<b>Total assets:</b>		
Hydrocarbons	\$ 2,136	\$ 1,906
Infrastructure, Government and Power	2,836	2,609
Services	590	578
Other	(145)	234
Total assets	\$ 5,417	\$ 5,327
<b>Goodwill:</b>		
Hydrocarbons	\$ 249	\$ 243
Infrastructure, Government and Power	399	149
Services	287	287
Other	12	12
Total	\$ 947	\$ 691
<b>Equity in/advances to related companies:</b>		
Hydrocarbons	\$ 49	\$ 8
Infrastructure, Government and Power	13	8
Services	33	30
Other	124	118
Total	\$ 219	\$ 164

Revenue by country is determined based on the location of services provided. Long-lived assets by country are determined based on the location of tangible assets.

**Selected Geographic Information**

Millions of dollars	Years ended December 31,		
	2010	2009	2008
<b>Revenue:</b>			
United States	\$ 2,082	\$ 2,550	\$ 1,761
Iraq	2,891	4,239	5,033
Africa	2,094	2,260	1,538

Edgar Filing: KBR, INC. - Form 10-K

Other Middle East	995	1,224	1,337
Asia Pacific (includes Australia)	1,030	624	719
Europe	585	607	815
Other Countries	422	601	378
<b>Total</b>	<b>\$ 10,099</b>	<b>\$ 12,105</b>	<b>\$ 11,581</b>

Millions of dollars	December 31,	
	2010	2009
<b>Long-Lived Assets (PP&amp;E):</b>		
United States	\$ 178	\$ 141
United Kingdom	111	42
Other Countries	66	68
<b>Total</b>	<b>\$ 355</b>	<b>\$ 251</b>

**Table of Contents****Note 6. Goodwill and Intangible Assets****Goodwill**

*Business Reorganization.* In the first quarter of 2010, we reorganized our business into discrete business units, each focused on a specific segment of the market with identifiable customers, business strategies, and sales and marketing capabilities. Certain realigned business units are reported under the newly formed Hydrocarbons and IGP segments. We have revised our segment reporting to represent how we now manage our business, restating prior periods to conform to the current segment presentation with the significant changes in presentation discussed below.

<i>In millions</i>	Hydrocarbons	IGP	Services	Other	Total
Balance at December 31, 2008 as previously reported	159	31	397	107	694
Retroactive effect of reorganization adjustments	84	118	(118)	(84)	
Balance at December 31, 2008 as adjusted	243	149	279	23	694
Impairment of goodwill				(6)	(6)
Purchase price and other adjustments			3		3
Reallocation adjustment			5	(5)	
Balance at December 31, 2009	243	149	287	12	691
Acquisition of R&S		250			250
Acquisition of Energo	6				6
Balance at December 31, 2010	\$ 249	\$ 399	\$ 287	\$ 12	\$ 947

The increase in goodwill was primarily due to the acquisition of R&S in December 2010 and Energo in April 2010. See Note 3 for further discussion of these acquired entities.

In the third quarter of 2009, we recognized a goodwill impairment charge of approximately \$6 million related to the AllStates staffing business unit in connection with our annual goodwill impairment test on September 30, 2009. The charge was primarily the result of a decline in the staffing market, the effect of the recession on the market, and our reduced forecasts of the sales, operating income and cash flows for this reporting unit that were identified through the course of our annual planning process. As of October 1, 2010, goodwill and intangibles for this reporting unit totaled approximately \$18 million, including goodwill of \$12 million.

**Intangible Assets**

Intangible assets are comprised of customer relationships, contracts, backlog, trade name licensing agreements and other. As of December 31, 2010 and 2009, the cost and accumulated amortization of our intangible assets were as follows:

<i>Millions of dollars</i>	At December 31,	
	2010	2009
Intangibles not subject to amortization	\$ 11	\$ 10
Intangibles subject to amortization	190	106
Total intangibles	201	116
Accumulated amortization of intangibles	(74)	(58)

Net intangibles	\$	127	\$	58
-----------------	----	-----	----	----

**Table of Contents**

Intangibles subject to amortization are amortized over their estimated useful lives of up to 15 years. Our intangible amortization expense for the years ended December 31, 2010, 2009 and 2008 is presented below:

<i>Millions of dollars</i>	Intangibles amortization expense
2008	\$ 11
2009	\$ 15
2010	\$ 12

Our expected intangibles amortization expense in future periods is presented below:

<i>Millions of dollars</i>	Expected future intangibles amortization expense
2011	\$ 15
2012	\$ 14
2013	\$ 13
2014	\$ 11
2015	\$ 10

**Note 7. Property, Plant and Equipment**

Other than those assets that have been written down to their fair values due to impairment, property, plant, and equipment are reported at cost less accumulated depreciation, which is generally provided on the straight-line method over the estimated useful lives of the assets. Some assets are depreciated on accelerated methods. Accelerated depreciation methods are also used for tax purposes, wherever permitted. Upon sale or retirement of an asset, the related costs and accumulated depreciation are removed from the accounts and any gain or loss is recognized.

Property, plant and equipment are composed of the following:

<i>Millions of dollars</i>	Estimated Useful Lives in Years	December 31,	
		2010	2009
Land	N/A	\$ 31	\$ 31
Buildings and property improvements	5-44	212	203
Equipment and other	3-20	446	281
Total		689	515
Less accumulated depreciation		(334)	(264)

Edgar Filing: KBR, INC. - Form 10-K

Net property, plant and equipment	\$ 355	\$ 251
-----------------------------------	--------	--------

In the fourth quarter of 2010, we recognized a \$5 million impairment charge on long-lived assets associated with a technology center in our Hydrocarbons segment primarily related to equipment, land and buildings. Our Hydrocarbons segment intends to replace the function of the technology operating center through alliances and joint-ventures with third parties rather than direct ownership. As a result of our decision to sell the assets, we adjusted the carrying values to fair value as of December 31, 2010 and such fair value was based on third-party market prices for similar assets.

---

**Table of Contents****Note 8. Debt and Other Credit Facilities***Revolving Credit Facility*

On November 3, 2009, we entered into a new syndicated, unsecured \$1.1 billion three-year revolving credit agreement (the *Revolving Credit Facility*), with Citibank, N.A., as agent, and a group of banks and institutional lenders replacing our previous facility, which was terminated when we entered into the new *Revolving Credit Facility*. The *Revolving Credit Facility* is used for working capital and letters of credit for general corporate purposes and expires in November 2012. While there is no sub-limit for letters of credit under this facility, letters of credit fronting commitments at December 31, 2010 totaled \$880 million, which we would seek to expand if necessary. Amounts drawn under the *Revolving Credit Facility* will bear interest at variable rates based either on the London interbank offered rate (LIBOR) plus 3%, or a base rate plus 2%, with the base rate being equal to the highest of reference bank's publicly announced base rate, the Federal Funds Rate plus 0.5%, or LIBOR plus 1%. The *Revolving Credit Facility* provides for fees on the undrawn amounts of letters of credit issued under the *Revolving Credit Facility* of 1.5% for performance and commercial letters of credit and 3% for all others. We are also charged an issuance fee of 0.05% for the issuance of letters of credit, a per annum commitment fee of 0.625% for any unused portion of the credit line, and a per annum fronting commitment fee of 0.25%. As of December 31, 2010, there were no outstanding advances and \$278 million in letters of credit issued and outstanding under the *Revolving Credit Facility*.

The *Revolving Credit Facility* includes financial covenants requiring maintenance of a ratio of consolidated debt to consolidated EBITDA of 3.5 to 1 and a minimum consolidated net worth of \$2 billion plus 50% of consolidated net income for each quarter ending after September 30, 2009 plus 100% of any increase in shareholders' equity attributable to the sale of equity securities.

The *Revolving Credit Facility* contains a number of covenants restricting, among other things, our ability to incur additional liens and sales of our assets, as well as limiting the amount of investments we can make. The *Revolving Credit Facility* also permits us, among other things, to declare and pay shareholder dividends and/or engage in equity repurchases not to exceed \$400 million in the aggregate and to incur indebtedness in respect of purchase money obligations, capitalized leases and refinancing or renewals secured by liens upon or in property acquired, constructed or improved in an aggregate principal amount not to exceed \$200 million. At December 31, 2010, the remaining limit of the above mentioned covenant that we can use to re-acquire KBR common stock or to pay dividends is approximately \$137 million. Our subsidiaries may incur unsecured indebtedness not to exceed \$100 million in aggregate outstanding principal amount at any time.

*Letters of credit*

In connection with certain projects, we are required to provide letters of credit or surety bonds to our customers. Letters of credit are provided to customers in the ordinary course of business to guarantee advance payments from certain customers, support future joint venture funding commitments and to provide performance and completion guarantees on engineering and construction contracts. We have \$1.9 billion in committed and uncommitted lines of credit to support letters of credit and as of December 31, 2010 and we had utilized \$623 million of our credit capacity for letters of credit, including \$37 million in letters of credit issued and outstanding under various Halliburton facilities that are irrevocably and unconditionally guaranteed by our former parent. Surety bonds are also posted under the terms of certain contracts primarily related to state and local government projects to guarantee our performance.

The \$623 million in letters of credit outstanding on KBR lines of credit was comprised of \$278 million issued under our *Revolving Credit Facility* and \$345 million issued under uncommitted bank lines at December 31, 2010. Of the total letters of credit outstanding, \$274 million relate to our joint venture operations and \$22 million of the letters of credit have terms that could entitle a bank to require cash collateralization on demand. Approximately \$182 million of the \$278 million letters of credit issued under our *Revolving Credit Facility* have expiry dates close to or beyond the maturity date of the facility. Under the terms of the *Revolving Credit Facility*, if the original maturities date of November 2, 2012 is not extended then the issuing banks may require that we provide cash collateral for these extended letters of credit no later than 95 days prior to the original maturity date. As the need arises, future projects will be supported by letters of credit issued under our *Revolving Credit Facility* or arranged on a bilateral basis. We believe we have adequate letter of credit capacity under our existing *Revolving Credit Facility* and bilateral lines of credit to support our operations for the next twelve months.

Halliburton has guaranteed certain letters of credit and surety bonds and provided parent company guarantees related to our performance and financial commitments on certain projects. We expect to cancel these letters of credit and surety bonds as we complete the underlying projects. We agreed to pay Halliburton a quarterly carry charge, which has increased in accordance with our extension provisions, for its guarantees of our outstanding letters of credit and surety bonds and agreed to indemnify Halliburton for all losses in connection with the outstanding credit support instruments and any new credit.





---

## **Table of Contents**

support instruments relating to our business for which Halliburton may become obligated following the separation. During 2009, we paid an annual fee to Halliburton calculated at 0.40% of the outstanding performance-related letters of credit, 0.80% of the outstanding financial-related letters of credit guaranteed by Halliburton and 0.25% of the outstanding guaranteed surety bonds. Effective January 1, 2010, the annual fee increased to 0.90%, 1.65% and 0.50% of the outstanding performance-related and financial-related outstanding issued letters of credit and the outstanding guaranteed surety bonds, respectively.

### *Nonrecourse Project Finance Debt*

In 2001, Fasttrax Limited, a joint venture in which we own a 50% equity interest with an unrelated partner, was awarded a contract with the U.K. MoD to provide a fleet of 92 heavy equipment transporters ( HETs ) to the British Army. Under the terms of the arrangement, Fasttrax Limited will operate and maintain the HET fleet for a term of 22 years. The purchase of the HETs by the joint venture was financed through a series of bonds secured by the assets of Fasttrax Limited totaling approximately £84.9 million and are non-recourse to KBR and its partner of which £12.2 million provided equity bridge financing. The bridge financing was replaced in 2005 with combined equity capital contributions and subordinated loans from the joint venture partners. The bonds are guaranteed by Ambac Assurance UK Ltd under a policy that guarantees the schedule of the principle and interest payments to the bond trustee in the event of non-payment by Fasttrax Limited. See Note 15 for additional details on Fasttrax Limited non-recourse project finance debt of a VIE that is consolidated by KBR.

### **Note 9. United States Government Contract Work**

We provide substantial work under our government contracts to the United States Department of Defense and other governmental agencies. These contracts include our worldwide United States Army logistics contracts, known as LogCAP III and IV, and the U.S. Army Europe ( USAREUR ) contract.

Given the demands of working in Iraq and elsewhere for the U.S. government, as discussed further below, we have disagreements and have experienced performance issues with the various government customers for which we work. When performance issues arise under any of our government contracts, the government retains the right to pursue remedies, which could include termination, under any affected contract. If any contract were so terminated, we may not receive award fees under the affected contract, and our ability to secure future contracts could be adversely affected, although we would receive payment for amounts owed for our allowable costs under cost-reimbursable contracts. Other remedies that could be sought by our government customers for any improper activities or performance issues include sanctions such as forfeiture of profits, suspension of payments, fines, and suspensions or debarment from doing business with the government. Further, the negative publicity that could arise from disagreements with our customers or sanctions as a result thereof could have an adverse effect on our reputation in the industry, reduce our ability to compete for new contracts, and may also have a material adverse effect on our business, financial condition, results of operations, and cash flow.

We have experienced and expect to be a party to various claims against us by employees, third parties, soldiers, subcontractors and others that have arisen out of our work in Iraq such as claims for wrongful termination, assaults against employees, personal injury claims by third parties and army personnel, and subcontractor claims. While we believe we conduct our operations safely, the environments in which we operate often lead to these types of claims. We believe the vast majority of these types of claims are governed by the Defense Base Act or precluded by other defenses. We have a dispute resolution program under which most employment claims are subject to binding arbitration. However, as a result of amendments to the Department of Defense Appropriations Act of 2010, certain types of employee claims cannot be compelled to binding arbitration. An unfavorable resolution or disposition of these matters could have a material adverse effect on our business, results of operations, financial condition and cash flow.

### *Award Fees*

In accordance with the provisions of the LogCAP III contract, we earn profits on our services rendered based on a combination of a fixed fee plus award fees granted by our customer. Both fees are measured as a percentage rate applied to estimated and negotiated costs. Our customer is contractually obligated to periodically convene Award-Fee Boards, which are comprised of individuals who have been designated to assist the Award Fee Determining Official ( AFDO ) in making award fee determinations. Award fees are based on evaluations of our performance using criteria set forth in the contract, which include non-binding monthly evaluations made by our customers in the field of operations. Although these criteria have historically been used by the Award-Fee Boards in reaching their recommendations, the amounts of award fees are determined at the sole discretion of the AFDO.

On February 19, 2010, KBR was notified by the AFDO that a determination had been made regarding the Company's



## **Table of Contents**

performance for the period January 2008 to April 2008 in Iraq. The notice stated that based on information received from various Department of Defense individuals and organizations after the date of the evaluation board held in June 2008, the AFDO made a unilateral decision to grant no award fees for the period of performance from January 2008 to April 2008.

As a result of the AFDO's adverse determination, in the fourth quarter of 2009, we reversed award fees that had previously been estimated as earned and recognized as revenue. Until we are able to reliably estimate fees to be awarded in the future, we will recognize award fees on the LogCAP III contract in the period they are awarded. In May 2010, we recognized an award fee of approximately \$60 million representing approximately 47% of the available award fee pool for the period of performance from May 2008 through August 2009 which we recorded as an increase to revenue in the second quarter of 2010. In September 2010, we recognized an award fee of approximately \$34 million representing approximately 66% of the available award fee pool for the period of performance from September 2009 through February 2010 on task orders in Iraq and from September 2009 through May 2010 on task orders in Afghanistan, which was recorded as an increase to revenue in the third quarter of 2010.

Prior to the fourth quarter of 2009, we recognized award fees on the LogCAP III contract using an estimated accrual of the amounts to be awarded. Once task orders underlying the work are definitized and award fees are granted, we adjusted our estimate of award fees to the actual amounts earned. We used 72% as our accrual rate through the third quarter of 2009.

### ***Government Compliance Matters***

The negotiation, administration, and settlement of our contracts with the U.S. Government, consisting primarily of Department of Defense contracts, are subject to audit by the Defense Contract Audit Agency (DCAA), which serves in an advisory role to the Defense Contract Management Agency (DCMA) which is responsible for the administration of our contracts. The scope of these audits include, among other things, the allowability, allocability, and reasonableness of incurred costs, approval of annual overhead rates, compliance with the Federal Acquisition Regulation (FAR) and Cost Accounting Standard (CAS) Regulations, compliance with certain unique contract clauses, and audits of certain aspects of our internal control systems. Issues identified during these audits are typically discussed and reviewed with us, and certain matters are included in audit reports issued by the DCAA, with its recommendations to our customer's administrative contracting officer (ACO). We attempt to resolve all issues identified in audit reports by working directly with the DCAA and the ACO. When agreement cannot be reached, DCAA may issue a Form 1, Notice of Contract Costs Suspended and/or Disapproved, which recommends withholding the previously paid amounts or it may issue an advisory report to the ACO. KBR is permitted to respond to these documents and provide additional support. At December 31, 2010, we had open Form 1's from the DCAA recommending suspension of payments totaling approximately \$319 million associated with our contract costs incurred in prior years, of which approximately \$160 million has been withheld from our current billings. As a consequence, for certain of these matters, we have withheld approximately \$81 million from our subcontractors under the payment terms of those contracts. In addition, we have outstanding demand letters received from our customer requesting that we remit a total of \$84 million of disapproved costs for which we currently do not intend to pay. We continue to work with our ACO's, the DCAA and our subcontractors to resolve these issues. However, for certain of these matters, we have filed claims with the Armed Services Board of Contract Appeals or the United States Court of Federal Claims.

KBR excludes from billings to the U.S. Government costs that are expressly unallowable, or mutually agreed to be unallowable, or not allocable to government contracts per applicable regulations. Revenue recorded for government contract work is reduced for our estimate of potentially refundable costs related to issues that may be categorized as disputed or unallowable as a result of cost overruns or the audit process. Our estimates of potentially unallowable costs are based upon, among other things, our internal analysis of the facts and circumstances, terms of the contracts and the applicable provisions of the FAR, quality of supporting documentation for costs incurred, and subcontract terms as applicable. From time to time, we engage outside counsel to advise us on certain matters in determining whether certain costs are allowable. We also review our analysis and findings with the ACO as appropriate. In some cases, we may not reach agreement with the DCAA or the ACO regarding potentially unallowable costs which may result in our filing of claims in various courts such as the Armed Services Board of Contract Appeals (ASBCA) or the United States Court of Federal Claims (COFC). We only include amounts in revenue related to disputed and potentially unallowable costs when we determine it is probable that such costs will result in revenue. We generally do not recognize additional revenue for disputed or potentially unallowable costs for which revenue has been previously reduced until we reach agreement with the DCAA and/or the ACO that such costs are allowable.

Certain issues raised as a result of contract audits and other investigations are discussed below.

***Private Security.*** In February 2007, we received a Form 1 notice from the Department of the Army informing us of their intent to adjust payments under the LogCAP III contract associated with the cost incurred for the years 2003 through



---

**Table of Contents**

2006 by certain of our subcontractors to provide security to their employees. Based on that notice, the Army withheld its initial assessment of \$20 million. The Army based its initial assessment on one subcontract wherein, based on communications with the subcontractor, the Army estimated 6% of the total subcontract cost related to the private security costs. The Army previously indicated that not all task orders and subcontracts have been reviewed and that they may make additional adjustments. In August 2009, we received a Form 1 notice from the DCAA disapproving an additional \$83 million of costs incurred by us and our subcontractors to provide security during the same periods. Since that time, the Army withheld an additional \$24 million in payments from us bringing the total payments withheld to approximately \$44 million as of December 31, 2010 out of the Form 1 notices issued to date of \$103 million.

The Army indicated that they believe our LogCAP III contract prohibits us and our subcontractors from billing costs of privately acquired security. We believe that, while the LogCAP III contract anticipates that the Army will provide force protection to KBR employees, it does not prohibit us or any of our subcontractors from using private security services to provide force protection to KBR or subcontractor personnel. In addition, a significant portion of our subcontracts are competitively bid fixed price subcontracts. As a result, we do not receive details of the subcontractors' cost estimate nor are we legally entitled to it. Further, we have not paid our subcontractors any additional compensation for security services. Accordingly, we believe that we are entitled to reimbursement by the Army for the cost of services provided by us or our subcontractors, even if they incurred costs for private force protection services. Therefore, we believe that the Army's position that such costs are unallowable and that they are entitled to withhold amounts incurred for such costs is wrong as a matter of law.

In 2007, we provided at the Army's request information that addresses the use of armed security either directly or indirectly charged to LogCAP III. In October 2007, we filed a claim to recover the original \$20 million that was withheld which was deemed denied as a result of no response from the contracting officer. To date, we have filed appeals to the ASBCA to recover \$44 million of the amounts withheld from us which is currently in the early stages of discovery. We believe these sums were properly billed under our contract with the Army. At this time, we believe the likelihood that a loss related to this matter has been incurred is remote. We have not adjusted our revenues or accrued any amounts related to this matter. This matter is also the subject of a separate claim filed by the Department of Justice ( DOJ ) for alleged violation of the False Claims Act as discussed further below under the heading Investigations, Qui Tams and Litigation.

**Containers.** In June 2005, the DCAA recommended withholding certain costs associated with providing containerized housing for soldiers and supporting civilian personnel in Iraq. The DCMA agreed that the costs be withheld pending receipt of additional explanation or documentation to support the subcontract costs. We have not received a final determination by the DCMA and, as requested, we continue to provide information to the DCMA. As of December 31, 2010, approximately \$26 million of costs have been suspended under Form 1 notices and withheld from us by our customer related to this matter of which \$30 million has been withheld by us from our subcontractor. In April 2008, we filed a counterclaim in arbitration against our LogCAP III subcontractor, First Kuwaiti Trading Company, to recover approximately \$51 million paid to the subcontractor for containerized housing as further described under the caption First Kuwaiti Trading Company arbitration below. We will continue working with the government and our subcontractor to resolve the remaining amounts. We believe that the costs incurred associated with providing containerized housing are reasonable and we intend to vigorously defend ourselves in this matter. We do not believe that we face a risk of significant loss from any disallowance of these costs in excess of the amounts we have withheld from subcontractors and the loss accruals we have recorded. At this time, the likelihood that a loss in excess of the amount accrued for this matter is remote.

**Dining facilities.** In 2006, the DCAA raised questions regarding our billings and price reasonableness of costs related to dining facilities in Iraq. We responded to the DCMA that our costs are reasonable. As of December 31, 2010, we have outstanding Form 1 notices from the DCAA disapproving \$165 million in costs related to these dining facilities until such time we provide documentation to support the price reasonableness of the rates negotiated with our subcontractor and demonstrate that the amounts billed were in accordance with the contract terms. We believe the prices obtained for these services were reasonable and intend to vigorously defend ourselves on this matter. We filed claims in the U.S. COFC to recover \$58 million of the \$80 million withheld from us by the customer. The claims proceedings are in the discovery process and no trial date has been set but is expected to occur in 2011. With respect to questions raised regarding billing in accordance with contract terms, as of December 31, 2010, we believe it is reasonably possible that we could incur losses in excess of the amount accrued for possible subcontractor costs billed to the customer that were possibly not in accordance with contract terms. However, we are unable to estimate an amount of possible loss or range of possible loss in excess of the amount accrued related to any costs billed to the customer that were not in accordance with the contract terms. We believe the prices obtained for these services were reasonable, we intend to vigorously defend ourselves in this matter and we do not believe we face a risk of significant loss from any disallowance of these costs in excess of amounts withheld from subcontractors. As of December 31, 2010, we had withheld \$41 million in payments from our subcontractors pending the resolution of these matters with our customer.

## **Table of Contents**

Additionally, one of our subcontractors, Tamimi, filed for arbitration to recover approximately \$35 million for payments we have withheld from them pending the resolution of the Form 1 notices with our customer. In December 2010, the arbitration panel ruled that the subcontract terms were not sufficient to hold retention from Tamimi for price reasonableness matters and awarded the subcontractor \$35 million plus interest thereon and certain legal costs. As a result of the arbitration award, we recorded an additional charge of \$5 million in the fourth quarter of 2010 associated with the interest due on the accrued retention payable to Tamimi and other costs awarded. We also have a claim pending in the U.S. COFC to recover the \$35 million from the U.S. government and we believe it is probable that we will recover such amounts.

**Transportation costs.** The DCAA, in performing its audit activities under the LogCAP III contract, raised a question about our compliance with the provisions of the Fly America Act. Subject to certain exceptions, the Fly America Act requires Federal employees and others performing U.S. Government-financed foreign air travel to travel by U.S. flag air carriers. There are times when we transported personnel in connection with our services for the U.S. military where we may not have been in compliance with the Fly America Act and its interpretations through the Federal Acquisition Regulations and the Comptroller General. As of December 31, 2010, we have accrued an estimate of the cost incurred for these potentially non-compliant flights with a corresponding reduction to revenue. The DCAA may consider additional flights to be noncompliant resulting in potential larger amounts of disallowed costs than the amount we have accrued. At this time, we cannot estimate a range of reasonably possible losses that may have been incurred, if any, in excess of the amount accrued. We will continue to work with our customer to resolve this matter.

**Construction services.** As of December 31, 2010, we have outstanding Form 1 notices from the DCAA disapproving approximately \$25 million in costs related to work performed under our CONCAP III contract with the U.S. Navy to provide emergency construction services primarily to Government facilities damaged by Hurricanes Katrina and Wilma. The DCAA claims the costs billed to the U.S. Navy primarily related to subcontract costs that were either inappropriately bid, included unallowable profit markup or were unreasonable. In April 2010, we met with the U.S. Navy in an attempt to settle the potentially unallowable costs. As a result of the meeting, approximately \$7 million of the potentially unallowable costs was agreed in principle to be allowable and approximately \$1 million unallowable. We are working with the ACO to finalize a settlement of this position. Settlement of the remaining disputed amounts is pending further discussions with the customer regarding the applicable provisions of the FAR and interpretations thereof, as well as providing additional supporting documentation to the customer. As of December 31, 2010, the U.S. Navy has withheld approximately \$10 million from us. We believe we undertook adequate and reasonable steps to ensure that proper bidding procedures were followed and the amounts billed to the customer were reasonable and not in violation of the FAR. As of December 31, 2010, we have accrued our estimate of probable loss related to this matter; however, it is reasonably possible we could incur additional losses.

### ***Investigations, Qui Tams and Litigation***

The following matters relate to ongoing litigation or investigations involving U.S. government contracts.

**McBride Qui Tam suit.** In September 2006, we became aware of a qui tam action filed against us by a former employee alleging various wrongdoings in the form of overbillings of our customer on the LogCAP III contract. This case was originally filed pending the government's decision whether or not to participate in the suit. In June 2006, the government formally declined to participate. The principal allegations are that our compensation for the provision of Morale, Welfare and Recreation ( MWR ) facilities under LogCAP III is based on the volume of usage of those facilities and that we deliberately overstated that usage. In accordance with the contract, we charged our customer based on actual cost, not based on the number of users. It was also alleged that, during the period from November 2004 into mid-December 2004, we continued to bill the customer for lunches, although the dining facility was closed and not serving lunches. There are also allegations regarding housing containers and our provision of services to our employees and contractors. On July 5, 2007, the court granted our motion to dismiss the qui tam claims and to compel arbitration of employment claims including a claim that the plaintiff was unlawfully discharged. The majority of the plaintiff's claims were dismissed but the plaintiff was allowed to pursue limited claims pending discovery and future motions. Substantially all employment claims were sent to arbitration under the Company's dispute resolution program and were subsequently resolved in our favor. In January 2009, the relator filed an amended complaint which is nearing completion of the discovery process. Trial for this matter is expected in 2011. We believe the relator's claim is without merit and that the likelihood that a loss has been incurred is remote. As of December 31, 2010, no amounts have been accrued.

**First Kuwaiti Trading Company arbitration.** In April 2008, First Kuwaiti Trading Company, one of our LogCAP III subcontractors, filed for arbitration of a subcontract under which KBR had leased vehicles related to work performed on our LogCAP III contract. First Kuwaiti alleged that we did not return or pay rent for many of the vehicles and seeks damages in the amount of \$134 million. We filed a counterclaim to recover amounts which may ultimately be determined due to the

---

**Table of Contents**

Government for the \$51 million in suspended costs as discussed in the preceding section of this footnote titled Containers. Three arbitration hearings took place in 2010 in Washington, D.C. primarily related to claims involving unpaid rents and damages on lost or unreturned vehicles totaling approximately \$77 million for which the arbitration panel awarded \$7 million to FKTC plus an unquantified amount for repair costs on certain vehicles, damages suffered as a result of late vehicle returns, and interest thereon, to be determined at a later date. No payments are expected to occur until all claims are arbitrated and awards finalized. The next arbitration hearing is scheduled to occur in May 2011 and we believe any damages ultimately awarded to First Kuwaiti will be billable under the LogCAP III contract. Accordingly, we have accrued amounts payable and a related unbilled receivable for the amounts awarded to First Kuwaiti pursuant to the terms of the contract.

***Paul Morell, Inc. d/b/a The Event Source vs. KBR, Inc.*** TES is a former LogCAP III subcontractor who provided DFAC services at six sites in Iraq from mid-2003 to early 2004. TES sued KBR in Federal Court in Virginia for breach of contract and tortious interference with TES's subcontractors by awarding subsequent DFAC contracts to the subcontractors. In addition, the Government withheld funds from KBR that KBR had submitted for reimbursement of TES invoices, and at that time, TES agreed that it was not entitled to payment until KBR was paid by the Government. Eventually KBR and the Government settled the dispute, and in turn KBR and TES agreed that TES would accept, as payment in full with a release of all other claims, the amount the Government paid to KBR for TES's services. TES filed a suit to overturn that settlement and release, claiming that KBR misrepresented the facts. The trial was completed in June 2009 and in January 2010, the Federal Court issued an order against us in favor of TES in the amount of \$15 million in actual damages and interest and \$4 million in punitive damages relating to the settlement and release entered into by the parties in May 2005. As of December 31, 2010, we have recorded un-reimbursable expenses and a liability of \$20 million for the full amount of the awarded damages. We have filed a notice of appeal with the Court.

***Electrocution litigation.*** During 2008, a lawsuit was filed against KBR alleging that the Company was responsible for an electrical incident which resulted in the death of a soldier. This incident occurred at the Radwaniyah Palace Complex. It is alleged in the suit that the electrocution incident was caused by improper electrical maintenance or other electrical work. We intend to vigorously defend this matter. KBR denies that its conduct was the cause of the event and denies legal responsibility. The case was removed to Federal Court where motion to dismiss was filed. The court issued a stay in the discovery of the case, pending an appeal of certain pre-trial motions to dismiss that were previously denied. In August 2010, the Court of Appeal dismissed our appeal concluding it did not have jurisdiction. The case is currently proceeding with the discovery process. We are unable to determine the likely outcome nor can we estimate a range of potential loss, if any, related to this matter at this time. As of December 31, 2010, no amounts have been accrued.

***Burn Pit litigation.*** KBR has been served with over 50 lawsuits in various states alleging exposure to toxic materials resulting from the operation of burn pits in Iraq or Afghanistan in connection with services provided by KBR under the LogCAP III contract. Each lawsuit has multiple named plaintiffs who purport to represent a large class of unnamed persons. The lawsuits primarily allege negligence, willful and wanton conduct, battery, intentional infliction of emotional harm, personal injury and failure to warn of dangerous and toxic exposures which has resulted in alleged illnesses for contractors and soldiers living and working in the bases where the pits are operated. All of the pending cases have been removed to Federal Court, the majority of which have been consolidated for multi-district litigation treatment. In the second quarter of 2010, we filed various motions including a motion to strike an amended consolidated petition filed by the plaintiffs and a motion to dismiss which the court has taken under advisement. In the September 2010, our motion to dismiss was denied. However, our motion to strike an amended consolidated petition filed by the plaintiffs was granted. The Court directed the parties to propose a plan for limited jurisdictional discovery. In December 2010, the Court stayed virtually all proceedings pending a decision from the Fourth Circuit Court of Appeals on three other cases involving the Political Question Doctrine and other jurisdictional issues. We intend to vigorously defend these matters. Due to the inherent uncertainties of litigation and because the litigation is at a preliminary stage, we cannot at this time accurately predict the ultimate outcome nor can we reliably estimate a range of possible loss, if any, related to this matter at this time. Accordingly, as of December 31, 2010, no amounts have been accrued.

***Convoy Ambush Litigation.*** In April 2004, a fuel convoy in route from Camp Anaconda to Baghdad International Airport for the U.S. Army under our LogCAP III contract was ambushed resulting in deaths and severe injuries to truck drivers hired by KBR. In 2005, survivors of the drivers killed and those that were injured in the convoy, filed suit in state court in Houston, Texas against KBR and several of its affiliates, claiming KBR deliberately intended that the drivers in the convoy would be attacked and wounded or killed. The suit also alleges KBR committed fraud in its hiring practices by failing to disclose the dangers associated with working in the Iraq combat zone. In September 2006, the case was dismissed based upon the court's ruling that it lacked jurisdiction because the case presented a non-justiciable political question. Subsequently, three additional suits were filed, arising out of insurgent attacks on other convoys that occurred in 2004 and were likewise dismissed as non-justiciable under the Political Question Doctrine.



## **Table of Contents**

The plaintiffs in all cases appealed the dismissals to the Fifth Circuit Court of Appeals which reversed and remanded the remaining cases to trial court. In July 2008, the trial court directed substantive discovery to commence including the re-submittal of dispositive motions on various grounds including the Defense Base Act and Political Question Doctrine. In February 2010, the trial court ruled in favor of the plaintiffs, denying two of our motions to dismiss the case. In March 2010, the trial court granted in part and denied in part our third motion to dismiss the case. We filed appeals on all issues with the Fifth Circuit Court of Appeals and have moved to stay all proceedings in the trial court pending the resolution of these appeals. The cases were removed from the trial docket and the Fifth Circuit Court of Appeals has heard all previous motions filed by both parties. In September 2010, the DOJ filed a brief in support of KBR's position that the cases should be dismissed in their entirety based upon the exclusive provisions in the Defense Base Act. We are unable to determine the likely outcome of these cases at this time nor can we reliably estimate a range of possible loss, if any. Accordingly, as of December 31, 2010, no amounts have been accrued.

***DOJ False Claims Act complaint.*** On April 1, 2010, the DOJ filed a complaint in the U.S. District Court in the District of Columbia alleging certain violations of the False Claims Act related to the use of private security firms. The complaint alleges, among other things, that we made false or fraudulent claims for payment under the LogCAP III contract because we allegedly knew that they contained costs of services for or that included improper use of private security. We believe these sums were properly billed under our contract with the Army and that the use of private security was not prohibited under LogCAP III. We have filed motions to dismiss the complaint which are currently pending. We have not adjusted our revenues or accrued any amounts related to this matter.

### ***Other Matters***

***Claims.*** Included in receivables in our consolidated balance sheets are unapproved claims for costs incurred under various government contracts totaling \$163 million at December 31, 2010 of which \$125 million is included in Accounts receivable and \$38 million is included in Unbilled receivables on uncompleted contracts. Unapproved claims relate to contracts where our costs have exceeded the customer's funded value of the task order. The unapproved claims at December 31, 2010 include approximately \$123 million resulting from the de-obligation of 2004 and 2005 funding on certain task orders that were also subject to Form 1 notices relating to certain DCAA audit issues discussed above. This amount includes \$71 million that was de-obligated in 2010 which consists of funds nearing the 5-year expiration date. We believe such disputed costs will be resolved in our favor at which time the customer will be required to obligate funds from appropriations for the year in which resolution occurs. The remaining unapproved claims balance of approximately \$40 million represents primarily costs for which incremental funding is pending in the normal course of business. The majority of costs in this category are normally funded within several months after the costs are incurred. The unapproved claims outstanding at December 31, 2010 are considered to be probable of collection and have been previously recognized as revenue.

### **Note 10. Other Commitments and Contingencies**

#### ***Foreign Corrupt Practices Act investigations***

On February 11, 2009 KBR LLC, entered a guilty plea related to the Bonny Island investigation in the United States District Court, Southern District of Texas, Houston Division (the Court). KBR LLC pled guilty to one count of conspiring to violate the FCPA and four counts of violating the FCPA, all arising from the intent to bribe various Nigerian officials through commissions paid to agents working on behalf of TSKJ on the Bonny Island project. The plea agreement reached with the DOJ resolves all criminal charges in the DOJ's investigation into the conduct of KBR LLC relating to the Bonny Island project, so long as the conduct was disclosed or known to DOJ before the settlement, including previously disclosed allegations of coordinated bidding. The plea agreement called for the payment of a criminal penalty of \$402 million, of which Halliburton was obligated to pay \$382 million under the terms of the indemnity in the master separation agreement, while we were obligated to pay \$20 million. We also agreed to a period of organizational probation of three years, during which we retain a monitor who assesses our compliance with the plea agreement and evaluate our FCPA compliance program over the three year period, with periodic reports to the DOJ.

On the same date, the SEC filed a complaint and we consented to the filing of a final judgment against us in the Court. The complaint and the judgment were filed as part of a settled civil enforcement action by the SEC, to resolve the civil portion of the government's investigation of the Bonny Island project. The complaint alleges civil violations of the FCPA's antibribery and books-and-records provisions related to the Bonny Island project. The complaint enjoins us from violating the FCPA's antibribery, books-and-records, and internal-controls provisions and requires Halliburton and KBR, jointly and severally, to make payments totaling \$177 million, all of which has been paid by Halliburton pursuant to the indemnification under the master separation agreement. The judgment also requires us to retain an independent monitor on the same terms as the plea agreement with the DOJ.

**Table of Contents**

Under both the plea agreement and judgment, we have agreed to cooperate with the SEC and DOJ in their investigations of other parties involved in TSKJ and the Bonny Island project.

As a result of the settlement, in the fourth quarter 2008 we recorded the \$402 million obligation to the DOJ and, accordingly, recorded a receivable from Halliburton for the \$382 million that Halliburton was obligated to pay to the DOJ on our behalf. The resulting charge of \$20 million to KBR was recorded in cost of sales of our Hydrocarbons business segment in the fourth quarter of 2008. Likewise, we recorded an obligation to the SEC in the amount of \$177 million and a receivable from Halliburton in the same amount. As of December 31, 2010, Halliburton has paid all installments to the DOJ and SEC, and such payments totaled \$559 million. Of the payments mentioned above, Halliburton paid \$142 million in 2010 and \$417 million in 2009, which have been reflected in the accompanying statement of cash flows as noncash operating activities. On October 1, 2010, we made the final payment to the DOJ related to our portion of the settlement agreement.

As part of the settlement of the FCPA matters, we agreed to the appointment of a corporate monitor for a period of up to three years. We proposed the appointment of a corporate monitor and received approval from the DOJ in the third quarter of 2009. We are responsible for paying the fees and expenses related to the monitor's review and oversight of our policies and activities relating to compliance with applicable anti-corruption laws and regulations.

Because of the guilty plea by KBR LLC, we are subject to possible suspension or debarment of our ability to contract with governmental agencies of the United States and of foreign countries. We received written confirmation from the U.S. Department of the Army stating that it does not intend to suspend or debar KBR from DoD contracting as a result of the guilty plea by KBR LLC. The U.K. Ministry of Defence ( MoD ) has indicated that it does not have any grounds to debar the KBR subsidiary with which it contracts under its public procurement regulations. Although there has been a threat to challenge the MOD's decision not to debar KBR, no formal proceedings have been issued since the threat was made. Therefore, we believe the risk of being debarred from contracting with the MOD is low. Although we do not believe we will be suspended or debarred of our ability to contract with other governmental agencies of the United States or any other foreign countries, suspension or debarment from the government contracts business would have a material adverse effect on our business, results of operations, and cash flow.

Under the terms of the Master Separation Agreement ( MSA ), Halliburton has agreed to indemnify us, and any of our greater than 50%-owned subsidiaries, for our share of fines or other monetary penalties or direct monetary damages, including disgorgement, as a result of claims made or assessed by a governmental authority of the United States, the United Kingdom, France, Nigeria, Switzerland or Algeria or a settlement thereof relating to FCPA and related corruption allegations, which could involve Halliburton and us through The M. W. Kellogg Company, M. W. Kellogg Limited ( MWKL ), or their or our joint ventures in projects both in and outside of Nigeria, including the Bonny Island, Nigeria project. Halliburton's indemnity will not apply to any other losses, claims, liabilities or damages assessed against us as a result of or relating to FCPA matters and related corruption allegations or to any fines or other monetary penalties or direct monetary damages, including disgorgement, assessed by governmental authorities in jurisdictions other than the United States, the United Kingdom, France, Nigeria, Switzerland or Algeria, or a settlement thereof, or assessed against entities such as TSKJ, in which we do not have an interest greater than 50%. As of December 31, 2010, we are not aware of any uncertainties related to the indemnity from Halliburton or any material limitations on our ability to recover amounts due to us for matters covered by the indemnity from Halliburton.

The U.K. Serious Fraud Office ( SFO ) conducted an investigation of activities by current and former employees of MWKL regarding the Bonny Island project. During the investigation process, MWKL self-reported to the SFO its corporate liability for corruption-related offenses arising out of the Bonny Island project and entered into a plea negotiation process under the Attorney General's Guidelines on Plea Discussions in Cases of Serious and Complex Fraud issued by the Attorney General for England and Wales. In February 2011, MWKL reached a settlement with the SFO in which the SFO accepted that MWKL was not party to any unlawful conduct and assessed a civil penalty of approximately \$11 million including interest and reimbursement of certain costs of the investigation. The settlement terms included a full release of all claims against MWKL, its current and former parent companies, subsidiaries and other related parties including their respective current or former officers, directors and employees with respect to the Bonny Island project. As of December 31, 2010, we recorded a liability to the SFO of \$11 million included in Other current liabilities in our consolidated balance sheet. Due to the indemnity from Halliburton under the MSA, we recognized a receivable from Halliburton of approximately \$6 million in Due to former parent, net in our consolidated balance sheet.

In 2010, we learned that charges were filed in Nigeria against various parties including Halliburton, KBR and TSKJ Nigeria Limited based on the facts associated with our settlement of the DOJ's FCPA investigation of the Bonny Island project. In December 2010, prior to KBR being served with a suit, Halliburton negotiated and paid a settlement with the Federal

---

## **Table of Contents**

Government of Nigeria without any admission of liability or financial impact to KBR. The settlement resulted in the dismissal of all charges against all parties. With the settlement of this matter, all known investigations in the Bonny Island project have been concluded.

### ***Commercial Agent Fees***

We have both before and after the separation from our former parent used commercial agents on some of our large-scale international projects to assist in understanding customer needs, local content requirements, vendor selection criteria and processes and in communicating information from us regarding our services and pricing. Prior to separation, it was identified by our former parent in performing its investigation of anti-corruption activities that certain of these agents may have engaged in activities that were in violation of anti-corruption laws at that time and the terms of their agent agreements with us. Accordingly, we have ceased the receipt of services from and payment of fees to these agents. Fees for these agents are included in the total estimated cost for these projects at their completion. In connection with actions taken by U.S. Government authorities, we have removed certain unpaid agent fees from the total estimated costs in the period that we obtained sufficient evidence to conclude such agents clearly violated the terms of their contracts with us. In the first and third quarters of 2009, we reduced project cost estimates by \$16 million and \$5 million, respectively, as a result of making such determinations. In September 2010, we executed a final settlement agreement with one of our agents in question after the agent was reviewed and approved under our policies on business conduct. Under the terms of the settlement agreement, the agent had, among other things, confirmed their understanding of and compliance with KBR's policies on business conduct and represented that they have complied with anti-corruption laws as they relate to prior services provided to KBR. We negotiated final payment for fees to this agent on several projects in our Hydrocarbons segment resulting in an overall reduction of estimated project costs of approximately \$60 million in the third quarter of 2010. As of December 31, 2010, the remaining unpaid agent fees of approximately \$8 million are included in the estimated costs related to a completed project.

### ***Barracuda-Caratinga Project Arbitration***

In June 2000, we entered into a contract with Barracuda & Caratinga Leasing Company B.V., the project owner, to develop the Barracuda and Caratinga crude oilfields, which are located off the coast of Brazil. Petrobras is a contractual representative that controls the project owner. In November 2007, we executed a settlement agreement with the project owner to settle all outstanding project issues except for the bolts arbitration discussed below.

At Petrobras' direction, we replaced certain bolts located on the subsea flowlines that failed through mid-November 2005, and we understand that additional bolts failed thereafter, which were replaced by Petrobras. These failed bolts were identified by Petrobras when it conducted inspections of the bolts. In March 2006, Petrobras notified us they submitted this matter to arbitration claiming \$220 million plus interest for the cost of monitoring and replacing the defective stud bolts and, in addition, all of the costs and expenses of the arbitration including the cost of attorneys' fees. The arbitration is being conducted in New York under the guidelines of the United Nations Commission on International Trade Law (UNCITRAL). Petrobras contends that all of the bolts installed on the project are defective and must be replaced.

During the time that we addressed outstanding project issues and during the conduct of the arbitration, KBR believed the original design specification for the bolts was issued by Petrobras, and as such, the cost resulting from any replacement would not be our responsibility. A hearing on legal and factual issues relating to liability with the arbitration panel was held in April 2008. In June 2009, we received an unfavorable ruling from the arbitration panel on the legal and factual issues as the panel decided the original design specification for the bolts originated with KBR and its subcontractors. The ruling concluded that KBR's express warranties in the contract regarding the fitness for use of the design specifications for the bolts took precedence over any implied warranties provided by the project owner. Our potential exposure would include the costs of the bolts replaced to date by Petrobras, any incremental monitoring costs incurred by Petrobras and damages for any other bolts that are subsequently found to be defective. We believe that it is probable that we have incurred some liability in connection with the replacement of bolts that have failed during the contract warranty period which expired June 30, 2006. In May 2010, the arbitration tribunal heard arguments from both parties regarding various damage scenarios and estimates of the amount of KBR's overall liability in this matter. The final arbitration arguments were made in August of 2010. Based on the damage estimates presented at this hearing, we estimate our minimum exposure, excluding interest, to be approximately \$12 million representing our estimate for replacement of bolts that failed during the warranty period and were not replaced. As of December 31, 2010, we have a liability of \$12 million and an indemnification receivable from Halliburton of \$12 million. The amount of any remaining liability will be dependent upon the legal and factual issues to be determined by the arbitration tribunal in the final arbitration hearings. For the remaining bolts at dispute, we cannot determine that we have liability nor determine the amount of any such liability and no additional amounts have been accrued.

Any liability incurred by us in connection with the replacement of bolts that have failed to date or related to the

---

## **Table of Contents**

remaining bolts at dispute in the bolt arbitration is covered by an indemnity from our former parent Halliburton. Under the MSA, Halliburton has agreed to indemnify us and any of our greater than 50%-owned subsidiaries as of November 2006, for all out-of-pocket cash costs and expenses (except for ongoing legal costs), or cash settlements or cash arbitration awards in lieu thereof, we may incur after the effective date of the master separation agreement as a result of the replacement of the subsea flowline bolts installed in connection with the Barracuda-Caratinga project. As of December 31, 2010, we are not aware of any uncertainties related to the indemnity from Halliburton or any material limitations on our ability to recover amounts due to us for matters covered by the indemnity from Halliburton. We do not believe any outcome of this matter will have a material adverse impact to our operating results or financial position.

### ***Foreign tax laws***

We conduct operations in many tax jurisdictions throughout the world. Tax laws in certain of these jurisdictions are not as mature as those found in highly developed economies. As a consequence, although we believe we are in compliance with such laws, interpretations of these laws could be challenged by the foreign tax authorities. In many of these jurisdictions, non-income based taxes such as property taxes, sales and use taxes, and value-added taxes are assessed on our operations in that particular location. While we strive to ensure compliance with these various non-income based tax filing requirements, there have been instances where potential non-compliance exposures have been identified. In accordance with accounting principles generally accepted in the United States of America, we make a provision for these exposures when it is both probable that a liability has been incurred and the amount of the exposure can be reasonably estimated. To date, such provisions have been immaterial, and we believe that, as of December 31, 2010, we adequately provided for such contingencies. However, it is possible that our results of operations, cash flows, and financial position could be adversely impacted if one or more non-compliance tax exposures are asserted by any of the jurisdictions where we conduct our operations.

### ***Environmental***

We are subject to numerous environmental, legal, and regulatory requirements related to our operations worldwide. In the United States, these laws and regulations include, among others: the Comprehensive Environmental Response, Compensation, and Liability Act; the Resources Conservation and Recovery Act; the Clean Air Act; the Federal Water Pollution Control Act; and the Toxic Substances Control Act. In addition to federal and state laws and regulations, other countries where we do business often have numerous environmental regulatory requirements by which we must abide in the normal course of our operations. These requirements apply to our business segments where we perform construction and industrial maintenance services or operate and maintain facilities.

We have not completed our analysis of the site conditions and until further information is available, we are only able to estimate a possible range of remediation costs. These locations were primarily utilized for manufacturing or fabrication work and are no longer in operation. The use of these facilities created various environmental issues including deposits of metals, volatile and semi-volatile compounds, and hydrocarbons impacting surface and subsurface soils and groundwater. The range of remediation costs could change depending on our ongoing site analysis and the timing and techniques used to implement remediation activities. We do not expect costs related to environmental matters will have a material adverse effect on our condensed consolidated financial position or results of operations. Based on the information presently available to us, we have accrued approximately \$7 million for the assessment and remediation costs associated with all environmental matters, which represents the low end of the range of possible costs that could be as much as \$14 million.

We have been named as a potentially responsible party ( PRP ) in various clean-up actions taken by federal and state agencies in the U.S. Based on the early stages of these actions, we are unable to determine whether we will ultimately be deemed responsible for any costs associated with these actions.

### ***Liquidated damages***

Many of our engineering and construction contracts have milestone due dates that must be met or we may be subject to penalties for liquidated damages if claims are asserted and we were responsible for the delays. These generally relate to specified activities that must be met within a project by a set contractual date or achievement of a specified level of output or throughput of a plant we construct. Each contract defines the conditions under which a customer may make a claim for liquidated damages. However, in some instances, liquidated damages are not asserted by the customer, but the potential to do so is used in negotiating claims and closing out the contract.

Based upon our evaluation of our performance and other legal analysis, we have not accrued for possible liquidated damages related to several projects totaling \$20 million at December 31, 2010 and \$18 million at December 31, 2009 (including amounts related to our share of unconsolidated subsidiaries), that we could incur based upon completing the



**Table of Contents**

projects as currently forecasted.

**Leases**

We are obligated under operating leases, principally for the use of land, offices, equipment, field facilities, and warehouses. We recognize minimum rental expenses over the term of the lease. When a lease contains a fixed escalation of the minimum rent or rent holidays, we recognize the related rent expense on a straight-line basis over the lease term and record the difference between the recognized rental expense and the amounts payable under the lease as deferred lease credits. We have certain leases for office space where we receive allowances for leasehold improvements. We capitalize these leasehold improvements as property, plant, and equipment and deferred lease credits. Leasehold improvements are amortized over the shorter of their economic useful lives or the lease term. Total rent expense was \$165 million, \$233 million and \$203 million in 2010, 2009 and 2008, respectively. Future total rental payments on noncancelable operating leases are as follows:

<i>Millions of dollars</i>	Future rental payments
2011	\$ 69
2012	\$ 59
2013	\$ 55
2014	\$ 53
2015	\$ 51
Beyond 2015	\$ 508

*Eldridge Park I Building Lease.* On September 30, 2010, we executed a lease agreement for office space located in a high-rise office building in Houston, Texas for the purpose of expanding our leased office space. The non-cancelable lease term expires on December 31, 2018. The lease term includes a rent holiday from the beginning of the lease through December 31, 2011; and a total combined leasehold improvement allowance of \$4 million. Annual base rent, excluding termination fees, based on currently planned occupancy ranges from \$1.6 million to \$1.8 million.

In February 2010, we executed two lease amendments for office space located in two separate high-rise office buildings in Houston, Texas for the purpose of significantly expanding our current leased office space and to extend the original term of the leases to June 30, 2030. These amendments did not change our historical accounting for these agreements as operating leases. The essential provisions of the lease amendments are as follows:

*601 Jefferson Building Lease.* The lease amendment extends the original term of the lease to June 30, 2030 and includes renewal options for three consecutive additional periods from 5 to 10 years each at prevailing market rates. Annual base rent for the leased office space escalates ratably over the lease term from \$9 million to \$14 million. The lease amendment includes a leasehold improvement allowance of \$29 million primarily for the construction of leasehold improvements. The lease may be terminated under a one-time option in March 2022 for all, or a portion, of the leased premises subject to a termination fee. The 601 Jefferson building is owned by a joint venture in which KBR owns 50% interest with an unrelated party owning the remaining 50% interest. The joint venture is funding the leasehold improvement allowance through joint venture partner capital contributions from each partner on a pro-rata basis.

*500 Jefferson Building Lease.* The lease amendment extends the original term of the lease to June 30, 2030 and includes renewal options for three consecutive additional periods from 5 to 10 years each at prevailing market rates. The lease terms include a rent holiday for the first six months of the lease beginning July 1, 2010. Annual base rent for the leased office space escalates ratably over the lease term from \$2 million to \$3 million. The lease amendment includes a leasehold improvement allowance of \$6 million primarily for the construction of leasehold improvements. The lease may be terminated under a one-time option in March 2022 for all, or a portion, of the leased premises subject to a termination fee.

**Table of Contents****Other**

We had commitments to provide funds to our privately financed projects of \$33 million as of December 31, 2010 and \$52 million as of December 31, 2009. Commitments to fund these projects are supported by letters of credit as discussed in Note 8. At December 31, 2010, approximately \$17 million of the \$33 million in commitments will become due within one year.

**Note 11. Income Taxes**

The components of the provision (benefit) for income taxes are as follows:

Millions of dollars	Years ended December 31		
	2010	2009	2008
<b>Current income taxes:</b>			
Federal	\$ 56	\$ (3)	\$ (41)
Foreign	118	99	165
State	3	7	
<b>Total current</b>	<b>177</b>	<b>103</b>	<b>124</b>
<b>Deferred income taxes:</b>			
Federal	15	(39)	107
Foreign	(1)	105	(13)
State		(1)	(6)
<b>Total deferred</b>	<b>14</b>	<b>65</b>	<b>88</b>
<b>Provision for income taxes</b>	<b>\$ 191</b>	<b>\$ 168</b>	<b>\$ 212</b>

KBR is subject to a tax sharing agreement primarily covering periods prior to the separation from Halliburton which occurred in April 2007. The tax sharing agreement provides, in part, that KBR will be responsible for any audit settlements related to its business activity for periods prior to its separation from Halliburton for which KBR recorded a charge to equity of \$17 million in 2007. As of December 31, 2010, we have recorded a \$43 million payable to Halliburton for tax related items under the tax sharing agreement. See Note 16 for further discussion related to our transactions with Halliburton.

The United States and foreign components of income from continuing operations before income taxes and noncontrolling interests were as follows:

Millions of dollars	Years ended December 31		
	2010	2009	2008
United States	\$ 105	\$ (128)	\$ (50)
Foreign	481	660	618
<b>Total</b>	<b>\$ 586</b>	<b>\$ 532</b>	<b>\$ 568</b>





**Table of Contents**

The reconciliations between the actual provision for income taxes on continuing operations and that computed by applying the United States statutory rate to income from continuing operations before income taxes and noncontrolling interests are as follows:

	Years ended December 31		
	2010	2009	2008
United States Statutory Rate	35.0%	35.0%	35.0%
Rate differentials on foreign earnings	(2.9)	(2.3)	1.6
Non-deductible expenses		0.4	1.6
State income taxes	0.2	0.9	0.1
Prior year foreign, federal and state taxes	2.1	(1.0)	(1.2)
Valuation allowance	0.2	1.7	0.1
Taxes on unincorporated joint ventures	(2.6)	(2.0)	
Other	0.6	(1.2)	0.1
<b>Total effective tax rate on continuing operations</b>	<b>32.6%</b>	<b>31.5%</b>	<b>37.3%</b>

We generally do not provide U.S. federal and state income taxes on the accumulated but undistributed earnings of non-United States subsidiaries except for certain entities in Mexico and certain other joint ventures. Taxes are provided as necessary with respect to earnings that are considered not permanently reinvested. For all other non-U.S. subsidiaries, no U.S. taxes are provided because such earnings are intended to be reinvested indefinitely to finance foreign activities. These accumulated but undistributed foreign earnings could be subject to additional tax if remitted, or deemed remitted, as a dividend. Determination of the amount of unrecognized deferred U.S. income tax liability is not practicable; however, the potential foreign tax credit associated with the deferred income would be available to reduce the resulting U.S. tax liabilities.

The primary components of our deferred tax assets and liabilities and the related valuation allowances are as follows:

Millions of dollars	Years ended December 31	
	2010	2009
<b>Gross deferred tax assets:</b>		
Depreciation and amortization	\$ 11	\$ 2
Employee compensation and benefits	159	182
Construction contract accounting	109	104
Loss carryforwards	63	44
Insurance accruals	30	18
Allowance for bad debt	11	10
Accrued liabilities	23	18
Foreign tax credit carryforwards		16
Deferred foreign tax credit		1
Other	4	8
<b>Total</b>	<b>\$ 410</b>	<b>\$ 403</b>
<b>Gross deferred tax liabilities:</b>		
Construction contract accounting	\$ (104)	\$ (101)
Intangibles	(39)	(30)
Depreciation and amortization	(16)	(11)
Deferred foreign tax credit carryforward	(8)	

Edgar Filing: KBR, INC. - Form 10-K

Other	(95)	(54)
Total	\$ (262)	\$ (196)

Valuation Allowances:		
Loss carryforwards	(32)	(30)

Net deferred income tax asset	\$ 116	\$ 177
-------------------------------	--------	--------

At December 31, 2010, we had \$167 million of net operating loss carryforwards that expire from 2011 through 2020, loss carryforwards of \$72 million that expire after 2020 and \$53 million of foreign net operating loss carryforwards with indefinite expiration dates.

For the year ended December 31, 2010, our valuation allowance was increased from \$30 million to \$32 million primarily as a result of net operating losses for which we do not believe we will be able to utilize in certain foreign locations.

**Table of Contents**

KBR is the parent of a group of domestic companies which are in the U.S. consolidated federal income tax return. We also file income tax returns in various states and foreign jurisdictions. With few exceptions, we are no longer subject to examination by tax authorities for U.S. federal or state and local income tax for years before 2003, or for non-U.S. income tax for years before 1998.

We account for uncertain tax positions in accordance with guidance in FASB ASC 740 which prescribes the minimum recognition threshold a tax position taken or expected to be taken in a tax return is required to meet before being recognized in the financial statements. A reconciliation of the beginning and ending amount of uncertain tax positions is as follows:

<i>In millions</i>	December 31, 2010
Balance at January 1, 2010	\$ 41
Increases as a result of tax positions taken during the current year	64
Decreases as a result of tax positions taken during a prior year	(9)
Other	(1)
<b>Balance at December 31, 2010</b>	<b>\$ 95</b>

The total amount of uncertain tax positions that, if recognized, would affect our effective tax rate was approximately \$75 million as of December 31, 2010. The difference between this amount and the amounts reflected in the tabular reconciliation above relates primarily to deferred U.S. federal and non-U.S. income tax benefits on uncertain tax positions related to U.S. federal and non-U.S. income taxes. In the next twelve months, it is reasonably possible that our uncertain tax positions could change by approximately \$7 million due to the expiration of the statute of limitations.

We recognize interest and penalties related to uncertain tax positions within the provision for income taxes in our consolidated statement of income. As of December 31, 2010 and 2009, we had accrued approximately \$23 million and \$14 million, respectively, in interest and penalties. During the year ended December 31, 2010, 2009 and 2008, we recognized approximately \$10 million, \$1 million and \$1 million, respectively in net interest and penalties charges related to uncertain tax positions.

As of December 31, 2010, the uncertain tax positions and accrued interest and penalties were not expected to be settled within one year and therefore are classified in noncurrent income tax payable. Increases as a result of positions taken during 2010 or in prior years were \$64 million of which approximately \$50 million related to balance sheet reclassifications from tax-related liability accounts or were offset by tax benefits recognized in the current year and therefore did not have an impact on the effective tax rate in 2010. The remaining \$14 million increase relates primarily to uncertain tax positions that were not previously accrued and, consequently, had an unfavorable impact on our effective tax rate in 2010.

*Other tax related matters.* On June 28, 2007, we completed the disposition of our 51% interest in DML to Babcock International Group plc. In connection with the sale, we received \$345 million in cash proceeds, net of direct transaction costs for our 51% interest in DML. The sale of DML resulted in a gain of approximately \$101 million, net of tax of \$115 million, in the year ended December 31, 2007. During the preparation of our 2007 tax return in 2008, we identified additional foreign tax credits upon completion of a tax pool study resulting from the sale of our interest in DML in the U.K. Approximately \$11 million of the foreign tax credits were recorded as a tax benefit in discontinued operations in the third quarter of 2008.

**Table of Contents****Note 12. Shareholders' Equity**

The following tables summarize our shareholders' equity activity:

Millions of dollars	Total	Paid-in Capital in Excess of par	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests
Balance at December 31, 2007	\$ 2,235	\$ 2,070	\$ 319		\$ (122)	\$ (32)
Cumulative effect of initial adoption of accounting for defined benefit pension and other postretirement plans	(1)		(1)			
Stock-based compensation	16	16				
Common stock issued upon exercise of stock options	3	3				
Tax benefit increase related to stock-based plans	2	2				
Dividends declared to shareholders	(41)		(41)			
Repurchases of common stock	(196)			(196)		
Distributions to noncontrolling interests	(21)					(21)
Acquisition of noncontrolling interests	2					2
Tax adjustments to noncontrolling interests	12					12
Comprehensive income:						
Net income	367		319			48
Other comprehensive income, net of tax (provision):						
Cumulative translation adjustment	(117)				(107)	(10)
Pension liability adjustment, net of tax of \$(85)	(226)				(209)	(17)
Other comprehensive gains (losses) on derivatives:						
Unrealized gains (losses) on derivatives	(1)				(1)	
Reclassification adjustments to net income (loss)	(1)				(1)	
Income tax benefit (provision) on derivatives	1				1	
Comprehensive income, total	23					
Balance at December 31, 2008	\$ 2,034	\$ 2,091	\$ 596	(196)	\$ (439)	\$ (18)
Stock-based compensation	17	17				
Common stock issued upon exercise of stock options	2	2				
Tax benefit decrease related to stock-based plans	(7)	(7)				
Dividends declared to shareholders	(32)		(32)			
Repurchases of common stock	(31)			(31)		
Issuance of ESPP shares	2			2		
Distributions to noncontrolling interests	(66)					(66)
Investments by noncontrolling interests	12					12
Comprehensive income:						
Net income	364		290			74
Other comprehensive income, net of tax (provision):						
Cumulative translation adjustment	18				15	3
Pension liability adjustment, net of tax of \$(5)	(15)				(18)	3
Other comprehensive gains (losses) on derivatives:						
Unrealized gains (losses) on derivatives	(3)				(3)	
Reclassification adjustments to net income (loss)	1				1	
Comprehensive income, total	365					

Edgar Filing: KBR, INC. - Form 10-K

Balance at December 31, 2009	\$	2,296	\$	2,103	\$	854	\$	(225)	\$	(444)	\$	8
Stock-based compensation		17		17								
Common stock issued upon exercise of stock options		5		5								
Dividends declared to shareholders		(23)				(23)						
Adjustment pursuant to tax sharing agreement with former parent		(8)		(8)								
Repurchases of common stock		(233)						(233)				
Issuance of ESPP shares		3				(1)		4				
Distributions to noncontrolling interests		(108)										(108)
Investments by noncontrolling interests		17										17
Acquisition of noncontrolling interests		(181)		(136)						(19)		(26)
Consolidation of Fastrax Limited		(4)										(4)
Other noncontrolling partner activity		(1)										(1)
Comprehensive income:												
Net income		395				327						68
Other comprehensive income, net of tax (provision):												
Net cumulative translation adjustment		5								3		2
Pension liability adjustment, net of tax of \$4		24								22		2
Other comprehensive gains (losses) on derivatives:												
Unrealized gains (losses) on derivatives		2								2		
Reclassification adjustments to net income (loss)		(1)								(1)		
Income tax benefit (provision) on derivatives		(1)								(1)		
Comprehensive income, total		424										
Balance at December 31, 2010	\$	2,204	\$	1,981	\$	1,157	\$	(454)	\$	(438)	\$	(42)

**Table of Contents****Accumulated other comprehensive income (loss)**

Millions of dollars	2010	December 31 2009	2008
Cumulative translation adjustments	\$ (52)	\$ (54)	\$ (69)
Pension liability adjustments	(382)	(386)	(368)
Unrealized gains (losses) on derivatives	(4)	(4)	(2)
Total accumulated other comprehensive loss	\$ (438)	\$ (444)	\$ (439)

Accumulated comprehensive loss for years ended December 31, 2010, 2009 and 2008 include approximately \$14 million, \$8 million, and \$8 million for the amortization of actuarial loss, net of taxes. The year ended December 31, 2008 also includes the amortization of prior service cost of \$1 million.

**Shares of common stock**

Millions of shares and dollars	Shares	Amount
Balance at December 31, 2008	170	\$
Common stock issued	1	
Balance at December 31, 2009	171	
Common stock issued		
Balance at December 31, 2010	171	\$

**Shares of treasury stock**

Millions of shares and dollars	Shares	Amount
Balance at December 31, 2008	8	\$ 196
Treasury stock acquired	2	29
Balance at December 31, 2009	10	225
Treasury stock acquired, net of ESPP shares issued	10	229
Balance at December 31, 2010	20	\$ 454

**Dividends**

We declared dividends totaling \$23 million in 2010 and \$32 million in 2009. As of December 31, 2010, we had accrued dividends of \$8 million.

**Note 13. Stock-based Compensation and Incentive Plans**

***Stock Plans***

In 2010, 2009, and 2008 stock-based compensation awards were granted to employees under KBR stock-based compensation plans.

***KBR 2006 Stock and Incentive Plan***

In November 2006, KBR established the KBR 2006 Stock and Incentive Plan (KBR 2006 Plan) which provides for the grant of any or all of the following types of stock-based awards:

stock options, including incentive stock options and nonqualified stock options;

stock appreciation rights, in tandem with stock options or freestanding;

restricted stock;

restricted stock units;

cash performance awards; and

stock value equivalent awards.

**Table of Contents**

Under the terms of the KBR 2006 Plan, 10 million shares of common stock have been reserved for issuance to employees and non-employee directors. The plan specifies that no more than 3.5 million shares can be awarded as restricted stock or restricted stock units or pursuant to cash performance awards. At December 31, 2010, approximately 4.9 million shares were available for future grants under the KBR 2006 Plan, of which approximately 1 million shares remained available for restricted stock awards or restricted stock unit awards.

***KBR Transitional Stock Adjustment Plan***

The KBR Transitional Stock Adjustment Plan was adopted solely for the purpose to convert Halliburton equity awards to KBR equity awards. No new awards can be made under this plan. Upon our separation from Halliburton on April 5, 2007, Halliburton stock options and restricted stock awards granted to KBR employees under Halliburton's 1993 Stock and Incentive Plan were converted to KBR stock options and restricted stock awards. A total of 1,217,095 Halliburton stock options and 612,857 Halliburton restricted stock awards were converted into 1,966,061 KBR stock options with a weighted average exercise price per share of \$9.35 and 990,080 restricted stock awards with a weighted average grant-date fair value per share of \$11.01. The conversion ratio for restricted stock was based on comparative KBR and Halliburton share prices. The conversion ratio was based upon the volume weighted average stock price of KBR and Halliburton shares for a three-day average.

The converted equity awards are subject to substantially the same terms as they were under the Halliburton 1993 Stock and Incentive Plan prior to conversion. All stock options under Halliburton's 1993 Stock and Incentive Plan were granted at the fair market value of the common stock at the grant date. Employee stock options vest ratably over a three- or four-year period and generally expire 10 years from the grant date.

The fair value of each option was estimated based on the date of grant using the Black-Scholes Merton option pricing model. The following assumptions were used in estimating the fair value of the KBR stock options for KBR employees at the date of modification:

<i>KBR transitional stock options assumption summary</i>	<b>Range</b>	
	<i>Start</i>	<i>End</i>
Expected term range (in years)	0.25	5.5
Expected volatility range	29.03 %	37.43%
Risk-free interest rate range	4.5 %	5.07%
Expected dividend yield range		

The expected term of KBR options was based upon the average of the life of the option and the vesting period of the option. The simplified estimate of expected term was utilized as we lack sufficient history to estimate an expected term for KBR options. Volatility for KBR options was based upon a blended rate that used the historical and implied volatility of common stock for KBR and selected peers. The risk-free interest rate applied to KBR options was based on the U.S. Treasury yield curve in effect at the date of modification.

***KBR Stock Options***

Under KBR's 2006 Plan, effective as of the closing date of the KBR initial public offering, stock options are granted with an exercise price not less than the fair market value of the common stock on the date of the grant and a term no greater than 10 years. The term and vesting periods are established at the discretion of the Compensation Committee at the time of each grant. We amortize the fair value of the stock options over the vesting period on a straight-line basis. Options are granted from shares authorized by our board of directors. Total number of stock options granted and the assumptions used to determine the fair value of granted options were as follows:

<i>KBR stock options assumptions summary</i>	<b>Years ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
Granted stock options (millions of shares)	0.8	1.4
Expected term (in years)	6.5	6.5
Weighted average grant-date fair value per share	\$ 9.49	\$ 6.57





**Table of Contents**

<i>KBR stock options ranged assumptions summary</i>	Years ended December 31,			
	2010		2009	
	Range Start	Range End	Range Start	Range End
Expected volatility range	44.91	48.03 %	50.05	68.40 %
Expected dividend yield range	0.74	0.95 %	0.88	1.72 %
Risk-free interest rate range	1.76	2.84 %	2.18	2.95 %

No KBR stock options were granted in 2008. For KBR stock options granted in both 2010 and 2009, the fair value of options at the date of grant was estimated using the Black-Scholes Merton option pricing model. The expected volatility of KBR options granted in each year is based upon a blended rate that uses the historical and implied volatility of common stock for KBR and selected peers. The expected term of KBR options granted in each year is based upon the average of the life of the option and the vesting period of the option. The simplified estimate of expected term is utilized as we lack sufficient history to estimate an expected term for KBR options. The estimated dividend yield is based upon KBR's annualized dividend rate divided by the market price of KBR's stock on the option grant date. The risk-free interest rate is based upon the yield of US government issued treasury bills or notes on the option grant date.

The following table presents stock options granted, exercised, forfeited and expired under KBR stock-based compensation plans for the year ended December 31, 2010.

<i>KBR stock options activity summary</i>	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in millions)
Outstanding at December 31, 2009	2,715,835	\$ 13.55	6.75	15.75
Granted	801,108	21.15		
Exercised	(360,225)	14.44		
Forfeited	(174,935)	15.48		
Expired	(33,137)	17.78		
Outstanding at December 31, 2010	2,948,646	\$ 15.29	6.84	\$ 44.77
Exercisable at December 31, 2010	1,470,750	\$ 14.02	4.96	\$ 24.19

The total intrinsic values of options exercised for the years ended December 31, 2010, 2009, and 2008 were \$4 million, \$1 million, and \$4 million, respectively. As of December 31, 2010, there was \$8 million of unrecognized compensation cost, net of estimated forfeitures, related to non-vested KBR stock options, expected to be recognized over a weighted average period of approximately 1.85 years. Stock option compensation expense was \$5 million in 2010, \$4 million in 2009 and \$3 million in 2008. Total income tax benefit recognized in net income for stock-based compensation arrangements was \$2 million for the period ended December 31, 2010 and \$1 million for both periods ended December 31, 2009 and 2008.

**KBR Restricted stock**

Restricted shares issued under the KBR's 2006 Plan are restricted as to sale or disposition. These restrictions lapse periodically over an extended period of time not exceeding 10 years. Restrictions may also lapse for early retirement and other conditions in accordance with our established policies. Upon termination of employment, shares on which restrictions have not lapsed must be returned to us, resulting in restricted stock forfeitures. The fair market value of the stock on the date of grant is amortized and ratably charged to income over the period during which the

restrictions lapse on a straight-line basis. For awards with performance conditions, an evaluation is made each quarter as to the likelihood of the performance criteria being met. Stock-based compensation is then adjusted to reflect the number of shares expected to vest and the cumulative vesting period met to date.

**Table of Contents**

The following table presents the restricted stock awards and restricted stock units granted, vested, and forfeited during 2010 under KBR's 2006 Stock and Incentive Plan.

<i>Restricted stock activity summary</i>	Number of Shares	Weighted Average Grant-Date Fair Value per Share
Nonvested shares at December 31, 2009	1,510,520	\$ 21.35
Granted	358,665	21.28
Vested	(563,836)	21.78
Forfeited	(167,906)	21.24
Nonvested shares at December 31, 2010	1,137,443	\$ 21.13

The weighted average grant-date fair value per share of restricted KBR shares granted to employees during 2010, 2009, and 2008 were \$21.28, \$12.34, and \$30.54, respectively. Restricted stock compensation expense was \$12 million during 2010 and \$13 million for both 2009 and 2008. Total income tax benefit recognized in net income for stock-based compensation arrangements was \$4 million in 2010, \$5 million in 2009 and \$4 million in 2008. As of December 31, 2010, there was \$18 million of unrecognized compensation cost, net of estimated forfeitures, related to KBR's nonvested restricted stock and restricted stock units, which is expected to be recognized over a weighted average period of 2.7 years. The total fair value of shares vested was \$13 million in 2010, \$12 million in 2009, and \$14 million in 2008 based on the weighted-average fair value on the vesting date. The total fair value of shares vested was \$12 million in 2010, \$15 million in 2009, and \$10 million in 2008 based on the weighted-average fair value on the date of grant.

***KBR Cash Performance Based Award Units ( Cash Performance Awards )***

Under KBR's 2006 Plan, for Cash Performance Awards granted in the year 2010, performance is based 75% on average Total Shareholder Return ( TSR ), as compared to the average TSR of KBR's peers, and 25% on KBR's Return on Capital ( ROC ). For awards granted in the years 2009 and 2008, performance is based 50% on cumulative TSR, as compared to our peer group and 50% on KBR's ROC. The performance award units may only be paid in cash. In accordance with the provisions of FASB ASC 718-10, the TSR portion of the performance award units are classified as liability awards and remeasured at the end of each reporting period at fair value until settlement. The fair value approach uses the Monte Carlo valuation method which analyzes the companies comprising KBR's peer group, considering volatility, interest rate, stock beta and TSR through the grant date. The ROC calculation is based on the company's weighted average net income from continuing operations plus (interest expense x (1-effective tax rate)), divided by average monthly capital from continuing operations. The ROC portion of the Cash Performance Award is also classified as a liability award and remeasured at the end of each reporting period based on our estimate of the amount to be paid at the end of the vesting period.

Under KBR's 2006 Plan, in 2010, we granted 25.2 million performance based award units ( Cash Performance Awards ) with a three-year performance period from January 1, 2010 to December 31, 2012. In 2009 we granted 20.4 million Cash Performance Awards with a performance period from January 1, 2009 to December 31, 2011. In 2008, we granted 24.3 million Cash Performance Awards with a performance period from January 1, 2008 to December 31, 2010. Cash Performance Awards forfeited were approximately 6 million in 2010, 4 million in 2009, and 2 million in 2008. At December 31, 2010, the outstanding balance for Cash Performance Award units was 58.4 million. No Cash Performance Awards will vest until such earned Cash Performance Awards, if any, are paid, subject to approval of the performance results by the certification committee.

Cost for the Cash Performance Awards is accrued over the requisite service period. For the years ended December 31, 2010, 2009, and 2008, we recognized \$26 million, \$30 million, and \$16 million, respectively, in expense for the Cash Performance Awards. The expense associated with these options is included in cost of services and general and administrative expense in our consolidated statements of income. The liability for awards included in Employee compensation and benefits on the consolidated balance sheet were \$48 million at December 31, 2010 of which \$27 million will become due within one year and \$49 million at December 31, 2009.



**Table of Contents*****KBR Employee Stock Purchase Plan ( ESPP )***

Under the KBR ESPP, eligible employees may withhold up to 10% of their earnings, subject to some limitations, to purchase shares of KBR's common stock. Unless KBR's Board of Directors shall determine otherwise, each six-month offering period commences at the beginning of February and August of each year. Employees who participate in the ESPP will receive a 5% discount on the stock price at the end of each six-month purchase period. During 2010, our employees purchased approximately 169,000 shares through the KBR ESPP. These shares were reissued from our treasury share account.

***Stock-based compensation***

The grant-date fair value of employee share options is estimated using option-pricing models. If an award is modified after the grant date, incremental compensation cost is recognized immediately before the modification. The benefits of tax deductions in excess of the compensation cost recognized for the options (excess tax benefits) are classified as addition to paid-in-capital, and cash retained as a result of these excess tax benefits is presented in the statement of cash flows as financing cash inflows.

***Stock-based compensation summary table****Millions of dollars*

	<b>Years ended December 31</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
Stock-based compensation	\$ 17	\$ 17	\$ 16
Total income tax benefit recognized in net income for stock-based compensation arrangements	\$ 6	\$ 6	\$ 5
Incremental compensation cost	\$ 2	\$ 1	\$
Tax benefit increase (decrease) related to stock-based plans	\$	\$ (7)	\$ 2

Incremental compensation cost resulted from modifications of previously granted stock-based awards which allowed certain employees to retain their awards after leaving the company. Excess tax benefits realized from the exercise of stock-based compensation awards has been recognized as paid-in capital in excess of par.

**Note 14. Financial Instruments and Risk Management**

**Foreign currency risk.** Techniques in managing foreign currency risk include, but are not limited to, foreign currency investing and the use of currency derivative instruments. We selectively manage significant exposures to potential foreign exchange losses considering current market conditions, future operating activities and the associated cost in relation to the perceived risk of loss. The purpose of our foreign currency risk management activities is to protect us from the risk that the eventual U.S. dollar cash flow resulting from the sale and purchase of products and services in foreign currencies will be adversely affected by changes in exchange rates.

We manage our foreign currency exposure through the use of currency derivative instruments as it relates to the major currencies, which are generally the currencies of the countries for which we do the majority of our international business. These contracts generally have an expiration date of two years or less. Forward exchange contracts, which are commitments to buy or sell a specified amount of a foreign currency at a specified price and time, are generally used to manage identifiable foreign currency commitments. Forward exchange contracts and foreign exchange option contracts, which convey the right, but not the obligation, to sell or buy a specified amount of foreign currency at a specified price, are generally used to manage exposures related to assets and liabilities denominated in a foreign currency. None of the forward or option contracts are exchange traded. While derivative instruments are subject to fluctuations in value, the fluctuations are generally offset by the value of the underlying exposures being managed. The use of some contracts may limit our ability to benefit from favorable fluctuations in foreign exchange rates.

Foreign currency contracts are not utilized to manage exposures in some currencies due primarily to the lack of available markets or cost considerations (non-traded currencies). We attempt to manage our working capital position to minimize foreign currency commitments in non-traded currencies and recognize that pricing for the services and products offered in these countries should cover the cost of exchange rate devaluations. We have historically incurred transaction losses in non-traded currencies.



---

**Table of Contents**

**Assets, liabilities and forecasted cash flow denominated in foreign currencies.** We utilize the derivative instruments described above to manage the foreign currency exposures related to specific assets and liabilities, that are denominated in foreign currencies; however, we have not elected to account for these instruments as hedges for accounting purposes. Additionally, we utilize the derivative instruments described above to manage forecasted cash flow denominated in foreign currencies generally related to long-term engineering and construction projects. Since 2003, we have designated these contracts related to engineering and construction projects as cash flow hedges. The ineffective portion of these hedges is included in operating income in the accompanying consolidated statements of income. During 2010, 2009 and 2008 no hedge ineffectiveness was recognized. Unrealized gains and losses include amounts attributable to cash flow hedges placed by our consolidated and unconsolidated subsidiaries and are included in other comprehensive income in the accompanying consolidated balance sheets. We had approximately \$2 million in unrealized net gains, \$1 million in unrealized net losses and \$1 million in unrealized net gains on these cash flow hedges as of December 31, 2010, 2009 and 2008, respectively. Changes in the timing or amount of the future cash flow being hedged could result in hedges becoming ineffective and, as a result, the amount of unrealized gain or loss associated with that hedge would be reclassified from other comprehensive income into earnings. At December 31, 2010, the maximum length of time over which we are hedging our exposure to the variability in future cash flow associated with foreign currency forecasted transactions is 41 months. Estimated amounts to be recognized in earnings in 2010 are not significant.

**Notional amounts and fair market values.** The notional amounts of open forward contracts and options held by our consolidated subsidiaries were \$403 million, \$406 million, and \$274 million at December 31, 2010, 2009, and 2008, respectively. The notional amounts of our foreign exchange contracts do not generally represent amounts exchanged by the parties, and thus, are not a measure of our exposure or of the cash requirements relating to these contracts. The amounts exchanged are calculated by reference to the notional amounts and by other terms of the derivatives, such as exchange rates.

**Credit risk.** Financial instruments that potentially subject us to concentrations of credit risk are primarily cash equivalents, investments and trade receivables. It is our practice to place our cash equivalents and investments in high-quality investment securities with various investment institutions. We derive the majority of our revenues from engineering and construction services to the energy industry and services provided to the United States government. There are concentrations of receivables in the United States and the United Kingdom. We maintain an allowance for losses based upon the expected collectability of all trade accounts receivable.

There are no significant concentrations of credit risk with any individual counterparty related to our derivative contracts. We select counterparties based on their profitability, balance sheet and a capacity for timely payment of financial commitments which is unlikely to be adversely affected by foreseeable events.

**Interest rate risk.** Certain of our unconsolidated subsidiaries and joint-ventures are exposed to interest rate risk through their variable rate borrowings. We manage our exposure to this variable-rate debt with interest rate swaps that are jointly owned through our investments. We had unrealized net losses on the interest rate cash flow hedges held by our unconsolidated subsidiaries and joint-ventures of approximately \$5 million, \$4 million, and \$3 million as of December 31, 2010, 2009, and 2008, respectively.

**Fair market value of financial instruments.** The carrying amount of variable rate long-term debt approximates fair market value because these instruments reflect market changes to interest rates. The carrying amount of short-term financial instruments, cash and equivalents, receivables, and accounts payable, as reflected in the consolidated balance sheets, approximates fair market value due to the short maturities of these instruments. The currency derivative instruments are carried on the balance sheet at fair value and are based upon third party quotes.

FASB ASC 820-10 addresses fair value measurements and disclosures, defining fair value, establishing a framework for using fair value to measure assets and liabilities, and expanding disclosures about fair value measurements. This standard applies whenever other standards require or permit assets or liabilities to be measured at fair value. ASC 820-10 establishes a three-tier value hierarchy, categorizing the inputs used to measure fair value. The hierarchy can be described as follows:

- Level 1 Observable inputs such as unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2 Inputs other than the quoted prices in active markets that are observable either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices that are in inactive markets; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.



**Table of Contents**

The financial assets and liabilities measured at fair value on a recurring basis are included below:

<i>Millions of dollars</i>	Fair Value Measurements at Reporting Date Using			
	December 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Pension plan assets	\$ 1,351	\$ 753	\$ 576	\$ 22
Marketable securities	\$ 16	\$ 12	\$ 4	\$
Derivative assets	\$ 8	\$	\$ 8	\$
Derivative liabilities	\$ 2	\$	\$ 2	\$

See Note 17 for additional details related to the fair values of our pension plan asset.

**Note 15. Equity Method Investments and Variable Interest Entities**

We conduct some of our operations through joint ventures which are in partnership, corporate, undivided interest and other business forms and are principally accounted for using the equity method of accounting. Additionally, the majority of our joint ventures are also variable interest entities which are further described under Variable Interest Entities. The following is a description of our significant investments accounted for on the equity method of accounting that are not variable interest entities.

**Equity Method Investments**

*Brown & Root Condor Spa ( BRC )*. BRC is a joint venture in which we owned 49% interest. During the third quarter of 2007, we sold our 49% interest and other rights in BRC to Sonatrach for approximately \$24 million resulting in a pre-tax gain of approximately \$18 million which is included in Equity in earnings (losses) of unconsolidated affiliates. As of December 31, 2010, we have not collected the remaining \$18 million due from Sonatrach for the sale of our interest in BRC, which is included in Accounts receivable. In the fourth quarter of 2008, we filed for arbitration in an attempt to force collection. An arbitration hearing occurred in January 2011 for which we expect a decision in mid-2011. We believe the amount owed to us is probable of recovery.

*MMM*. MMM is a joint venture formed under a Partners Agreement related to the Mexico contract with PEMEX. The MMM joint venture was set up under Mexican maritime law in order to hold navigation permits to operate in Mexican waters. The scope of the business is to render services of maintenance, repair and restoration of offshore oil and gas platforms and provisions of quartering in the territorial waters of Mexico. KBR holds a 50% interest in the MMM joint venture. In 2009, the MMM joint venture repurchased outstanding equity interests from each of the joint venture partners on a pro-rata basis. We accounted for the transaction as a return of our initial investment resulting in a \$28 million reduction of Equity in and advances to related companies in our Consolidated Balance Sheet.

**Table of Contents**

Consolidated summarized financial information for all jointly owned operations including variable interest entities that are accounted for using the equity method of accounting is as follows:

**Balance Sheets**

<i>Millions of dollars</i>	December 31,	
	2010	2009
Current assets	\$ 2,694	\$ 3,217
Noncurrent assets	3,949	3,973
Total assets	\$ 6,643	\$ 7,190
Current liabilities	\$ 1,658	\$ 1,804
Noncurrent liabilities	4,541	5,550
Member s equity	444	(164)
Total liabilities and member s equity	\$ 6,643	\$ 7,190

**Statements of Operations**

<i>Millions of dollars</i>	Years ended December 31,		
	2010	2009	2008
Revenue	\$ 2,497	\$ 2,535	\$ 2,642
Operating income	\$ 617	\$ 221	\$ 79
Net income (loss)	\$ 334	\$ 63	\$ (45)

**Unconsolidated VIEs**

The following is a summary of the significant variable interest entities in which we have a significant variable interest, but we are not the primary beneficiary:

<i>Unconsolidated VIEs</i>	Year ended December 31, 2010		
	VIE Total assets	VIE Total liabilities	Maximum exposure to loss
<i>(in millions, except for percentages)</i>			
U.K. Road projects	\$ 1,506	\$ 1,531	\$ 30
Fermoy Road project	\$ 240	\$ 269	\$ 3
Allenby & Connaught project	\$ 2,913	\$ 2,885	\$ 62
EBIC Ammonia project	\$ 604	\$ 388	\$ 38
Other Liquefied Natural Gas projects	\$ 164	\$ 148	\$ 29

Edgar Filing: KBR, INC. - Form 10-K

Year ended December 31, 2009

<i>Unconsolidated VIEs</i>	VIE Total assets	VIE Total liabilities
<i>(in millions, except for percentages)</i>		
U.K. Road projects	\$ 1,660	\$ 1,603
Fermoy Road project	\$ 271	\$ 295
Allenby & Connaught project	\$ 3,037	\$ 3,020
EBIC Ammonia project	\$ 598	\$ 489
Other Liquefied Natural Gas projects	\$ 410	\$ 467

*U.K. Road projects.* We are involved in four privately financed projects, executed through joint ventures, to design, build, operate, and maintain roadways for certain government agencies in the United Kingdom. We have a 25% ownership interest in each of these joint ventures and account for them using the equity method of accounting. The joint ventures have obtained financing through third parties that is nonrecourse to the joint venture partners. These joint ventures are variable interest entities; however, we are not the primary beneficiary of these joint ventures. Our maximum exposure to loss represents our equity investments in these ventures.

*Fermoy Road project.* We participate in a privately financed project executed through certain joint ventures formed to design, build, operate, and maintain a toll road in southern Ireland. The joint ventures were funded through debt and were formed with minimal equity. These joint ventures are variable interest entities; however, we are not the primary beneficiary of the joint ventures. We have up to a 25% ownership interest in the project's joint ventures, and we are accounting for these interests using the equity method of accounting.

**Table of Contents**

*Allenby & Connaught project.* In April 2006, Aspire Defence, a joint venture between us, Carillion Plc. and two financial investors, was awarded a privately financed project contract, the Allenby & Connaught project, by the MoD to upgrade and provide a range of services to the British Army's garrisons at Aldershot and around Salisbury Plain in the United Kingdom. In addition to a package of ongoing services to be delivered over 35 years, the project includes a nine-year construction program to improve soldiers' single living, technical and administrative accommodations, along with leisure and recreational facilities. Aspire Defence manages the existing properties and is responsible for design, refurbishment, construction and integration of new and modernized facilities. We indirectly own a 45% interest in Aspire Defence, the project company that is the holder of the 35-year concession contract. In addition, we own a 50% interest in each of two joint ventures that provide the construction and the related support services to Aspire Defence. As of December 31, 2010, our performance through the construction phase is supported by \$73 million in letters of credit and approximately \$15 million in surety bonds. Furthermore, our financial and performance guarantees are joint and several, subject to certain limitations, with our joint venture partners. The project is funded through equity and subordinated debt provided by the project sponsors and the issuance of publicly held senior bonds which are nonrecourse to us. The entities we hold an interest in are variable interest entities; however, we are not the primary beneficiary of these entities. We account for our interests in each of the entities using the equity method of accounting. Our maximum exposure to construction and operating joint venture losses is limited to the funding of any future losses incurred by those entities under their respective contracts with the project company. As of December 31, 2010, our assets and liabilities associated with our investment in this project, within our consolidated balance sheet, were \$31 million and \$2 million, respectively. The \$60 million difference between our recorded liabilities and aggregate maximum exposure to loss was primarily related to our equity investments and \$33 million remaining commitment to fund subordinated debt to the project in the future.

*EBIC Ammonia project.* We have an investment in a development corporation that has an indirect interest in the Egypt Basic Industries Corporation (EBIC) ammonia plant project located in Egypt. We are performing the engineering, procurement and construction (EPC) work for the project and operations and maintenance services for the facility. We own 65% of this development corporation and consolidate it for financial reporting purposes. The development corporation owns a 25% ownership interest in a company that consolidates the ammonia plant which is considered a variable interest entity. The development corporation accounts for its investment in the company using the equity method of accounting. The variable interest entity is funded through debt and equity. Indebtedness of EBIC under its debt agreement is non-recourse to us. We are not the primary beneficiary of the variable interest entity. As of December 31, 2010, our assets and liabilities associated with our investment in this project, within our consolidated balance sheet, were \$55 million and \$9 million, respectively. The \$29 million difference between our recorded liabilities and aggregate maximum exposure to loss was related to our investment balance and other receivables in the project as of December 31, 2010.

*Other Liquefied Natural Gas (LNG) projects.* We have equity ownership in two joint ventures to execute EPC projects. Our equity ownership ranges from 33% to 50%, and these joint ventures are variable interest entities. We are not the primary beneficiary and thus account for these joint ventures using the equity method of accounting. Our aggregate, maximum exposure to loss related to these entities was primarily comprised of our equity investment and contract receivables with both joint ventures. Our maximum exposure to loss primarily represent our equity investments in and other receivables due from these joint ventures.

**Consolidated VIEs**

The following is a summary of the significant VIEs where we are the primary beneficiary:

<i>Consolidated VIEs</i>	Year ended December 31, 2010	
	VIE Total assets	VIE Total liabilities
<i>(in millions, except for percentages)</i>		
Fasttrax Limited project	\$ 106	\$ 112
Escravos Gas-to-Liquids project	\$ 356	\$ 423
Pearl GTL project	\$ 174	\$ 167
Gorgon LNG project	\$ 347	\$ 372

<i>Consolidated VIEs</i>	Year ended December 31, 2009	
	VIE Total assets	VIE Total liabilities
<i>(in millions, except for percentages)</i>		

Edgar Filing: KBR, INC. - Form 10-K

Escravos Gas-to-Liquids project	\$ 387	\$	482
Pearl GTL project	\$ 157	\$	138
Gorgon LNG project	\$ 109	\$	109

**Table of Contents**

*Fasttrax Limited project.* Effective January 1, 2010, upon the adoption of the newly issued guidance in FASB ASC 810 Consolidation, we determined that we are the primary beneficiary of this project entity because we control the activities that most significantly impact economic performance of the entity. This variable interest entity, in which we have a 50% ownership interest, was previously accounted for using the equity method of accounting because no party absorbed the majority of the expected losses which was the determining factor under the superseded standard. We have applied the requirements of FASB ASC 810 on a prospective basis from the date of adoption. Upon consolidation of this joint venture, consolidated current assets increased by \$26 million primarily related to cash and equivalents, consolidated noncurrent assets increased by \$89 million related to property, plant and equipment, consolidated current liabilities increased by \$10 million primarily related to accounts payable, and noncurrent liabilities increased by \$112 million related to the outstanding senior bonds and subordinated debt issued to finance the JV's operations. No gain or loss was recognized by KBR upon consolidation of this VIE. Assets collateralizing the JV's senior bonds include cash and equivalents of \$21 million and property, plant, and equipment of approximately \$80 million, net of accumulated depreciation of \$38 million as of December 31, 2010. The bonds of the SPV, being non-recourse to KBR, are shown on the face of our condensed consolidated balance sheet as Non-recourse project-finance debt.

In December 2001, the Fasttrax Joint Venture (the JV) was created to provide to the United Kingdom Ministry of Defense (MOD) a fleet of 92 new heavy equipment transporters (HETs) capable of carrying a 72-ton Challenger II tank. The JV owns, operates and maintains the HET fleet and provides heavy equipment transportation services to the British Army. The purchase of the assets was completed in 2004, and the operating and service contracts related to the assets extend through 2023. The JV's entity structure includes a parent entity and its 100%-owned subsidiary, Fasttrax Ltd (the SPV). KBR and its partner own each 50% of the parent entity.

The JV's purchase of the assets was funded through the issuance of several series guaranteed secured bonds totaling approximately £84.9 million issued by the SPV including £12.2 million which was replaced in 2005 when the shareholders funded combined equity and subordinated debt of approximately £12.2 million. The bonds are guaranteed by Ambac Assurance U.K. Ltd under a policy that guarantees the schedule of principle and interest payments to the bond trustee in the event of non-payment by Fasttrax. The total amount of non-recourse project-finance debt of a VIE consolidated by KBR at December 31, 2010, is summarized in the following table.

**Consolidated amount of non-recourse project-finance debt of a VIE**

<i>Millions of Dollars</i>	December 31, 2010
Current non-recourse project-finance debt of a VIE consolidated by KBR	\$ 9
Noncurrent non-recourse project-finance debt of a VIE consolidated by KBR	\$ 92
<b>Total non-recourse project-finance debt of a VIE consolidated by KBR</b>	<b>\$ 101</b>

The guaranteed secured bonds were issued in two classes consisting of Class A 3.5% Index Linked Bonds in the amount of £56 million and Class B 5.9% Fixed Rate Bonds in the amount of £16.7 million. Principal payments on both classes of bonds commenced in March 2005 and are due in semi-annual installments over the term of the bonds which end in 2021. Subordinated notes payable to our 50% partner initially bear interest at 11.25% increasing to 16% over the term of the note through 2025. Payments on the subordinated debt commenced in March 2006 and are due in semi-annual installments over the term of the note. The following table summarizes the combined principal installments for both classes of bonds and subordinated notes, including inflation adjusted bond indexation over the next five-years and beyond as of December 31, 2010:

<i>Millions of pounds</i>	Debt Payments	
2011	£	6
2012	£	6
2013	£	6
2014	£	6
2015	£	7
Beyond 2015	£	48

*Escravos Gas-to-Liquids ( GTL ) project.* During 2005, we formed a joint venture to engineer and construct a gas monetization facility. As noted in the VIE summary table above, we own 50% equity interest and determined that we are the primary beneficiary of the joint venture which is consolidated for financial reporting purposes. There are no consolidated assets that collateralize the joint venture's obligations. However, at December 31, 2010 and 2009, the joint venture had

**Table of Contents**

approximately \$84 million and \$128 million of cash, respectively, which mainly relate to advanced billings in connection with the joint venture's obligations under the EPC contract.

*Pearl GTL project.* In July 2006, we were awarded, through a 50%-owned joint venture (as noted in the VIE summary table above), a contract with Qatar Shell GTL Limited to provide project management and cost-reimbursable engineering, procurement and construction management services for the Pearl GTL project in Ras Laffan, Qatar. The project, which is expected to be completed by 2011, consists of gas production facilities and a GTL plant. The joint venture is considered a VIE. We consolidate the joint venture for financial reporting purposes because we are the primary beneficiary.

*Gorgon LNG project.* As noted in the VIE summary table above, we have a 30% ownership in an Australian joint venture which was awarded a contract by Chevron for cost-reimbursable FEED and EPCM services to construct a LNG plant. The joint venture is considered a VIE, and, as a result of our being the primary beneficiary, we consolidate this joint venture for financial reporting purposes.

**Note 16. Transactions with Former Parent and Other Related Party Transactions**

In connection with the initial public offering in November 2006 and the separation of our business from Halliburton, in April 2007, we entered into various agreements with Halliburton including, among others, a master separation agreement, tax sharing agreement, transition services agreements and an employee matters agreement. Pursuant to our master separation agreement, we agreed to indemnify Halliburton for, among other matters, all past, present and future liabilities related to our business and operations. We agreed to indemnify Halliburton for liabilities under various outstanding and certain additional credit support instruments relating to our businesses and for liabilities under litigation matters related to our business. Halliburton agreed to indemnify us for, among other things, liabilities unrelated to our business, for certain other agreed matters relating to the investigation of FCPA and related corruption allegations and the Barracuda-Caratinga project and for other litigation matters related to Halliburton's business. Under the transition services agreements, Halliburton provided various interim corporate support services to us and we provided various interim corporate support services to Halliburton. The tax sharing agreement provides for certain allocations of U.S. income tax liabilities and other agreements between us and Halliburton with respect to tax matters.

Our balance payable to our former parent, Halliburton, at December 31, 2010 and 2009, of \$43 million and \$53 million, respectively, was comprised of amounts owed to Halliburton primarily for estimated outstanding income taxes under the tax sharing agreement. See Note 11 for further discussion of amounts outstanding under the tax sharing agreement.

We perform many of our projects through incorporated and unincorporated joint ventures. In addition to participating as a joint venture partner, we often provide engineering, procurement, construction, operations or maintenance services to the joint venture as a subcontractor. Where we provide services to a joint venture that we control and therefore consolidate for financial reporting purposes, we eliminate intercompany revenues and expenses on such transactions. In situations where we account for our interest in the joint venture under the equity method of accounting, we do not eliminate any portion of our revenues or expenses. We recognize the profit on our services provided to joint ventures that we consolidate and joint ventures that we record under the equity method of accounting primarily using the percentage-of-completion method.

Our total revenue and profit from services provided to our unconsolidated joint ventures recorded in our consolidated statements of income is presented in the table below:

<i>Millions of dollars</i>	December 31,		
	2010	2009	2008
Revenue from services provided to unconsolidated joint ventures	\$ 145	\$ 166	\$ 202
Profit from services provided to unconsolidated joint ventures	\$ 12	\$ 1	\$ 28

**Note 17. Retirement Plans**

We have various plans that cover our employees. These plans include defined contribution plans and defined benefit plans. Our plans' plan assets and obligations related to other postretirement plans are immaterial.



## Edgar Filing: KBR, INC. - Form 10-K

Our defined contribution plans provide retirement benefits in return for services rendered. These plans provide an individual account for each participant and have terms that specify how contributions to the participant's account are to be determined rather than the amount of pension benefits the participant is to receive. Contributions to these plans are based on pretax income and/or discretionary amounts determined on an annual basis. Our expense for the defined contribution plans totaled \$64 million in 2010, \$61 million in 2009, and \$47 million in 2008.

**Table of Contents**

Additionally, we participate in a Canadian multi-employer plan to which we contributed \$12 million in 2010, \$17 million in 2009, and \$9 million in 2008;

Our defined benefit plans are funded pension plans, which define an amount of pension benefit to be provided, usually as a function of age, years of service, or compensation.

We account for our defined benefit pension plan in accordance with FASB ASC 715 Compensation Retirement Benefits, which requires an employer to:

recognize on its balance sheet the funded status (measured as the difference between the fair value of plan assets and the benefit obligation) of pension plan;

recognize, through comprehensive income, certain changes in the funded status of a defined benefit plan in the year in which the changes occur;

measure plan assets and benefit obligations as of the end of the employer's fiscal year; and

disclose additional information.

**Benefit obligation and plan assets**

We used a December 31 measurement date for all plans in 2010 and 2009. Plan asset, expenses, and obligation for retirement plans are presented in the following tables.

<i>Benefit obligation</i>	<b>Pension Benefits</b>			
	<b>United States</b>	<b>Int 1</b>	<b>United States</b>	<b>Int 1</b>
<i>Millions of dollars</i>	<b>2010</b>		<b>2009</b>	
<b>Change in projected benefit obligation</b>				
Projected benefit obligation at beginning of period	\$ 80	\$ 1,528	\$ 73	\$ 1,256
Service cost		1		2
Interest cost	4	85	5	77
Plan Amendments				1
Curtailement				(8)
Foreign currency exchange rate changes		(52)		93
Actuarial (gain) loss	3	27	8	153
Benefits paid	(6)	(51)	(6)	(46)
Projected benefit obligation at end of period	\$ 81	\$ 1,538	\$ 80	\$ 1,528
Accumulated benefit obligation at end of period	\$ 81	\$ 1,538	\$ 80	\$ 1,528

<i>Plan assets</i>	<b>Pension Benefits</b>		
	<b>Int 1</b>	<b>United States</b>	<b>Int 1</b>

Edgar Filing: KBR, INC. - Form 10-K

<i>Millions of dollars</i>	United States		United States	
	2010		2009	
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of period	\$ 57	\$ 1,231	\$ 46	\$ 985
Actual return on plan assets	8	134	12	200
Employer contributions	6	14	5	18
Foreign currency exchange rate changes		(42)		74
Benefits paid	(6)	(51)	(6)	(46)
Fair value of plan assets at end of period	\$ 65	\$ 1,286	\$ 57	\$ 1,231
Funded status	\$ (16)	\$ (252)	\$ (23)	\$ (297)
Employer contribution				
Net amount recognized	\$ (16)	\$ (252)	\$ (23)	\$ (297)
<b>Amounts recognized on the consolidated balance sheet</b>				
Noncurrent liabilities	\$ (16)	\$ (252)	\$ (23)	\$ (297)
<b>Weighted-average assumptions used to determine benefit obligations at measurement date</b>				
Discount rate	4.84%	5.45%	5.35%	5.84%
Rate of compensation increase	N/A	N/A	N/A	N/A

**Table of Contents**

Assumed long-term rates of return on plan assets, discount rates for estimating benefit obligations, and rates of compensation increases vary for the different plans according to the local economic conditions. The overall expected long-term rate of return on assets was determined by reviewing targeted asset allocations and historical index performance of the applicable asset classes on a long-term basis of at least 15 years. The discount rate was determined by reviewing yields on high-quality bonds that receive one of the two highest ratings given by a recognized rating agency and the expected duration of the obligations specific to the characteristics of the Company's plans.

Plan fiduciaries of the Company's retirement plans set investment policies and strategies and oversee its investment direction, which includes selecting investment managers, commissioning asset-liability studies and setting long-term strategic targets. Long-term strategic investment objectives include preserving the funded status of the plan and balancing risk and return and have a wide diversification of asset types, fund strategies and fund managers. Targeted asset allocation ranges are guidelines, not limitations, and occasionally plan fiduciaries will approve allocations above or below a target range.

The 2011 and 2010 targeted asset allocation ranges for the International plans, by asset class, are as follows:

<i>International Plans</i>	<i>Asset Class</i>	2011 Targeted Percentage Range		2010 Targeted Percentage Range	
		Minimum	Maximum	Minimum	Maximum
	Equity securities	56%	61%	48%	53%
	Fixed income securities	35%	40%	43%	48%
	Cash equivalents and other assets		4%		4%

The targeted asset allocation ranges for the Domestic plans for both 2011 and 2010, by asset class, are as follows:

<i>Domestic Plans</i>	<i>Asset Class</i>	Targeted Percentage Range	
		Minimum	Maximum
	U.S. equity securities	49%	73%
	Fixed income securities	30%	44%
	Cash equivalents		2%

The inputs and methodology used for valuing securities are not an indication of the risk associated with investing in those securities. The following is a description of the primary valuation methodologies used for assets measured at fair value:

Common Stocks and Corporate Bonds: Valued at the closing price reported on the active market on which the individual securities are traded.

Corporate Bonds, Government Bonds and Mortgage Backed Securities: Valued at quoted prices in markets that are not active, broker dealer quotations, or other methods by which all significant inputs are observable, either directly or indirectly.

Common Collective Trust Funds: Valued at the net asset value per unit held at year end as quoted by the funds.

Mutual Funds: Valued at the net asset value of shares held at year end as quoted in the active market.

Real Estate: Valued at net asset value per unit held at year end as quoted by the manager.

Annuities: Valued by computing the present value of the expected benefits based on the demographic information of the participants.

Other: Estimated income to be received on the Plan assets as computed by our trustee

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement as of the reporting date.



**Table of Contents**

A summary of total investments for KBR's pension plan assets measured at fair value at December 31, 2010 is presented below. See Note 14 for a detailed description of fair value measurements and the hierarchy established for Level 1, 2 and 3 valuation inputs.

<i>Millions of dollars</i>	<b>Fair Value Measurements at Reporting Date Using</b>			
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Asset Category at December 31, 2010</b>				
<u>United States plan assets</u>				
U.S. equity securities	\$ 28	\$ 27	\$ 1	\$
Non-U.S. equity securities	15	15		
Government bonds	4		4	
Corporate bonds	15	8	7	
Mortgage backed securities	1		1	
Cash and cash equivalents	2	2		
<b>Total U.S. plan assets</b>	<b>\$ 65</b>	<b>\$ 52</b>	<b>\$ 13</b>	<b>\$</b>
<u>International plan assets</u>				
U.S. equity securities	\$ 188	\$ 188	\$	\$
Non-U.S. equity securities	460	440	20	
Government bonds	269		269	
Corporate bonds	293	19	274	
Other bonds	2	2		
Annuity contracts	5			5
Real estate	8			8
Cash and cash equivalents	52	52		
Other	9			9
<b>Total international plan assets</b>	<b>\$ 1,286</b>	<b>\$ 701</b>	<b>\$ 563</b>	<b>\$ 22</b>
<b>Total plan assets at December 31, 2010</b>	<b>\$ 1,351</b>	<b>\$ 753</b>	<b>\$ 576</b>	<b>\$ 22</b>
<b>Asset Category at December 31, 2009</b>				
<u>United States plan assets</u>				
U.S. equity securities	\$ 25	\$ 25	\$	\$
Non-U.S. equity securities	10	10		
Government bonds	4		4	
Corporate bonds	15	8	7	
Mortgage backed securities	1		1	
Cash and cash equivalents	1	1		
Other	1		1	
<b>Total U.S. plan assets</b>	<b>\$ 57</b>	<b>\$ 44</b>	<b>\$ 13</b>	<b>\$</b>
<u>International plan assets</u>				
U.S. equity securities	\$ 123	\$ 123	\$	\$
Non-U.S. equity securities	433	433		
Government bonds	266		266	
Corporate bonds	344	14	330	

Edgar Filing: KBR, INC. - Form 10-K

Other bonds	1		1	
Annuity contracts	6			6
Real estate	7			7
Cash and cash equivalents	44	44		
Other	7			7
<b>Total international plan assets</b>	<b>\$ 1,231</b>	<b>\$ 614</b>	<b>\$ 597</b>	<b>\$ 20</b>
<b>Total plan assets at December 31, 2009</b>	<b>\$ 1,288</b>	<b>\$ 658</b>	<b>\$ 610</b>	<b>\$ 20</b>

**Table of Contents**

The fair value measurement of plan assets using significant unobservable inputs (level 3) changed during 2010 due to the following:

**Level 3 fair value measurement rollforward for 2010**

<i>Millions of dollars</i>	<b>Total</b>	<b>Annuity Contracts</b>	<b>Real Estate</b>	<b>Other</b>
<b>International plan assets</b>				
Balance at December 31, 2009	\$ 20	\$ 6	\$ 7	\$ 7
Actual return on plan assets held at end of year	1		1	
Purchases, sales and settlements	1	(1)		2
Balance at December 31, 2010	\$ 22	\$ 5	\$ 8	\$ 9

**Level 3 fair value measurement rollforward for 2009**

<i>Millions of dollars</i>	<b>Total</b>	<b>Annuity Contracts</b>	<b>Real Estate</b>	<b>Other</b>
<b>International plan assets</b>				
Balance at December 31, 2008	\$ 15	\$ 6	\$ 6	\$ 3
Actual return on plan assets held at end of year	1		1	
Purchases, sales and settlements	4			4
Balance at December 31, 2009	\$ 20	\$ 6	\$ 7	\$ 7

The amounts in accumulated other comprehensive loss that have not yet been recognized as components of net periodic benefit cost at December 31, 2010, net of tax were as follows:

<i>Millions of dollars</i>	<b>Pension Benefits</b>	
	<b>United States</b>	<b>Int'l</b>
	<b>2010</b>	
Net actuarial loss, net of tax of \$10 and \$146, respectively	\$ 19	\$ 363
Total in accumulated other comprehensive loss	\$ 19	\$ 363

**Expected cash flows**

**Contributions.** Funding requirements for each plan are determined based on the local laws of the country where such plan resides. In certain countries the funding requirements are mandatory while in other countries they are discretionary. We expect to contribute \$63 million to our international pension plans and \$5 million to our domestic plan in 2011.



## Edgar Filing: KBR, INC. - Form 10-K

*Benefit payments.* The following table presents the expected benefit payments over the next 10 years.

<i>Millions of dollars</i>	<b>Pension Benefits</b>	
	<b>United States</b>	<b>Int 1</b>
2011	\$ 7	\$ 53
2012	\$ 7	\$ 56
2013	\$ 6	\$ 59
2014	\$ 7	\$ 61
2015	\$ 6	\$ 65
Years 2016 2020	\$ 30	\$ 376

**Table of Contents***Net periodic cost*

<i>Millions of dollars</i>	Pension Benefits					
	United States 2010	Int 1	United States 2009	Int 1	United States 2008	Int 1
<b>Components of net periodic benefit cost</b>						
Service cost	\$	\$ 1	\$	\$ 2	\$	\$ 8
Interest cost	4	85	5	77	4	90
Expected return on plan assets	(3)	(90)	(4)	(84)	(4)	(102)
Amortization of prior service cost						(1)
Settlements/curtailments			1	(4)		
Recognized actuarial loss	1	18	1	11		12
Net periodic benefit cost	\$ 2	\$ 14	\$ 3	\$ 2	\$	\$ 7

**Weighted-average assumptions used to****determine net periodic benefit cost for****years ended December 31**

	Pension Benefits					
	United States 2010	Int 1	United States 2009	Int 1	United States 2008	Int 1
Discount rate	5.35%	5.84%	6.15%	5.98%	6.13%	5.70%
Expected return on plan assets	7.00%	7.00%	7.63%	7.00%	7.81%	7.00%
Rate of compensation increase	N/A	NA%	N/A	4.00%	N/A	4.30%

Estimated amounts that will be amortized from accumulated other comprehensive income, net of tax, into net periodic benefit cost in 2011 are as follows:

<i>Millions of dollars</i>	Pension Benefits	
	United States	International
Actuarial (gain) loss	\$ 1	\$ 14
Total	\$ 1	\$ 14

**Note 18. Recent Accounting Pronouncements**

In October 2009, the FASB issued Accounting Standards Update ( ASU ) 2009-13, Revenue Recognition (Topic 605) - Multiple-Deliverable Revenue Arrangements. ASU 2009-13 addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. Specifically, this guidance amends the criteria in Subtopic 605-25, Revenue Recognition-Multiple-Element Arrangements, for separating consideration in multiple-deliverable arrangements. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) estimates. This guidance also eliminates the residual method of allocation and requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. In addition, this guidance significantly expands required disclosures related to a vendor's multiple-deliverable revenue arrangements. ASU 2009-13 is effective

## Edgar Filing: KBR, INC. - Form 10-K

prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The adoption of this accounting standard update did not have a material impact on our financial position, results of operations, cash flows and disclosures.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB's objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, ASU 2010-06 amends Codification Subtopic 820-10 to now require:

A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and  
In the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements.

---

**Table of Contents**

In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures:

For purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and

A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

The ASU is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Early application is permitted. The adoption of this accounting standard update did not have a material impact on our financial position, results of operations, cash flows and disclosures.

In December 2010, the FASB issued ASU No. 2010-28, Intangibles - Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. This ASU reflects the decision reached in EITF Issue No. 10-A. The amendments in this ASU modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance and examples, which require that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. We are evaluating the impact of this account standard update. However, we do not expect the adoption of this accounting standard update will have a material impact on our financial position, results of operations, cash flows and disclosures.

In December 2010, the FASB issued ASU 2010-29, Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations. This ASU reflects the decision reached in EITF Issue No. 10-G. The amendments in this ASU affect any public entity as defined by Topic 805, Business Combinations, that enters into business combinations that are material on an individual or aggregate basis. The amendments in this ASU specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. We are evaluating the impact of this account standard update. However, we do not expect the adoption of this accounting standard update will have a material impact on our financial position, results of operations, cash flows and disclosures.

**Table of Contents****Note 19. Quarterly Data (Unaudited)**

Summarized quarterly financial data for the years ended December 31, 2010 and 2009 are presented in the following table. In the following table, the sum of basic and diluted Net income attributable to KBR per share for the four quarters may differ from the annual amounts due to the required method of computing weighted average number of shares in the respective periods. Additionally, due to the effect of rounding, the sum of the individual quarterly earnings per share amounts may not equal the calculated year earnings per share amount.

(in millions, except per share amounts)	First	Second	Quarter Third	Fourth	Year
<b>2010</b>					
Revenue	\$ 2,631	\$ 2,671	\$ 2,455	\$ 2,342	\$ 10,099
Operating income	99	199	163	148	609
Income from continuing operations, net of tax	59	122	117	97	395
Net income attributable to noncontrolling interests	13	16	20	19	68
Net income attributable to KBR	46	106	97	78	327
<b>Net income attributable to KBR per share :</b>					
Net income attributable to KBR per share Basic	\$ 0.29	\$ 0.66	\$ 0.62	\$ 0.52	\$ 2.08
Net income attributable to KBR per share Diluted	\$ 0.29	\$ 0.66	\$ 0.62	\$ 0.51	\$ 2.07
<b>2009</b>					
Revenue	\$ 3,200	\$ 3,101	\$ 2,840	\$ 2,964	\$ 12,105
Operating income	144	137	131	124	536
Income from continuing operations, net of tax	95	83	97	89	364
Net income attributable to noncontrolling interests	18	16	24	16	74
Net income attributable to KBR	77	67	73	73	290
<b>Net income attributable to KBR per share :</b>					
Net income attributable to KBR per share Basic	\$ 0.48	\$ 0.42	\$ 0.46	\$ 0.46	\$ 1.80
Net income attributable to KBR per share Diluted	\$ 0.48	\$ 0.42	\$ 0.45	\$ 0.45	\$ 1.79

Net income attributable to KBR for the quarter ended December 31, 2009 includes a correction of errors related to prior periods which resulted in a decrease to net income of approximately \$12 million, net of tax of \$6 million, or approximately \$0.08 per share.

---

**Table of Contents**

**Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosures**

None

**Item 9A. Controls and Procedures**

***Management's Evaluation of Disclosure Controls and Procedures***

In accordance with Rules 13a-15 and 15d-15 under the Securities and Exchange Act of 1934 as amended (the "Exchange Act"), we carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2010 to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Our disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

***Changes in Internal Control Over Financial Reporting***

There has been no change in our internal control over financial reporting that occurred during the three months ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

***Management's Annual Report on Internal Control Over Financial Reporting***

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in the Securities Exchange Act Rule 13a-15(f). Internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Further, because of changes in conditions, the effectiveness of internal control over financial reporting may vary over time.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation to assess the effectiveness of our internal control over financial reporting as of December 31, 2010, based upon criteria set forth in the Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment, we have concluded that, as of December 31, 2010, our internal control over financial reporting is effective. Our independent registered public accounting firm, KPMG LLP, has issued its report on the effectiveness of our internal control over financial reporting as of December 31, 2010, which follows.

---

**Table of Contents**

***Report of Independent Registered Public Accounting Firm***

The Board of Directors and Shareholders

KBR, Inc.:

We have audited KBR, Inc.'s internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). KBR, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, KBR, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of KBR, Inc. as of December 31, 2010 and 2009, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2010, and our report dated February 23, 2011 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Houston, Texas

February 23, 2011

**Table of Contents**

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this Item is incorporated herein by reference to the KBR, Inc. Company Proxy Statement for our 2011 Annual Meeting of Stockholders.

**Item 11. Executive Compensation**

The information required by this Item is incorporated herein by reference to the KBR, Inc. Company Proxy Statement for our 2011 Annual Meeting of Stockholders.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this Item is incorporated herein by reference to the KBR, Inc. Company Proxy Statement for our 2011 Annual Meeting of Stockholders.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this Item is incorporated herein by reference to the KBR, Inc. Company Proxy Statement for our 2011 Annual Meeting of Stockholders.

**Item 14. Principal Accounting Fees and Services**

The information required by this Item is incorporated herein by reference to the KBR, Inc. Company Proxy Statement for our 2011 Annual Meeting of Stockholders.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules.**

1. Financial Statements:

- (a) The report of the Independent Registered Public Accounting Firm and the financial statements of the Company as required by Part II, Item 8, are included on page 59 and pages 60 through 112 of this annual report. See index on page 58.

2. Financial Statement Schedules:

Page No.

- (a) KPMG LLP Report on supplemental schedule 119
- (b) Schedule II Valuation and qualifying accounts for the three years ended December 31, 2010 120

Note: All schedules not filed with this report required by Regulations S-X have been omitted as not applicable or not required, or the information required has been included in the notes to financial statements.



**Table of Contents**

## 3. Exhibits:

**Exhibit**

<b>Number</b>	<b>Description</b>
2.1	Agreement and Plan of Merger dated as of May 6, 2008, by and among KBR, Inc., BE&K, Inc., and Whitehawk Sub, Inc., (incorporated by reference to Exhibit 2.1 to KBR's Current Report on Form 8-K; File No. 001-33416)
3.1	KBR Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to KBR's registration statement on Form S-1; Registration No. 333-133302)
3.2	Amended and Restated Bylaws of KBR, Inc. (incorporated by reference to Exhibit 3.1 to KBR's Form 10-Q for the period ended June 30, 2008; File No. 1-33146)
4.1	Form of specimen KBR common stock certificate (incorporated by reference to Exhibit 4.1 to KBR's registration statement on Form S-1; Registration No. 333-133302)
10.1	Master Separation Agreement between Halliburton Company and KBR, Inc. dated as of November 20, 2006 (incorporated by reference to Exhibit 10.1 to KBR's current report on Form 8-K dated November 20, 2006; File No. 001-33146)
10.2	Tax Sharing Agreement, dated as of January 1, 2006, by and between Halliburton Company, KBR Holdings, LLC and KBR, Inc., as amended effective February 26, 2007 (incorporated by reference to Exhibit 10.2 to KBR's Annual Report on Form 10-K for the year ended December 31, 2006; File No. 001-33146)
10.3	Amended and Restated Registration Rights Agreement, dated as of February 26, 2007, between Halliburton Company and KBR, Inc. (incorporated by reference to Exhibit 10.3 to KBR's Annual Report on Form 10-K for the year ended December 31, 2006; File No. 001-33146)
10.4	Transition Services Agreement dated as of November 20, 2006, by and between Halliburton Energy Services, Inc. and KBR, Inc. (KBR as service provider) (incorporated by reference to Exhibit 10.4 to KBR's current report on Form 8-K dated November 20, 2006; File No. 001-33146)
10.5	Transition Services Agreement dated as of November 20, 2006, by and between Halliburton Energy Services, Inc. and KBR, Inc. (Halliburton as service provider) (incorporated by reference to Exhibit 10.5 to KBR's current report on Form 8-K dated November 20, 2006; File No. 001-33146)
10.6	Employee Matters Agreement dated as of November 20, 2006, by and between Halliburton Company and KBR, Inc. (incorporated by reference to Exhibit 10.6 to KBR's current report on Form 8-K dated November 20, 2006; File No. 001-33146)
10.7	Intellectual Property Matters Agreement dated as of November 20, 2006, by and between Halliburton Company and KBR, Inc. (incorporated by reference to Exhibit 10.7 to KBR's current report on Form 8-K dated November 20, 2006; File No. 001-33146)
10.8+	Severance and change in control agreement with William P. Utt, President and Chief Executive Officer of KBR. (incorporated by reference to Exhibit 10.7 to KBR's current report on Form 8-K dated January 7, 2009; File No. 1-33146)
10.9	Form of Indemnification Agreement between KBR, Inc. and its directors (incorporated by reference to Exhibit 10.18 to KBR's registration statement on Form S-1; Registration No. 333-133302)
10.10+	KBR, Inc. 2006 Stock and Incentive Plan (as amended June 27, 2007) (incorporated by reference to Exhibit 10.1 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.11+	KBR, Inc. Senior Executive Performance Pay Plan (incorporated by reference to Exhibit 10.21 to KBR's Form 10-K for the fiscal year ended December 31, 2006; File No. 1-33146)
10.12+	KBR, Inc. Management Performance Pay Plan (incorporated by reference to Exhibit 10.22 to KBR's Form 10-K for the fiscal year ended December 31, 2006; File No. 1-33146)
10.13+	KBR, Inc. Transitional Stock Adjustment Plan (incorporated by reference to Exhibit 10.23 to KBR's Form 10-K for the fiscal year ended December 31, 2006; File No. 1-33146)
10.14+	KBR Dresser Deferred Compensation Plan (incorporated by reference to Exhibit 4.5 to KBR's Registration Statement on Form S-8 filed on April 13, 2007)



**Table of Contents****Exhibit**

<b>Number</b>	<b>Description</b>
10.15+	KBR Supplemental Executive Retirement Plan (incorporated by reference to Exhibit 10.3 to KBR's current report on Form 8-K dated April 9, 2007; File No. 1-33146).
10.16+	KBR Benefit Restoration Plan (incorporated by reference to Exhibit 10.4 to KBR's current report on Form 8-K dated April 9, 2007; File No. 1-33146).
10.17+	KBR Elective Deferral Plan (incorporated by reference to Exhibit 10.5 to KBR's current report on Form 8-K dated April 9, 2007; File No. 1-33146).
10.18+	Restricted Stock Unit Agreement pursuant to KBR, Inc. 2006 Stock and Incentive Plan (incorporated by reference to Exhibit 10.2 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.19+	Stock Option Agreement pursuant to KBR, Inc. 2006 Stock and Incentive Plan (incorporated by reference to Exhibit 10.3 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.20+	KBR Restricted Stock Agreement pursuant to KBR, Inc. 2006 Stock and Incentive Plan (incorporated by reference to Exhibit 10.4 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.21+	KBR, Inc. Transitional Stock Adjustment Plan Stock Option Award (incorporated by reference to Exhibit 10.5 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.22+	KBR, Inc. Transitional Stock Adjustment Plan Restricted Stock Award (incorporated by reference to Exhibit 10.6 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.23+	Form of Restricted Stock Agreement between KBR, Inc. and William P. Utt pursuant to KBR, Inc. 2006 Stock and Incentive Plan (incorporated by reference to Exhibit 10.1 to KBR's Form 10-Q for the quarter ended September 30, 2007; File No. 1-33146)
10.24+	Form of KBR Performance Award Agreement pursuant to KBR, Inc. 2006 Stock and Incentive Plan (incorporated by reference to Exhibit 10.5 to KBR's Form 10-Q for the quarter ended September 30, 2007; File No. 1-33146)
*10.25+	Form of revised KBR Performance Award Agreement pursuant to KBR, Inc. 2006 Stock and Incentive Plan.
10.26+	KBR, Inc., 2009 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.1 to KBR's Form 10-Q for the quarter ended June 30, 2008; File No. 1-33146)
10.27+	Form of Severance and Change in Control Agreement (incorporated by reference to Exhibit 10.1 to KBR's Form 10-Q for the quarter ended September 30, 2008; File No. 1-33146)
10.28	Three Year Revolving Credit Agreement dated as of November 3, 2009 among KBR, Inc., the Lenders party thereto, BBVA Compass, as Syndication Agent, The Royal Bank of Scotland PLC, Bank of America, N.A. and Regions Bank, as Co-Documentation Agents, Citigroup Global Markets Inc. and RBS Securities Inc., as Co-Lead Arrangers, and Citibank, N.A. as Administrative Agent (incorporated by reference to Exhibit 10.1 to KBR's current report on Form 8-K dated November 3, 2009; File No. 1-33146)
10.29+	Severance and Change of Control Agreement, between KBR Technical Services, Inc., a Delaware corporation, KBR, Inc., and Susan K. Carter (incorporated by reference to Exhibit 10.1 to KBR's current report on Form 8-K dated October 26, 2009; File No. 1-33146)
10.30+	Severance and Change of Control Agreement, between KBR Technical Services, Inc., a Delaware corporation, KBR, Inc., and Mark S. Williams (incorporated by reference to Exhibit 10.1 to KBR's current report on Form 8-K dated January 18, 2010; File No. 1-33416)
10.31+	Severance and Change of Control Agreement (incorporated by reference to Exhibit 10.1 to KBR's current report on Form 8-K dated August 16, 2010, by and between KBR and Dennis S. Baldwin; File No. 1-33146)

**Table of Contents****Exhibit**

<b>Number</b>	<b>Description</b>
*21.1	List of subsidiaries
*23.1	Consent of KPMG LLP - Houston, Texas
*31.1	Certification by Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a).
*31.2	Certification by Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a).
**32.1	Certification Furnished Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
**32.2	Certification Furnished Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
***101.INS	XBRL Instance Document
***101.SCH	XBRL Taxonomy Extension Schema Document
***101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
***101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
***101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
*	Filed with this Form 10-K
**	Furnished with this Form 10-K
***	In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Annual Report on Form 10-K shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

+ Management contracts or compensatory plans or arrangements

**Table of Contents**

**Report of Independent Registered Public Accounting Firm on Supplementary Information**

The Board of Directors and Shareholders

KBR, Inc.:

Under the date of February 23, 2011, we reported on the consolidated balance sheets of KBR, Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2010, which reports appear in the December 31, 2010 Annual Report on Form 10-K of KBR, Inc. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related consolidated financial statement schedule (Schedule II) included in the Company's Annual Report on Form 10-K. The financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statement schedule based on our audits.

In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Notes 1 and 15 to the consolidated financial statements, the Company changed its method of accounting for variable interest entities on a prospective basis as of January 1, 2010.

/s/ KPMG LLP

Houston, Texas

February 23, 2011

**Table of Contents****KBR, Inc.****Schedule II - Valuation and Qualifying Accounts (Millions of Dollars)**

The table below presents valuation and qualifying accounts for continuing operations.

Descriptions	Balance at Beginning Period	Additions		Deductions	Balance at End of Period
		Charged to Costs and Expenses	Charged to Other Accounts		
Year ended December 31, 2010:					
Deducted from accounts and notes receivable:					
Allowance for bad debts	\$ 26	\$ 13	\$	\$ (12)(a)	\$ 27
Reserve for losses on uncompleted contracts	\$ 40	\$ 1	\$	\$ (15)	\$ 26
Reserve for potentially disallowable costs incurred under government contracts	\$ 116	\$	\$ 34(b)	\$ (9)	\$ 141
Year ended December 31, 2009:					
Deducted from accounts and notes receivable:					
Allowance for bad debts	\$ 19	\$ 6	\$ 3	\$ (2)(a)	\$ 26
Reserve for losses on uncompleted contracts	\$ 76	\$ 3	\$	\$ (39)	\$ 40
Reserve for potentially disallowable costs incurred under government contracts	\$ 112	\$	\$ 9(b)	\$ (5)	\$ 116
Year ended December 31, 2008:					
Deducted from accounts and notes receivable:					
Allowance for bad debts	\$ 23	\$ 1	\$ 1	\$ (6)(a)	\$ 19
Reserve for losses on uncompleted contracts	\$ 117	\$ 27	\$	\$ (68)	\$ 76
Reserve for potentially disallowable costs incurred under government contracts	\$ 99	\$	\$ 18(b)	\$ (5)	\$ 112

(a) Receivable write-offs, net of recoveries, and reclassifications.

(b) Reserves have been recorded as reductions of revenue, net of reserves no longer required.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: February 23, 2011

**KBR, INC.**

By: /s/ William P. Utt

**William P. Utt**

**President and Chief Executive Officer**

Dated: February 23, 2011

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title
/s/ William P. Utt <b>William P. Utt</b>	President, Chief Executive Officer and Director (Principal Executive Officer)
/s/ Susan K. Carter <b>Susan K. Carter</b>	Executive Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ Dennis Baldwin <b>Dennis Baldwin</b>	Senior Vice President and Chief Accounting Officer (Principal Accounting Officer)
/s/ W. Frank Blount <b>W. Frank Blount</b>	Director
/s/ Loren K. Carroll <b>Loren K. Carroll</b>	Director
/s/ Jeffrey E. Curtiss <b>Jeffrey E. Curtiss</b>	Director
/s/ John R. Huff <b>John R. Huff</b>	Director

Edgar Filing: KBR, INC. - Form 10-K

/s/ Lester L. Lyles

Director

**Lester L. Lyles**

/s/ Richard J. Slater

Director

**Richard J. Slater**

121



**Table of Contents****EXHIBIT INDEX****Exhibit**

<b>Number</b>	<b>Description</b>
2.1	Agreement and Plan of Merger dated as of May 6, 2008, by and among KBR, Inc., BE&K, Inc., and Whitehawk Sub, Inc., (incorporated by reference to Exhibit 2.1 to KBR's Current Report on Form 8-K; File No. 001-33416)
3.1	KBR Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to KBR's registration statement on Form S-1; Registration No. 333-133302)
3.2	Amended and Restated Bylaws of KBR, Inc. (incorporated by reference to Exhibit 3.1 to KBR's Form 10-Q for the period ended June 30, 2008; File No. 1-33146)
4.1	Form of specimen KBR common stock certificate (incorporated by reference to Exhibit 4.1 to KBR's registration statement on Form S-1; Registration No. 333-133302)
10.1	Master Separation Agreement between Halliburton Company and KBR, Inc. dated as of November 20, 2006 (incorporated by reference to Exhibit 10.1 to KBR's current report on Form 8-K dated November 20, 2006; File No. 001-33146)
10.2	Tax Sharing Agreement, dated as of January 1, 2006, by and between Halliburton Company, KBR Holdings, LLC and KBR, Inc., as amended effective February 26, 2007 (incorporated by reference to Exhibit 10.2 to KBR's Annual Report on Form 10-K for the year ended December 31, 2006; File No. 001-33146)
10.3	Amended and Restated Registration Rights Agreement, dated as of February 26, 2007, between Halliburton Company and KBR, Inc. (incorporated by reference to Exhibit 10.3 to KBR's Annual Report on Form 10-K for the year ended December 31, 2006; File No. 001-33146)
10.4	Transition Services Agreement dated as of November 20, 2006, by and between Halliburton Energy Services, Inc. and KBR, Inc. (KBR as service provider) (incorporated by reference to Exhibit 10.4 to KBR's current report on Form 8-K dated November 20, 2006; File No. 001-33146)
10.5	Transition Services Agreement dated as of November 20, 2006, by and between Halliburton Energy Services, Inc. and KBR, Inc. (Halliburton as service provider) (incorporated by reference to Exhibit 10.5 to KBR's current report on Form 8-K dated November 20, 2006; File No. 001-33146)
10.6	Employee Matters Agreement dated as of November 20, 2006, by and between Halliburton Company and KBR, Inc. (incorporated by reference to Exhibit 10.6 to KBR's current report on Form 8-K dated November 20, 2006; File No. 001-33146)
10.7	Intellectual Property Matters Agreement dated as of November 20, 2006, by and between Halliburton Company and KBR, Inc. (incorporated by reference to Exhibit 10.7 to KBR's current report on Form 8-K dated November 20, 2006; File No. 001-33146)
10.8+	Severance and change in control agreement with William P. Utt, President and Chief Executive Officer of KBR. (incorporated by reference to Exhibit 10.7 to KBR's current report on Form 8-K dated January 7, 2009; File No. 1-33146)
10.9	Form of Indemnification Agreement between KBR, Inc. and its directors (incorporated by reference to Exhibit 10.18 to KBR's registration statement on Form S-1; Registration No. 333-133302)
10.10+	KBR, Inc. 2006 Stock and Incentive Plan (as amended June 27, 2007) (incorporated by reference to Exhibit 10.1 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.11+	KBR, Inc. Senior Executive Performance Pay Plan (incorporated by reference to Exhibit 10.21 to KBR's Form 10-K for the fiscal year ended December 31, 2006; File No. 1-33146)
10.12+	KBR, Inc. Management Performance Pay Plan (incorporated by reference to Exhibit 10.22 to KBR's Form 10-K for the fiscal year ended December 31, 2006; File No. 1-33146)
10.13+	KBR, Inc. Transitional Stock Adjustment Plan (incorporated by reference to Exhibit 10.23 to KBR's Form 10-K for the fiscal year ended December 31, 2006; File No. 1-33146)

Edgar Filing: KBR, INC. - Form 10-K

10.14+ KBR Dresser Deferred Compensation Plan (incorporated by reference to Exhibit 4.5 to KBR's Registration Statement on Form S-8 filed on April 13, 2007)

122

**Table of Contents****Exhibit**

<b>Number</b>	<b>Description</b>
10.15+	KBR Supplemental Executive Retirement Plan (incorporated by reference to Exhibit 10.3 to KBR's current report on Form 8-K dated April 9, 2007; File No. 1-33146).
10.16+	KBR Benefit Restoration Plan (incorporated by reference to Exhibit 10.4 to KBR's current report on Form 8-K dated April 9, 2007; File No. 1-33146).
10.17+	KBR Elective Deferral Plan (incorporated by reference to Exhibit 10.5 to KBR's current report on Form 8-K dated April 9, 2007; File No. 1-33146).
10.18+	Restricted Stock Unit Agreement pursuant to KBR, Inc. 2006 Stock and Incentive Plan (incorporated by reference to Exhibit 10.2 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.19+	Stock Option Agreement pursuant to KBR, Inc. 2006 Stock and Incentive Plan (incorporated by reference to Exhibit 10.3 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.20+	KBR Restricted Stock Agreement pursuant to KBR, Inc. 2006 Stock and Incentive Plan (incorporated by reference to Exhibit 10.4 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.21+	KBR, Inc. Transitional Stock Adjustment Plan Stock Option Award (incorporated by reference to Exhibit 10.5 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.22+	KBR, Inc. Transitional Stock Adjustment Plan Restricted Stock Award (incorporated by reference to Exhibit 10.6 to KBR's Form 10-Q for the quarter ended June 30, 2007; File No. 1-33146)
10.23+	Form of Restricted Stock Agreement between KBR, Inc. and William P. Utt pursuant to KBR, Inc. 2006 Stock and Incentive Plan (incorporated by reference to Exhibit 10.1 to KBR's Form 10-Q for the quarter ended September 30, 2007; File No. 1-33146)
10.24+	Form of KBR Performance Award Agreement pursuant to KBR, Inc. 2006 Stock and Incentive Plan (incorporated by reference to Exhibit 10.5 to KBR's Form 10-Q for the quarter ended September 30, 2007; File No. 1-33146)
*10.25+	Form of revised KBR Performance Award Agreement pursuant to KBR, Inc. 2006 Stock and Incentive Plan.
10.26+	KBR, Inc., 2009 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.1 to KBR's Form 10-Q for the quarter ended June 30, 2008; File No. 1-33146)
10.27+	Form of Severance and Change in Control Agreement (incorporated by reference to Exhibit 10.1 to KBR's Form 10-Q for the quarter ended September 30, 2008; File No. 1-33146)
10.28	Three Year Revolving Credit Agreement dated as of November 3, 2009 among KBR, Inc., the Lenders party thereto, BBVA Compass, as Syndication Agent, The Royal Bank of Scotland PLC, Bank of America, N.A. and Regions Bank, as Co-Documentation Agents, Citigroup Global Markets Inc. and RBS Securities Inc., as Co-Lead Arrangers, and Citibank, N.A. as Administrative Agent (incorporated by reference to Exhibit 10.1 to KBR's current report on Form 8-K dated November 3, 2009; File No. 1-33146)
10.29+	Severance and Change of Control Agreement, between KBR Technical Services, Inc., a Delaware corporation, KBR, Inc., and Susan K. Carter (incorporated by reference to Exhibit 10.1 to KBR's current report on Form 8-K dated October 26, 2009; File No. 1-33146)
10.30+	Severance and Change of Control Agreement, between KBR Technical Services, Inc., a Delaware corporation, KBR, Inc., and Mark S. Williams (incorporated by reference to Exhibit 10.1 to KBR's current report on Form 8-K dated January 18, 2010; File No. 1-33416)
10.31+	Severance and Change of Control Agreement (incorporated by reference to Exhibit 10.1 to KBR's current report on Form 8-K dated August 16, 2010, by and between KBR and Dennis S. Baldwin; File No. 1-33146)

**Table of Contents****Exhibit**

<b>Number</b>	<b>Description</b>
*21.1	List of subsidiaries
*23.1	Consent of KPMG LLP - Houston, Texas
*31.1	Certification by Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a).
*31.2	Certification by Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a).
**32.1	Certification Furnished Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
**32.2	Certification Furnished Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
***101.INS	XBRL Instance Document
***101.SCH	XBRL Taxonomy Extension Schema Document
***101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
*** 101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
*** 101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
*	Filed with this Form 10-K
**	Furnished with this Form 10-K
***	In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Annual Report on Form 10-K shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

+ Management contracts or compensatory plans or arrangements