

KBR, INC.
Form 10-Q
July 31, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2014

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)

(a Delaware Corporation)
20-4536774
601 Jefferson Street
Suite 3400
Houston, Texas 77002
(Address of Principal Executive Offices)
Telephone Number – Area Code (713) 753-3011

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 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 Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) 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

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As of July 15, 2014, there were 145,227,622 shares of KBR, Inc. common stock, \$0.001 par value per share, outstanding.

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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 quarterly 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 disclosed in our 2013 Annual Report on Form 10-K/A contained in Part I under "Risk Factors."

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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

KBR, Inc.

Condensed Consolidated Statements of Income (Loss)

(In millions, except for per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Revenues	\$1,659	\$1,950	\$3,292	\$3,779
Cost of revenues	(1,631)	(1,810)	(3,225)	(3,483)
Gross profit	28	140	67	296
Equity in earnings of unconsolidated affiliates	49	46	80	76
General and administrative expenses	(60)	(63)	(120)	(115)
Gain (loss) on disposition of assets	8	—	8	(1)
Operating income	25	123	35	256
Interest expense, net of interest income	(2)	(1)	(4)	(2)
Foreign currency gains (losses)	(4)	4	(11)	—
Other non-operating expenses	(1)	—	(1)	(1)
Income before income taxes and noncontrolling interests	18	126	19	253
Provision for income taxes	(10)	(15)	(31)	(45)
Net income (loss)	8	111	(12)	208
Net income attributable to noncontrolling interests	(16)	(21)	(39)	(30)
Net income (loss) attributable to KBR	\$(8)	\$90	\$(51)	\$178
Net income (loss) attributable to KBR per share:				
Basic	\$(0.06)	\$0.61	\$(0.35)	\$1.21
Diluted	\$(0.06)	\$0.61	\$(0.35)	\$1.20
Basic weighted average common shares outstanding	145	147	146	147
Diluted weighted average common shares outstanding	145	148	146	148
Cash dividends declared per share	\$0.08	\$0.08	\$0.16	\$0.08

See accompanying notes to condensed consolidated financial statements.

KBR, Inc.

Condensed Consolidated Statements of Comprehensive Income (Loss)

(In millions)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income (loss)	\$8	\$111	\$(12)	\$208
Other comprehensive income (loss), net of tax:				
Cumulative translation adjustments ("CTA"):				
Cumulative translation adjustments, net of tax	13	(44)	22	(52)
Reclassification adjustment for CTA included in net income	1	—	1	1
Net cumulative translation adjustment, net of tax	14	(44)	23	(51)
Pension liability adjustments, net of tax:				
Pension liability adjustments, net of tax	(1)	—	—	—
Reclassification adjustment for pension liability losses included in net income	9	9	17	16
Net pension liability adjustments, net of tax	8	9	17	16
Unrealized gains (losses) on derivatives:				
Unrealized holding gains (losses) on derivatives, net of tax	—	1	(1)	—
Net unrealized gain (loss) on derivatives, net of tax	—	1	(1)	—
Other comprehensive income (loss), net of tax	22	(34)	39	(35)
Comprehensive income, net of tax	30	77	27	173
Less: Comprehensive income attributable to noncontrolling interests	(16)	(26)	(39)	(35)
Comprehensive income (loss) attributable to KBR	\$14	\$51	\$(12)	\$138

See accompanying notes to condensed consolidated financial statements.

KBR, Inc.
Condensed Consolidated Balance Sheets
(In millions, except share data)

	June 30, 2014 (Unaudited)	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$969	\$1,106
Accounts receivable, net of allowance for doubtful accounts of \$23 and \$18	962	1,056
Costs and estimated earnings in excess of billings on uncompleted contracts ("CIE")	515	399
Deferred income taxes	132	168
Other current assets	167	196
Total current assets	2,745	2,925
Property, plant, and equipment, net of accumulated depreciation of \$426 and \$397 (including net PPE of \$66 and \$67 owned by a variable interest entity)	421	415
Goodwill	774	772
Intangible assets, net of amortization	80	85
Equity in and advances to unconsolidated affiliates	174	156
Deferred income taxes	377	344
Claims and accounts receivable	625	628
Other assets	115	113
Total assets	\$5,311	\$5,438
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$726	\$747
Payable to former parent	107	105
Billings in excess of costs and estimated earnings on uncompleted contracts ("BIE")	436	401
Accrued salaries, wages and benefits	234	235
Nonrecourse project debt	10	10
Other current liabilities	397	409
Total current liabilities	1,910	1,907
Pension obligations	462	477
Employee compensation and benefits	120	114
Income tax payable	65	70
Deferred income taxes	86	86
Nonrecourse project debt	74	78
Other liabilities	255	267
Total liabilities	2,972	2,999
KBR shareholders' equity:		
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, 174,384,602 and 173,924,509 shares issued, and 145,221,579 and 148,195,208 shares outstanding	—	—
Paid-in capital in excess of par ("PIC")	2,081	2,065
Accumulated other comprehensive loss ("AOCL")	(701	) (740)
Retained earnings	1,673	1,748
Treasury stock, 29,163,023 shares and 25,729,301 shares, at cost	(704) (610)

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Total KBR shareholders' equity	2,349	2,463
Noncontrolling interests ("NCI")	(10) (24
Total shareholders' equity	2,339	2,439
Total liabilities and shareholders' equity	\$5,311	\$5,438

See accompanying notes to condensed consolidated financial statements.

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KBR, Inc.

Condensed Consolidated Statements of Cash Flows

(In millions)

(Unaudited)

	Six Months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net income (loss)	\$(12	) \$208
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	36	31
Equity in earnings of unconsolidated affiliates	(80	) (76
Deferred income tax expense	11	103
Other	21	9
Changes in operating assets and liabilities:		
Accounts receivable, net of allowance for doubtful accounts	93	(60
Costs and estimated earnings in excess of billings on uncompleted contracts	(88	) (55
Accounts payable	(31	) (31
Billings in excess of costs and estimated earnings on uncompleted contracts	8	(1
Accrued salaries, wages and benefits	(1	) (18
Reserve for loss on uncompleted contracts	17	(16
Receipts of advances from unconsolidated affiliates, net	7	6
Distributions of earnings from unconsolidated affiliates	59	101
Payment on performance bonds for EPC 1 project in Mexico	—	(108
Income taxes payable	20	(155
Pension funding	(24	) (12
Other assets and liabilities	(16	) (23
Total cash flows provided by (used in) operating activities	20	(97
Cash flows from investing activities:		
Purchases of property, plant and equipment	(34	) (40
Proceeds from sale of assets and investments	9	6
Total cash flows used in investing activities	\$(25) \$(34

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KBR, Inc.

Condensed Consolidated Statements of Cash Flows

(In millions)

(Unaudited)

	Six Months Ended June 30,	
	2014	2013
Cash flows from financing activities:		
Payments to reacquire common stock	\$(96)	\$(6)
Distributions to noncontrolling interests, net of investments	(25)	(46)
Payments of dividends to shareholders	(24)	(12)
Net proceeds from issuance of common stock	4	4
Excess tax benefits from stock-based compensation	1	—
Payments on short-term and long-term borrowings	(7)	(9)
Total cash flows used in financing activities	(147)	(69)
Effect of exchange rate changes on cash	15	(53)
Decrease in cash and equivalents	(137)	(253)
Cash and equivalents at beginning of period	1,106	1,053
Cash and equivalents at end of period	\$969	\$800
Supplemental disclosure of cash flows information:		
Cash paid for interest	\$6	\$6
Cash paid for income taxes (net of refunds)	\$4	\$84
Noncash operating activities		
Other assets change for Barracuda arbitration (Note 13)	\$—	\$(219)
Other liabilities change for Barracuda arbitration (Note 13)	\$—	\$219
Noncash financing activities		
Dividends declared	\$12	\$12
See accompanying notes to condensed consolidated financial statements.		

KBR, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1. Description of Company and Significant Accounting Policies

KBR, Inc., a Delaware corporation, was formed on March 21, 2006 and is headquartered in Houston, Texas. KBR, Inc. and its wholly owned and majority-owned subsidiaries (collectively referred to herein as "KBR", "the Company", "we", "us" or "our") is a global engineering, procurement, construction, and services company supporting the energy, hydrocarbons, power, industrial, civil infrastructure, minerals, government services and commercial markets. Our capabilities include engineering, procurement, construction and construction management, technology licensing, operations and maintenance and other support services for a diverse, global customer base, including international and national oil and gas companies, independent refiners, petrochemical producers, fertilizer producers, regulated utilities, manufacturers, power and mining companies and domestic and foreign governments.

Principles of consolidation

Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and include the accounts of KBR and our wholly owned and majority-owned, controlled subsidiaries and variable interest entities of which we are the primary beneficiary. We account for investments over which we have significant influence but not a controlling financial interest using the equity method of accounting. See Note 7 for further discussion on our equity investments and variable interest entities. The cost method is used when we do not have the ability to exert significant influence. All material intercompany balances and transactions are eliminated in consolidation.

Certain prior year amounts have been reclassified to conform to the current year presentation on the condensed consolidated statement of income (loss), condensed consolidated balance sheets and the condensed consolidated statements of cash flows. Effective December 31, 2013, we reclassified equity in earnings of unconsolidated affiliates from revenues to a separate component of operating income on our condensed consolidated statement of income (loss). We reclassified the three months and six months ended June 30, 2013 amounts to conform to our revised presentation as a component of operating income but not a component of revenues.

We have evaluated all events and transactions occurring after the balance sheet date but before the financial statements were issued and have made the appropriate adjustments and included the appropriate disclosures.

Use of estimates

The preparation of our condensed consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period, including:

- project revenues, costs and profits on engineering, construction, pipe fabrication and module assembly, and government services contracts, including recognition of estimated losses on uncompleted contracts,
- uncollectible receivables, claims to and from customers, recoveries of costs from subcontractors, vendors and others,
- provisions for income taxes, recoverability of deferred tax assets and valuation of uncertain tax positions,
- recoverability of goodwill, other intangibles and long-lived assets and related estimated lives,
- recoverability of equity method and cost method investments,
- valuation of pension obligations,
- accruals for estimated liabilities and litigation outcomes,

- consolidation of variable interest entities, and
- valuation of stock-based compensation.

In accordance with normal practice in the construction industry, we include in current assets and current liabilities amounts related to construction contracts realizable and payable over a period in excess of one year. Actual amounts may differ from those included in the accompanying condensed consolidated financial statements, if the underlying estimates and assumptions upon which the financial statements are based change in the future.

Gross Profit

Gross profit represents revenues less the cost of revenues, which includes overhead costs directly attributable to the business

segment. See Note 2 for our discussion on gross profit.

Accounts Receivable

Accounts receivable are recorded at the invoiced amount based on contracted prices. Amounts collected on accounts receivable are included in net cash provided by operating activities in the condensed consolidated statements of cash flows.

We establish an allowance for doubtful accounts based on the assessment of the customers' willingness and ability to pay. In addition to such allowances, there are often items in dispute or being negotiated that may require us to make an estimate as to the ultimate outcome. Past due receivable balances are written off when our internal collection efforts have been unsuccessful in collecting the amounts due. See Note 4 for our discussion on accounts receivable.

Retainage, included in accounts receivable, represents amounts withheld from billings by our customers pursuant to provisions in the contracts and may not be paid to us until the completion of specific tasks on the project. Retainage may also be subject to restrictive conditions such as performance guarantees. Our retainage receivable excludes amounts withheld by the United States ("U.S.") government on certain contracts. See Note 11 for our discussion on U.S. government receivables.

Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts (including Claims) and Advanced Billings and Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts

Costs and estimated earnings in excess of billings on uncompleted contracts ("CIE") represent the excess of contract costs and profits recognized to date using the percentage-of-completion method over billings to date on certain contracts. Billings in excess of costs and estimated earnings on uncompleted contracts ("BIE") represents the excess of billings to date over the amount of contract costs and profits recognized to date using the percentage-of-completion method on certain contracts. See Note 5 for our discussion on CIE and BIE.

Unapproved change orders and claims

When estimating the amount of total gross profit or loss on a contract, we include unapproved change orders and claims to our customers as adjustments to revenues and claims to vendors, subcontractors and others as adjustments to total estimated costs. Claims are recorded to the extent of the lesser of the amounts management expects to recover or to costs incurred and include no profit until they are finalized or approved.

Goodwill

Effective January 1, 2014, we reorganized four of the five reporting units in the Infrastructure, Government and Power ("IGP") business segment into three geographic-based units. This reorganization allows the IGP business segment to focus its engineering, procurement, construction and defense services to customers on a more local level. We have concluded that each of these geographic-based units will be considered a separate reporting unit for goodwill impairment testing purposes. As a result, we performed an additional impairment test on the three newly reorganized reporting units on January 1, 2014 as required by ASC 350-20, utilizing the same methodology as our annual goodwill impairment test, and no indication of impairment was identified. For more detail on our methodology and assumptions, see "Critical Accounting Policies" in our 2013 Annual Report on Form 10-K/A.

Share-based Compensation

Effective January 1, 2014, we changed our methodology for estimating the expected term of our option awards and we will no longer utilize the simplified method. We will measure all future stock option awards using an expected term based on KBR's historical experience.

Reserve for estimated losses on uncompleted contracts

Our reserve for estimated losses on uncompleted contracts is included in "other current liabilities" on our condensed consolidated balance sheet. Our total reserve as of June 30, 2014 and December 31, 2013 is \$127 million and \$109 million, respectively, including \$115 million and \$97 million, respectively, related to our Canadian pipe fabrication and module assembly projects. Based on current contracts and work authorizations, we anticipate completion of these Canadian pipe fabrication and module assembly projects in 2015. See Note 2 for additional information on changes in estimates related to our Canadian pipe fabrication and module assembly projects.

Note 2. Business Segment Information

Our business segment information has been prepared in accordance with ASC 280 - Segment Reporting. Certain reporting units meet the definition of operating segments contained in 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 Technical Staffing Resources (formerly a part of Allstates Technical Services) as well as corporate expenses not included in the operating segments' results.

Reportable segment performance is evaluated by our Chief Operating Decision Maker ("CODM") using reportable segment gross profit (loss) which is defined as business segment revenues less the cost of revenues, which includes business segment overhead directly attributable to the segment, but excludes equity in earnings of unconsolidated affiliates.

Business Reorganization

During 2013, we reorganized our business to better serve our customers, improve our organizational efficiency and achieve future growth objectives. In order to attain these objectives, we separated our Hydrocarbons reportable segment into two separate reportable segments, Gas Monetization and Hydrocarbons. Our five reportable segments are Gas Monetization, Hydrocarbons, IGP, Services and Other. Each reportable segment, excluding Other, is led by a separate Segment President who reports directly to our CODM. We have revised our business segment reporting to reflect our current management approach and recast prior periods to conform to the current business segment presentation.

The following table presents revenues, gross profit (loss), equity in earnings of unconsolidated affiliates and operating income (loss) by reporting segment.

Operations by Reportable Segment

Millions of dollars	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Revenues:				
Gas Monetization	\$362	\$593	\$762	\$1,188
Hydrocarbons	533	344	985	686
Infrastructure, Government and Power	315	375	652	774
Services	439	620	872	1,098
Other	10	18	21	33
Total	\$1,659	\$1,950	\$3,292	\$3,779
Gross profit (loss):				
Gas Monetization	\$48	\$80	\$143	\$169
Hydrocarbons	34	44	56	93
Infrastructure, Government and Power	(20	) 8	(40	) 27
Services	(40	) 20	(100	) 31
Other	5	5	10	8
Labor cost absorption not allocated to the business segments - favorable (unfavorable)	1	(17	) (2	) (32
Total	\$28	\$140	\$67	\$296
Equity in earnings of unconsolidated affiliates:				
Gas Monetization	\$18	\$17	\$34	\$27
Hydrocarbons	—	—	—	—
Infrastructure, Government and Power	24	18	33	26
Services	—	3	—	10
Other	7	8	13	13
Total	\$49	\$46	\$80	\$76
Segment operating income (loss):				
Gas Monetization	\$66	\$97	\$177	\$196
Hydrocarbons	34	44	56	93
Infrastructure, Government and Power	4	26	(7	) 53
Services	(40	) 23	(100	) 41
Other	20	13	31	20
Labor cost absorption not allocated to the business segments - favorable (unfavorable)	1	(17	) (2	) (32
Corporate general and administrative expense not allocated to the business segments	(60	) (63	) (120	) (115
Total operating income	\$25	\$123	\$35	\$256

Changes in Estimates

There are many factors, including, but not limited to, the availability and costs of labor, materials and equipment, and resources, productivity, and weather, that can affect the accuracy of our cost estimates, and ultimately, our future profitability. In the past, we have realized both lower and higher than expected margins and have incurred losses as a result of unforeseen changes in our project costs. However, historically, our estimates have been reasonably dependable regarding the recognition of revenues and profit on percentage of completion contracts.

Our Services business segment recognized revisions in our estimates of losses at completion on our Canadian pipe fabrication and module assembly projects of \$41 million and \$82 million during the three and six months ended

June 30, 2014, respectively. All of these projects were in loss positions at June 30, 2014 and December 31, 2013. Our estimates of revenues and costs at completion on these projects have been, and may continue to be, impacted by our performance, the performance of our subcontractors, the Canadian labor market, the nature and complexity of modules submitted by our customers, our contractual arrangements and our ability to accumulate information and negotiate final contract settlements with our customers. We recognize revisions of revenues and costs in the period in which the revisions are determined. This may result in the recognition of costs

before the recognition of related revenues recovery, if any. Our estimated losses as of June 30, 2014 on these projects represent our best estimate based on current information. Actual results could differ from the estimates we have used to account for these projects as of June 30, 2014.

During the six months ended June 30, 2014, we recognized revisions in estimates associated with approved man hours and other revisions in estimates which had a \$21 million positive impact on the gross profit of our Gas Monetization business segment. Additionally, our Gas Monetization business segment recognized revisions in estimates resulting from a favorable settlement of claims which had a \$33 million net positive impact on gross profit. Both of these revisions to estimates were recognized in the first quarter of 2014.

Significant revisions to contract estimates as a result of client-driven revised project man-hour estimates had a \$13 million positive impact during the three months ended June 30, 2013 and a \$51 million positive impact during the six months ended June 30, 2013 on the gross profit of our Gas Monetization business segment.

Note 3. Cash and Cash Equivalents

We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents include cash balances held by our wholly-owned subsidiaries as well as cash held by joint ventures that we consolidate. 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. We expect to use joint venture cash for project costs and distributions of earnings related to joint venture operations. However, some of the earnings distributions may be paid to other KBR entities where the cash can be used for general corporate needs.

The components of our cash and cash equivalents balance are as follows:

Millions of dollars	June 30, 2014		
	International (a)	Domestic (b)	Total
Operating cash	\$250	\$170	\$420
Time deposits	372	102	474
Cash held in joint ventures	65	10	75
Total	\$687	\$282	\$969

Millions of dollars	December 31, 2013		
	International (a)	Domestic (b)	Total
Operating cash	\$197	\$215	\$412
Time deposits	478	140	618
Cash held in joint ventures	67	9	76
Total	\$742	\$364	\$1,106

(a) Includes deposits held in non-U.S. operating accounts considered to be permanently reinvested outside the U.S. and for which no incremental U.S. tax has been provisioned or paid

(b) Includes U.S. dollar and foreign currency deposits held in operating accounts that constitute onshore cash for tax purposes but may reside either in the U.S. or in a foreign country

Our international cash balances are primarily held in Australia, the United Kingdom ("U.K.") and Canada. We generally do not provide U.S. federal and state income taxes on the accumulated undistributed earnings of non-U.S.

subsidiaries except for certain entities in Mexico and certain other joint ventures, as well as for approximately 50% of our earnings from our operations in Australia since 2012. Taxes are provided as necessary with respect to earnings that are considered not permanently reinvested. We will continue to provide for U.S. federal and state taxes on 50% of the earnings of our Australian operations as we no longer intend to permanently reinvest these amounts. In determining whether earnings would be considered permanently invested, we considered future non-U.S. cash needs such as: 1) our anticipated foreign working capital requirements, including funding of our U.K. pension plan; 2) the expected growth opportunities across all geographical markets; and 3) our plans to invest in strategic growth opportunities that may include acquisitions around the world. For all other non-U.S. subsidiaries, no U.S. taxes are provided because such earnings are intended to be permanently reinvested to finance foreign activities. These accumulated but undistributed foreign earnings could be subject to additional tax if remitted, or deemed remitted, as a dividend. If any portion of the unremitted

earnings were ever foreseen to not be permanently reinvested outside the U.S., or if we elect to repatriate a portion of current year foreign earnings, U.S. income tax expense would be required to be recognized and that expense could be material.

Note 4. Accounts Receivable

The components of our accounts receivable, net of allowance for doubtful accounts balance are as follows:

	June 30, 2014		
Millions of dollars	Trade	Retainage	Total
Gas Monetization	\$129	\$—	\$129
Hydrocarbons	362	23	385
Infrastructure, Government and Power	144	16	160
Services	239	46	285
Other	3	—	3
Total	\$877	\$85	\$962

	December 31, 2013		
Millions of dollars	Trade	Retainage	Total
Gas Monetization	\$255	\$—	\$255
Hydrocarbons	284	31	315
Infrastructure, Government and Power	137	15	152
Services	278	54	332
Other	2	—	2
Total	\$956	\$100	\$1,056

In addition, noncurrent retainage receivable included in "other assets" on our condensed consolidated balance sheets was \$17 million and \$14 million as of June 30, 2014 and December 31, 2013, respectively, primarily related to a waste-to-energy project in the U.S. in our IGP business segment.

Note 5. Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts and Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts

Our CIE balances by business segment are as follows:

	June 30,	December 31,
Millions of dollars	2014	2013
Gas Monetization	\$10	\$34
Hydrocarbons	226	146
Infrastructure, Government and Power	122	131
Services	153	83
Other	4	5
Total	\$515	\$399

Our BIE balances by business segment are as follows:

	June 30, 2014	December 31, 2013
Millions of dollars		
Gas Monetization	\$28	\$ 30
Hydrocarbons	199	139
Infrastructure, Government and Power	180	199
Services	29	33
Other	—	—
Total	\$436	\$ 401

Unapproved change orders and claims

The amounts of unapproved change orders and claims included in determining the profit or loss on contracts are as follows:

Millions of dollars	2014	2013
Amounts included in estimated project revenues at completion at January 1,	\$115	\$167
Increase in estimated project revenues at completion	3	55
Approved by client	(56	) (25
Amounts included in estimated project revenues at completion at June 30,	\$62	\$197
Amounts recorded in revenues on a percentage-of-completion basis at June 30,	\$36	\$167

In 2014, approved change orders reflect approvals on an air quality project in North America and a construction project in our Services business segment for which the client routinely issues scope changes which are subsequently followed with a change order.

Included in our 2013 estimated project revenues are increases related to the construction project in our Services business segment mentioned above.

The table above excludes unapproved change orders and claims related to our unconsolidated subsidiaries. Our proportionate share of unapproved change orders and claims on a percentage-of-completion basis were \$90 million as of June 30, 2014 and \$55 million as of June 30, 2013 related to the Ichthys LNG project joint venture.

Liquidated damages

Some of our engineering and construction contracts have schedule dates and performance obligations that if not met could subject us to penalties for liquidated damages. These generally relate to specified activities that must be completed by a set contractual date or by achievement of a specified level of output or throughput. 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 or settling claims and closing out the contract.

Based upon our evaluation of our performance and other legal analysis, we have not accrued for possible but not probable liquidated damages related to several projects totaling \$12 million at June 30, 2014 and \$10 million at December 31, 2013 (including amounts related to our proportional share of unconsolidated subsidiaries), that we could incur based upon completing the projects as currently forecasted.

Advances

We may receive customer advances in the normal course of business, most of which are applied to invoices usually within one to three months. In addition, we hold advances from customers to assist us in financing project activities, including subcontractor costs. As of June 30, 2014 and December 31, 2013, \$43 million and \$50 million, respectively, of these finance-related advances are included in BIE on our condensed consolidated balance sheets.

Note 6. Claims and Accounts Receivable

The components of our claims and accounts receivable account balance not expected to be collected within the next 12 months are as follows:

Millions of dollars	June 30, 2014	December 31, 2013
Hydrocarbons	\$401	\$ 401
Infrastructure, Government and Power	223	226
Other	1	1
Total	\$625	\$ 628

Hydrocarbons claims and accounts receivable includes \$401 million related to the EPC 1 arbitration award. We expect this legal judgment of \$465 million to be recovered from Petróleos Mexicanos ("PEMEX") Exploration and Production ("PEP"), which includes the original confirmation of the 2009 arbitration award and approximately \$106 million for 2013 performance bonds recovery and post judgment interest. See Note 12 for further discussion on our EPC 1 arbitration.

IGP claims and accounts receivable includes \$223 million of claims for costs incurred under various U.S. government contracts. See "Other Matters" in Note 11 for further discussion on our U.S. government matters.

Note 7. Equity Method Investments and Variable Interest Entities

We conduct some of our operations through joint ventures which operate through 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 ASC 810 - Consolidations - Variable Interest Entities.

The following table presents a rollforward of our equity in and advances to unconsolidated affiliates:

Millions of dollars	2014	2013
Balance at January 1,	\$ 156	\$ 217
Equity in earnings of unconsolidated affiliates	80	76
Dividends received	(59	) (101
Advances	(7	) (6
Cumulative translation adjustment	4	(7
Balance at June 30,	\$ 174	\$ 179

Related Party Transactions

We often provide services as a subcontractor, which include engineering and construction management services, to the joint ventures in which we are a participant. The amounts included in our revenues represent revenues from services provided directly to the joint ventures as a subcontractor. As of June 30, 2014 and 2013, our revenues included \$144 million and \$119 million, respectively, primarily related to services we provided to our Ichthys LNG project joint venture.

Amounts included in our condensed consolidated balance sheets related to services we provided to our joint ventures as of June 30, 2014 and December 31, 2013 are as follows:

Millions of dollars	June 30, 2014	December 31, 2013
Accounts Receivable, net of allowance for doubtful accounts	\$2	\$ 6

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Costs and estimated earnings in excess of billings on uncompleted contracts	\$3	\$2
Billings in excess of costs and estimated earnings on uncompleted contracts	\$23	\$24

Our related party accounts payable for both periods were immaterial.

Equity Method Investments

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

Millions of dollars	June 30, 2014	December 31, 2013
Current assets	\$4,017	\$4,114
Noncurrent assets	4,440	4,222
Total assets	\$8,457	\$8,336
Current liabilities	\$3,632	\$3,679
Noncurrent liabilities	4,550	4,400
Total liabilities	\$8,182	\$8,079

Statements of Operations

Millions of dollars	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenues	\$1,372	\$1,245	\$2,608	\$2,148
Operating income	\$174	\$171	\$328	\$299
Net income	\$126	\$128	\$206	\$195

Unconsolidated Variable Interest Entities

The following summarizes the total assets and total liabilities as reflected in our condensed consolidated balance sheets as well as our maximum exposure to losses related to our unconsolidated variable interest entities ("VIEs") in which we have a significant variable interest but are not the primary beneficiary. Generally, our maximum exposure to loss is limited to our equity investment in the joint venture and any amounts payable to us for services we provided to the joint venture, reduced for any unearned revenues on the projects.

Millions of dollars	June 30, 2014		
	Total assets	Total liabilities	Maximum exposure to loss
Aspire Defence project	\$27	\$10	\$27
Ichthys LNG project	\$21	\$31	\$11
U.K. Road projects	\$37	\$11	\$35
EBIC Ammonia project	\$44	\$2	\$27
Fermoy Road project	\$3	\$4	\$2

Millions of dollars	December 31, 2013	
	Total assets	Total liabilities
Aspire Defence project	\$20	\$2
Ichthys LNG project	\$1	\$18
U.K. Road projects	\$34	\$8
EBIC Ammonia project	\$47	\$2
Fermoy Road project	\$1	\$2

On the Aspire Defence project, in addition to the maximum exposure to loss indicated in the table above, we have exposure to any losses incurred by the construction or operating joint ventures under their respective subcontract arrangements with the project company. Our exposure is, however, limited to our equity participation in these entities. The Ichthys LNG project joint

venture executes a project that has a lump sum component; in addition to the maximum exposure to loss indicated in the table above, we have an exposure to losses if the project exceeds the lump sum component to the extent of our ownership percentage in the joint venture. Our maximum exposure to loss on the EBIC Ammonia project reflects our 65% ownership of the development corporation which owns 25% of the company that consolidates the ammonia plant.

Consolidated Variable Interest Entities

We consolidate VIEs if we determine we are the primary beneficiary of the project entity because we control the activities that most significantly impact the economic performance of the entity. The following is a summary of the significant VIEs where we are the primary beneficiary:

	June 30, 2014	
Millions of dollars	Total assets	Total liabilities
Gorgon LNG project	\$432	\$455
Escravos Gas-to-Liquids project	\$38	\$61
Fasttrax Limited project	\$93	\$93

	December 31, 2013	
Millions of dollars	Total assets	Total liabilities
Gorgon LNG project	\$446	\$476
Escravos Gas-to-Liquids project	\$43	\$72
Fasttrax Limited project	\$96	\$98

Note 8. Nonrecourse Project Debt

Fasttrax Limited, a joint venture in which we indirectly own a 50% equity interest with an unrelated partner, was awarded a concession contract in 2001 with the U.K. Ministry of Defence ("MoD") to provide a Heavy Equipment Transporter Service to the British Army. Under the terms of the arrangement, Fasttrax Limited operates and maintains 91 heavy equipment transporters ("HETs") 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 (approximately \$120 million at the exchange rate on the date of the transaction) and a bridge loan totaling approximately £12.2 million (approximately \$17 million at the exchange rate on the date of the transaction) which are nonrecourse to KBR and its partner. The bridge loan was replaced when the shareholders funded combined equity and subordinated debt in 2005. The secured bonds are an obligation of Fasttrax Limited and are not a debt obligation of KBR because they are nonrecourse 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 Fasttrax Limited for repayment.

The guaranteed secured bonds were issued in two classes consisting of Class A 3.5% Index Linked Bonds in the amount of £56 million (approximately \$79 million at the exchange rate on the date of the transaction) and Class B 5.9% Fixed Rate Bonds in the amount of £16.7 million (approximately \$24 million at the exchange rate on the date of the transaction). 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 mature in 2021. Subordinated notes payable to each of the 50% partners initially bear interest at 11.25% increasing to 16% over the term of the notes through 2025. For financial reporting purposes, only our partner's portion of the subordinated notes appears in the condensed consolidated financial statements. Payments on the subordinated debt commenced in March 2006 and are due in semi-annual installments over the term of the notes.

Note 9. Pension Plans

The components of net periodic benefit cost related to pension benefits for the three and six months ended June 30, 2014 and 2013 were as follows:

Millions of dollars	Three Months Ended June 30,			
	2014		2013	
	United States	Int'l	United States	Int'l
Components of net periodic benefit cost				
Service cost	\$—	\$1	\$—	\$—
Interest cost	1	22	—	20
Expected return on plan assets	(1	) (26	) (1	) (23
Recognized actuarial loss	1	10	1	9
Net periodic benefit cost	\$1	\$7	\$—	\$6

Millions of dollars	Six Months Ended June 30,			
	2014		2013	
	United States	Int'l	United States	Int'l
Components of net periodic benefit cost				
Service cost	\$—	\$1	\$—	\$1
Interest cost	1	45	1	41
Expected return on plan assets	(2	) (52	) (2	) (45
Recognized actuarial loss	2	19	1	17
Net periodic benefit cost	\$1	\$13	\$—	\$14

For the six months ended June 30, 2014, we have contributed approximately \$23 million of the \$46 million we currently expect to contribute to our international plans in 2014, and we have contributed approximately \$1 million of the \$3 million we currently expect to contribute to our domestic plans in 2014.

Note 10. Income Taxes

Our estimated annual effective tax rate for the years 2014 and 2013 reconciled to the 35% U.S. statutory federal rate is as follows:

	2014		2013	
		%		%
U.S. statutory federal rate	35.0	%	35.0	%
Rate differentials on foreign earnings	(5.6	)%	(5.0)%
Taxes on unincorporated joint ventures	(6.6	)%	(6.5)%
Taxes on unconsolidated affiliates	(9.2	)%	(3.7)%
U.S. taxes provided on foreign earnings	5.9	%	1.7	%
State taxes	0.3	%	0.5	%
Other	2.7	%	1.4	%
Estimated annual effective tax rate	22.5	%	23.4	%

We generally do not provide U.S. federal and state income taxes on the accumulated undistributed earnings of non-U.S. subsidiaries except for certain entities in Mexico and certain other joint ventures, as well as for approximately 50% of our earnings from our operations in Australia since 2012. See Note 3 for additional information regarding our accumulated undistributed earnings. Due to historical and forecasted losses for certain non-U.S. affiliates, we are not allowed to record a tax benefit for current period net operating losses recognized by these

affiliates.

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Our effective tax rate reflected in our condensed consolidated statements of income (loss) for the three and six months ended June 30, 2014 is not reflective of our estimated annual effective tax rate shown in the table above as a result of discrete items including the recording of a valuation allowance on the losses recognized on our Canadian pipe fabrication and module assembly business.

The effective tax rate was approximately 11.9% for the three months ended June 30, 2013 and 17.8% for the six months ended June 30, 2013. Our effective tax rate for the six months ended June 30, 2013 was lower than our estimated annual effective rate of 23.4% due to discrete items. In the first six months of 2013, we recognized discrete net tax benefits of approximately \$14 million including benefits related to the recognition of previously unrecognized tax benefits related to tax positions in prior years, primarily as a result of the resolution of transfer pricing issues involving our U.K. subsidiaries.

The valuation allowance for deferred tax assets as of June 30, 2014 and December 31, 2013 was \$115 million and \$83 million, respectively. The net change in the total valuation allowance was an increase of \$32 million from December 31, 2013, including an increase of \$10 million during the three months ended June 30, 2014. The valuation allowance at June 30, 2014 and December 31, 2013 was primarily related to Canadian losses and state net operating loss carryforwards that, in the judgment of management, are not more-likely-than-not to be realized.

In assessing the realizability of deferred tax assets, management considers 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. Management considers the scheduled reversal of deferred tax liabilities (including the impact of available carryback and carryforward periods), projected future taxable income and tax-planning strategies in making this assessment. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

Note 11. U.S. Government Matters

We provide services to various U.S. governmental agencies, which include the United States Department of Defense ("DoD"), the Department of State and others. We may have disagreements or experience performance issues on our U.S. government contracts. When performance issues arise under any of these contracts, the government retains the right to pursue various remedies, including challenges to expenditures, suspension of payments, fines and suspensions or debarment from future business with the government.

With the U.S. Army's withdrawal from Iraq, our work with the U.S. government in the war zone areas has ended. We have been in the process of closeout with these contracts since 2011, and we expect the closeout process to continue through at least 2018. As a result of our work in a war zone from 2002 to 2011, there are multiple claims and disputes pending between us and the government, all of which need to be resolved to close the contracts. The closeout process includes resolving objections raised by the government through a billing dispute process referred to as Form 1s and Memorandums for Record ("MFRs") and resolving results from government audits. We continue to work with the government to resolve these issues. However, for certain of these matters, we have filed claims with the Armed Services Board of Contract Appeals ("ASBCA") or the U.S. Court of Federal Claims ("COFC"). We also have matters related to ongoing litigation or investigations involving U.S. government contracts. We anticipate billing additional labor, vendor resolution and litigation costs as we resolve the open matters. At this time, we cannot determine the timing or net amounts to be collected or paid to close out these contracts.

Form 1s

The government has issued Form 1s questioning or objecting to costs we billed to them. We believe the amounts we have invoiced the customer is in compliance with our contract terms; however, we continue to evaluate our ability to recover these amounts from our customer as new information becomes known. A summary of our Form 1s received and amounts associated with our Form 1s is as follows:

Millions of dollars	June 30, 2014	December 31, 2013
Form 1s issued by the government and outstanding (a)	\$266	\$274
Amounts withheld by government (included in the Form 1s amount above) (b)	137	137
Amounts withheld from subcontractors by us	51	50
Claims loss accruals (c)	61	74

- (a) Included in the amounts shown is \$56 million related to our Private Security matter discussed below in which KBR was granted full recovery of the amounts claimed.
- (b) Recorded in "claims and accounts receivable" on our condensed consolidated balance sheets. We believe these amounts are probable of collection.
- (c) Recorded as a reduction to "claims and accounts receivable" and in "other liabilities" on our condensed consolidated balance sheets. At this time, we believe the likelihood we would incur a loss related to this matter in excess of the loss accruals we have recorded is remote.

Summarized below are some of the details associated with individual Form 1s as part of the total explained above.

Private Security. Starting in February 2007, we received a series of Form 1s from the Defense Contract Audit Agency ("DCAA") informing us of the government's intent to deny reimbursement to us under the LogCAP III contract for amounts related to the use of private security contractors ("PSCs") by KBR and a subcontractor in connection with its work for KBR providing dining facility services in Iraq between 2003 and 2006. The government challenged \$56 million in billings. The government had previously paid \$11 million and has withheld payments of \$45 million, which as of June 30, 2014, we have recorded due from the government related to this matter in "claims and accounts receivable" on our condensed consolidated balance sheets.

On June 16, 2014, we received a decision from the ASBCA which agreed with the KBR's position that the LogCAP III contract did not prohibit the use of PSCs to provide force protection to KBR or subcontractor personnel, that there was a need for force protection and that the costs were reasonable. The ASBCA also found that the Army breached its obligation to provide force protection. Accordingly, we believe that we are entitled to reimbursement by the Army for the amounts charged by our subcontractors, even if they incurred costs for PSCs. The Army has 120 days to appeal. We believe the likelihood that we will incur a loss related to this matter is remote, and therefore we have not accrued any loss provisions related to this matter.

Containers. In June 2005, the DCAA questioned billings on costs associated with providing containerized housing for soldiers and supporting civilian personnel in Iraq. The Defense Contract Management Agency ("DCMA") recommended that payment for the billings be withheld pending receipt of additional explanation or documentation to support the subcontract costs. The Form 1 was issued for \$51 million in billings. Of this amount, the government had previously paid \$25 million and has withheld payments of \$26 million, which as of June 30, 2014, we have recorded in "claims and accounts receivable" on our condensed consolidated balance sheets.

Included in "other liabilities" on our condensed consolidated balance sheets is \$46 million of payments withheld from subcontractors related to pay-when-paid contractual terms. Of this amount, \$15 million is due from the government and recorded in "claims and accounts receivable" on our condensed consolidated balance sheets. At this time, we believe that the likelihood we would incur a loss related to this matter in excess of the amounts we have withheld from subcontractors and the loss accruals we have recorded is remote.

There are three related actions stemming from the DCMA's action to disallow and withhold funds. First, in April 2008 we filed a counterclaim in arbitration against our LogCAP III subcontractor, First Kuwaiti Trading Company, to recover the amounts we paid to the subcontractor for containerized housing if we should lose the contract dispute with the government over the allowability of the container claims. Second, during the first quarter of 2011 we filed a complaint before the ASBCA to contest the Form 1s and to recover the amounts withheld from us by the government. At the request of the government, that complaint

was dismissed without prejudice in January 2013 so that the government could pursue its False Claims Act suit described below. We are free to re-file the complaint in the future. Third, 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."

Tamimi.

Tamimi - Form 1. In 2006, the DCAA questioned the price reasonableness of billed costs related to dining facilities in Iraq. We responded to the DCMA that we believe our costs are reasonable. The prices obtained for these services were from our subcontractor Tamimi. The Form 1 was issued for \$68 million in billings. The government had previously paid \$25 million and has withheld payments of \$43 million.

At June 30, 2014, we have recorded \$43 million due from the government related to these matters in "claims and accounts receivable" on our condensed consolidated balance sheets and accrued our estimate related to any probable loss in "other liabilities" on our condensed consolidated balance sheets. At this time, we believe the likelihood we would incur a loss related to this matter in excess of the loss accruals we have recorded is remote.

In April 2012, the U.S. COFC ruled that KBR's negotiated price for certain dining facility services was not reasonable and that we were entitled to only \$12 million of the amounts withheld from us by the government plus any applicable interest (\$2 million). In addition, while this matter was before the court the U.S. government withheld an additional \$1 million. As a result of this ruling, we recognized a pre-tax charge of \$28 million as a reduction to revenues. We appealed the U.S. COFC ruling and in September 2013, a three judge panel of the Federal Circuit Court of Appeals issued its opinion upholding the ruling. In June 2014, we filed a joint petition for certiorari with the U.S. Supreme Court for this litigation and in a related case involving another subcontractor. One amicus brief has been filed in support of KBR's legal arguments.

Tamimi - DOJ. In March 2011, the DOJ filed a counterclaim in the U.S. COFC alleging KBR employees accepted bribes from Tamimi in exchange for awarding a master agreement for dining facilities services to Tamimi. The April 2012 ruling on the Tamimi matter discussed above dismissed the DOJ claims as lacking merit. On appeal, the DOJ's efforts to overturn the trial court ruling have been denied.

Fly America. In 2007, the DCAA questioned costs related to 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 contracts to travel by U.S. flag air carriers. There were 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 ("FAR") and the Comptroller General. In October 2011, at the request of the DCMA, we submitted an estimate of the impact of our non-compliance with the Fly America Act for 2003 and 2004. In May 2014, the Contracting Officer rendered a Contracting Officer Final Determination ("COFD") disallowing \$3 million in billings. We have entered into negotiations and at this time, we believe the likelihood we would incur a loss related to this matter in excess of the loss accruals we have recorded is remote.

H-29. In the first quarter of 2011, we received a Form 1 from the DCAA disapproving certain transportation costs associated with replacing employees who were deployed in Iraq and Afghanistan for less than 179 days. The Form 1 was issued for \$27 million in billings, all of which had been previously paid by the government. No payments have been withheld by the government for this matter. The DCAA claims these replacement costs violate the terms of the LogCAP III contract which expressly disallow certain costs associated with the contractor rotation of employees who have deployed less than 179 days including costs for transportation, lodging, meals, orientation and various forms of per diem allowances. We disagreed with the DCAA's interpretation and application of the contract terms as it was

applied to circumstances outside of our control including war risks, sickness, death, termination for cause or resignation and that such costs should be allowable. We filed a declaratory judgment to have the clause interpreted before the COFC. On July 9, 2014, we reached agreement with the Army on the matter of an interpretation of the clause that essentially confirms KBR's interpretation and rejects that of the DCAA. At June 30, 2014, we have accrued our estimate of the potentially non-compliant cost incurred recorded in "other liabilities" on our condensed consolidated balance sheets. At this time, we do not believe we face a risk of material loss from any disallowance of these costs in excess of the loss accruals we have recorded. There is a parallel qui tam further described under the caption "Chillcott qui tam" below.

CONCAP III. From February 2009 through September 2010, we received Form 1s from the DCAA disapproving billed 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 Form 1 was issued for \$25 million in billings. The government had previously paid \$15 million and has withheld payments of \$10 million.

As of June 30, 2014, we have recorded \$10 million due from the government related to these matters in "claims and accounts receivable" on our condensed consolidated balance sheets. As of June 30, 2014, we have accrued our estimate of probable loss related to an unfavorable settlement of this matter recorded in "other liabilities" on our condensed consolidated balance sheets. At this time, we believe that the likelihood we would incur a loss related to this matter in excess of the amounts we have accrued is remote.

In February 2012, the Contracting Officer rendered a COFD disallowing \$15 million of direct costs. We filed an appeal with the ASBCA in June 2012. We believe we undertook adequate and reasonable steps to ensure that proper bidding procedures were followed and the amounts billed to the government were reasonable and not in violation of the FAR.

Other. The government has issued Form 1s for other matters questioning \$39 million of billed costs. For these matters, the government previously paid \$26 million and has withheld payment of \$13 million, which we have recorded in "claims and accounts receivable" on our condensed consolidated balance sheets. We have accrued our estimate of probable loss in "other liabilities" on our condensed consolidated balance sheets. At this time, we believe that the likelihood we would incur a loss related to this matter in excess of the amounts we have accrued is remote.

We have other matters in dispute with the government either in the COFC or before the ASBCA. These claims represent \$12 million in claimed costs primarily associated with the pass-through of subcontractor claims associated with a termination for convenience in Iraq. We have accrued \$2 million as our estimate of probable loss in "other liabilities" on our condensed consolidated balance sheets.

Audits

In addition to reviews being performed by the U.S. government through the Form 1 process, the negotiation, administration and settlement of our contracts, consisting primarily of DoD contracts, are subject to audit by the DCAA, which serves in an advisory role to the DCMA. The DCMA 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, provisional approval of annual billing rates, approval of annual overhead rates, compliance with the FAR and Cost Accounting Standards ("CAS"), compliance with certain unique contract clauses and audits of certain aspects of our internal control systems. We attempt to resolve all issues identified in audit reports by working directly with the DCAA and the Administrative Contracting Officers ("ACOs").

As a result of these audits, there are risks that what we have billed as recoverable costs may be assessed by the government to be unallowable. We believe our billings are in compliance with our contract terms. In some cases, we may not reach agreement with the DCAA or the ACOs regarding potentially unallowable costs which may result in our filing of claims in various courts such as the ASBCA or the U.S. COFC. We have accrued our estimate of potentially unallowable costs using a combination of specific estimates and our settlement rate experience with the government. As of June 30, 2014, we have accrued \$51 million as our estimate of probable loss as a reduction to "claims and accounts receivable" and in "other liabilities" on our condensed consolidated balance sheets. These accrued amounts are associated with years for which we have or do not have audit reports. We have received audit reports for 2004 through 2007 and 2009. We have not yet received completed audit reports for 2008 or 2010 through 2012. Additionally, we have not reached an agreement with the government on definitive incurred cost rates after 2003 except for 2007.

We only include amounts in revenues related to disputed and potentially unallowable costs when we determine it is probable that such costs will result in the collection of revenues. We generally do not recognize additional revenues for disputed or potentially unallowable costs for which revenues has been previously reduced until we reach agreement with the DCAA and/or the ACOs that such costs are allowable.

In addition to audits of our incurred costs, the government also reviews our compliance with the cost accounting standards ("CAS") and the adequacy and compliance of our CAS disclosure statements. We are working with the government to resolve several outstanding alleged CAS non-compliance issues.

Investigations, Qui Tams and Litigation

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

First Kuwaiti Trading Company arbitration. In April 2008, First Kuwaiti Trading Company ("FKTC" or "First Kuwaiti"), one of our LogCAP III subcontractors, filed for arbitration with the American Arbitration Association of all its claims under various LogCAP III subcontracts. First Kuwaiti sought damages in the amount of \$134 million. After completing hearings on all of FKTC's claims, an arbitration panel awarded \$17 million to FKTC for claims involving damages on lost or unreturned vehicles.

In addition, we have determined that we owe FKTC \$30 million in connection with five other subcontracts. We have an agreement with FKTC that no damages will be paid until our counterclaim is decided, but FKTC has now filed a motion with the arbitration panel to compel KBR to pay all amounts outstanding. We are contesting this motion and a hearing has been set for September 2, 2014. We believe any damages ultimately awarded to First Kuwaiti will be billable under the LogCAP III contract. Accordingly, we have accrued amounts in "accounts payable" and "other current liabilities" on our condensed consolidated balance sheets and related amounts in "claims and accounts receivable" on our condensed consolidated balance sheets for the amounts awarded to First Kuwaiti pursuant to the terms of the contract. At this time, we do not believe we face a risk of material loss in excess of the accruals we have recorded. We also have a counterclaim still pending for any funds we should have to return or refund to the government in the container litigation discussed above.

Electrocution litigation. During 2008, a lawsuit was filed against KBR in Pittsburgh, PA, in the Allegheny County Common Pleas Court 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 near Baghdad, Iraq. It is alleged in the suit that the electrocution incident was caused by improper electrical maintenance or other electrical work. KBR denies that its conduct was the cause of the event and denies legal responsibility. Plaintiffs are claiming unspecified damages for personal injury, death and loss of consortium by the parents. On July 13, 2012, the Court granted our motions to dismiss, concluding that the case is barred by the Political Question Doctrine and preempted by the Combatant Activities Exception to the Federal Tort Claims Act. The plaintiffs appealed to the Third Circuit Court of Appeals. In August 2013, the Third Circuit Court of Appeals issued an opinion reversing the trial court's dismissal and remanding for further discovery and legal rulings. KBR filed its motion for rehearing en banc, which was denied, and we have filed an application for writ of certiorari to the U.S. Supreme Court. Four amicus briefs have been filed in support of KBR's legal arguments. On June 16, 2014, the U.S. Supreme Court issued an order inviting the Solicitor General to file briefs in the electrocution litigation, expressing the views of the United States as to KBR's pending applications for writ of certiorari. We anticipate these briefs will not be filed until the fourth quarter of 2014. At this time, we believe the likelihood we would incur a loss related to this matter is remote. As of June 30, 2014, no amounts have been accrued.

Burn Pit litigation. From November 2008 through March 2013, KBR was 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 and seeks class certification. 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 were operated. The plaintiffs are claiming unspecified damages. All of the pending cases were removed to Federal Court and have been consolidated for multi-district litigation treatment before the U.S. Federal District Court in Baltimore, Maryland.

In February 2013, the Court dismissed the case against KBR, accepting all of KBR's defense claims including the Political Question Doctrine; the Combatant Activities Exception to the Federal Tort Claims Act; and Derivative Sovereign Immunity. The plaintiffs appealed to the Fourth Circuit Court of Appeals on March 27, 2013. On March 6, 2014, the Fourth Circuit Court vacated the order of dismissal and remanded this multi-district litigation for further action, including a ruling on state tort law and its impact upon the "Contractor on the Battlefield" defenses. KBR has filed a petition for certiorari with the U.S. Supreme Court. Three amicus briefs have been filed in support of KBR's legal arguments. On June 16, 2014, the U.S. Supreme Court issued an order inviting the Solicitor General to file briefs in the burn pit litigation, expressing the views of the United States as to KBR's pending applications for writ of certiorari. We anticipate these briefs will not be filed until the fourth quarter of 2014. At this time we believe the likelihood that we would incur a loss related to this matter is remote. As of June 30, 2014, no amounts have been accrued.

Sodium Dichromate litigation. From December 2008 through September 2009, five cases were filed in various Federal District Courts against KBR by national guardsmen and other military personnel alleging exposure to sodium dichromate at the Qarmat Ali Water Treatment Plant in Iraq in 2003. The majority of the cases were re-filed and consolidated into two cases, with one pending in the U.S. District Court for the Southern District of Texas and one pending in the U.S. District Court for the District of Oregon. A single plaintiff case was filed on November 30, 2012 in the District of Oregon Eugene Division. Collectively, the suits represent approximately 170 individual plaintiffs all of which are current and former national guardsmen or British soldiers who claim they were exposed to sodium dichromate while providing security services or escorting KBR employees who were working at the water treatment plant, claim that the defendants knew or should have known that the potentially toxic substance existed and posed a health hazard, and claim that the defendants negligently failed to protect the plaintiffs from exposure. The plaintiffs are claiming unspecified damages. The U.S. Army Corps of Engineers (“USACE”) was contractually obligated to provide a benign site free of war and environmental hazards before KBR's commencement of work on the site. KBR notified the USACE within two days after discovering the potential sodium dichromate issue and took effective measures to remediate the site. Services provided by KBR to the USACE were under the direction and control of the military and therefore, KBR believes it has adequate defenses to these claims. KBR also has asserted the Political Question Doctrine and other government contractor defenses.

Additionally, studies by the U.S. government and others on the effects of exposure to the sodium dichromate contamination at the water treatment plant have found no long term harm to the soldiers.

Texas Proceedings. On August 16, 2012, the court in the case pending in the U.S. District Court for the Southern District of Texas Court denied KBR's motion to dismiss plaintiffs' claims. On August 29, 2012, the court certified its order for immediate appeal under 28 U.S.C. § 1292(b) to the U.S. Court of Appeals for the Fifth Circuit, and stayed proceedings in the District Court pending the appeal. On November 28, 2012, the Fifth Circuit granted KBR permission to appeal. On November 7, 2013, a three judge panel of the Court returned the case to the trial court, holding the interlocutory appeal was improperly granted. We sought review by the entire court on this opinion which was denied. We have asked the trial court to stay the trial while we seek review by the U.S. Supreme Court. KBR has filed a petition for certiorari with the U.S. Supreme Court. At this time we believe the likelihood that we would incur a loss related to this matter is remote. As of June 30, 2014, no amounts have been accrued.

Oregon Proceedings. On November 2, 2012 in the Oregon case, a jury in the U.S. District Court for the District of Oregon issued a verdict in favor of the plaintiffs on their claims, and awarded them approximately \$10 million in actual damages and \$75 million in punitive damages. We filed post-verdict motions asking the court to overrule the verdict or order a new trial. On April 26, 2013, the court ruled for plaintiffs on all issues except one, reducing the total damages to \$81 million which consists of \$6 million in actual damages and \$75 million in punitive damages. Trials for the remaining plaintiffs in Oregon will not take place until the appellate process is concluded. The court issued a final judgment on May 10, 2013, which was consistent with the previous ruling. KBR appealed the ruling. Briefing is complete and oral arguments have not yet been scheduled by the court. Additionally, five amicus curiae briefs have been filed in support of our arguments. Our basis for appeal include the trial court's denial of the Political Question Doctrine, the Combat Activities Exception in the Federal Tort Claims Act, a lack of personal jurisdiction over KBR in Oregon and numerous other legal issues stemming from the court's rulings before and during the trial. We have already filed proceedings to enforce our rights to reimbursement and payment pursuant to the FAR under the Restore Iraqi Oil contract ("RIO contract") with the USACE as referenced below.

In the U.S. Court of Appeals for the Ninth Circuit, we have also filed a motion for summary reversal of the court's decision on personal jurisdiction due to a recently issued Supreme Court decision which supports our position that the Oregon court did not have jurisdiction in the case because KBR did not have contact with the state. The U.S. Court of Appeals for the Ninth Circuit has consolidated the motion with our pending appeal.

At this time we believe the likelihood that we will ultimately incur a loss related to this matter is remote. As of June 30, 2014, no amounts have been accrued.

COFC Claims. During the period of time since the first litigation was filed against us, we have incurred legal defense costs that we believe are reimbursable under the related government contract. We have billed for these costs and filed claims to recover the associated costs incurred to date. In late 2012 and early 2013, we filed suits against the U.S. government in the U.S. COFC for denying indemnity in the sodium dichromate cases, for reimbursement of legal fees pursuant to our contract with the government and for breach of contract by the government for failure to provide a benign site as required by our contract. The RIO contract required KBR personnel to begin work in Iraq as soon as the invasion began in March 2003. Due to KBR's inability to procure adequate insurance coverage for this work, the Secretary of the Army approved the inclusion of an indemnification provision in the RIO Contract pursuant to Public Law 85-804.

On March 7, 2014, the COFC issued a ruling on the government's motion dismissing KBR's claims on procedural grounds. The decision did not prohibit us from resubmitting the claims to the contracting officer which we did. On April 4, 2014, we submitted a supplemental certified claim to the RIO contracting officer for an additional \$7 million in legal fees incurred in defending the sodium dichromate cases. On June 9, 2014, we filed an appeal to the ASBCA

due to the contracting officer's failure to issue a final decision on these claims totaling approximately \$30 million.

Qui Tams. Of the active qui tams for which we are aware, the government has joined one of them (see DOJ FCA complaint - Iraq Subcontractor below). We believe the likelihood that we would incur a loss in the qui tams the government has not joined is remote and as of June 30, 2014, no amounts have been accrued. Costs incurred in defending the qui tams cannot be billed to the government until those matters are successfully resolved in our favor. If successfully resolved, we can bill 80% of the costs to the government under the controlling provisions of the FAR. As of June 30, 2014, we have incurred \$10 million in legal costs to date in defending ourselves in qui tams.

Barko qui tam. Relator Harry Barko was a KBR subcontracts administrator in Iraq for a year in 2004/2005. He filed a qui tam lawsuit in June 2005 in the U.S. District Court for the District of Columbia, alleging violations of the False Claims Act by KBR and KBR subcontractors Daoud & Partners and Eamar Combined for General Trading and Contracting. The claim was unsealed in March of 2009. Barko alleges that KBR fraudulently charged the government for the purchase of laundry facilities

from Daoud, that KBR paid Daoud for the construction of a substandard man-camp, that Daoud double-billed KBR for labor, that KBR improperly awarded well-drilling subcontracts to Daoud, and that Daoud charged excessive prices for these services and did not satisfactorily complete them. Barko also alleges fraudulent charges arising out of Eamar's well-drilling services.

The DOJ investigated Barko's allegations and elected not to intervene. KBR filed a Motion to Dismiss alleging that the complaint was legally insufficient to state a case under the False Claims Act and this motion was denied. KBR filed its Answer to the First Amended Complaint and a Motion for Summary judgment. On February 3, 2014, Barko filed a Motion to Compel production of privileged investigative files, which KBR opposed. On March 6, 2014, in an unprecedented opinion, the Court granted the motion and ordered KBR to produce the records, thereafter also denying KBR's motions to stay the order and for interlocutory appeal. On March 12, 2014, KBR filed its Petition for Mandamus with the D.C. Circuit Court, seeking an order reversing the trial court's order of production. On the same day the Circuit Court issued a stay order and requested briefing. An amicus brief was filed in support of KBR's legal arguments and the briefing process was completed in April 2014. A hearing on the mandamus was argued on May 7, 2014 and on June 27, 2014, the Circuit Court granted KBR's Petition for Mandamus and vacated the trial court's order of production. Barko has indicated that he will appeal the mandamus ruling. All other scheduled activity, including a ruling on KBR's Motion for Summary Judgment, has been stayed pending the outcome of the mandamus appeal. We believe the likelihood that we will incur a loss related to this matter is remote, and therefore as of June 30, 2014 we have not accrued any loss provisions related to this matter.

Chillcott qui tam. On November 21, 2011, KBR was advised of the partial unsealing of a qui tam suit brought by a former KBR employee, Karen Chillcott, in the U.S. District Court for the Central District of Illinois, Rock Island Division, alleging that KBR committed fraud in billing the government for unallowable mobilization and demobilization costs for LogCAP III and IV personnel. Chillcott alleges that these costs are unallowable under Clause H-29 of the LogCAP III Contract and Clause H-26 of the LogCAP IV Contract (the "Tour of Duty" clauses). The government declined to intervene in this suit. Although this matter is in the early stages, we have been addressing issues surrounding the H-29 clause for several years. We do not believe the complaint raises new factual issues. We believe that this case is defensible.

The case was partially unsealed on September 10, 2013. The DOJ investigated Chillcott's allegations and declined to intervene. On June 28, 2013, KBR filed a Motion to Dismiss which was denied on October 25, 2013. On February 20, 2014, the Court entered a scheduling order and discovery has begun in this case. Dispositive motions are to be filed by March 1, 2015, and, if necessary, trial will begin on July 21, 2015. Also, on June 10, 2014, KBR notified Chillcott of the interpretation agreement with the Army as described in more detail above in the H-29 Form 1 discussion. We believe the likelihood that we will incur a loss related to this matter is remote, and therefore as of June 30, 2014 we have not accrued any loss provisions related to this matter.

DOJ False Claims Act complaint - Containers. In November 2012, the DOJ filed a complaint in the U.S. District Court for the Central District of Illinois in Rock Island, IL, related to our settlement of delay claims by our subcontractor, FKTC, in connection with FKTC's provision of living trailers for the bed down mission in Iraq in 2003-2004. The DOJ alleges that KBR knew that FKTC had submitted inflated costs; that KBR did not verify the costs; that FKTC had contractually assumed the risk for the costs which KBR submitted to the government; that KBR concealed information about FKTC's costs from the government; that KBR claimed that an adequate price analysis had been done when in fact one had not been done; and that KBR submitted false claims for reimbursement to the government in connection with FKTC's services during the bed down mission. Our contractual dispute with the Army over this settlement has been ongoing since 2005. We believe these sums were properly billed under our contract with the Army and are not prohibited under the LogCAP III contract. We strongly contend that no fraud was committed. On May 6, 2013, KBR filed a motion to dismiss. In March 2014 the motion to dismiss was denied. We filed our answer on May 2, 2014 and on May 23, 2014 the government filed a Motion to Strike certain affirmative defenses.

We are contesting that motion and proceeding with discovery. At this time, we believe the likelihood that we would incur a loss related to this matter is remote. As of June 30, 2014, no amounts have been accrued.

DOJ False Claims Act complaint - Iraq Subcontractor. In January 2014, the DOJ filed a complaint in the U.S. District Court for the Central District of Illinois in Rock Island, IL, against KBR and two former KBR subcontractors alleging that three former KBR employees were offered and accepted kickbacks from these subcontractors in exchange for favorable treatment in the award and performance of subcontracts to be awarded during the course of KBR's performance of the LogCAP III contract in Iraq. The complaint alleges that as a result of the kickbacks, we submitted invoices with inflated or unjustified subcontract prices, resulting in alleged violations of the False Claims Act and the Anti-Kickback Act. While the suit is new, the DOJ's investigation dates back to 2004. We self-reported most of the violations and tendered credits to the government as appropriate. On April 22, 2014, we filed our answer and on May 13, 2014 the government filed a Motion to Strike certain affirmative defenses. We are contesting this motion. As of June 30, 2014, we have accrued our best estimate of probable loss related to an unfavorable settlement of this matter recorded in "other liabilities" on our condensed consolidated balance sheets. At this time, we believe the likelihood that we would incur a loss related to this matter in excess of the amounts we have accrued is remote.

Other Matters

Claims. We have filed claims with the government related to payments not yet received for costs incurred under various government contracts. Included in our condensed consolidated balance sheets are claims for costs incurred under various government contracts totaling \$248 million at June 30, 2014. These claims relate to disputed costs and/or contracts where our costs have exceeded the government's funded value on the task order. We have \$123 million of claims primarily from de-obligated funding on certain task orders that were also subject to Form 1s relating to certain DCAA audit issues discussed above. We believe such disputed costs will be resolved in our favor at which time the government will be required to obligate funds from appropriations for the year in which resolution occurs. These claims are recorded in "claims and accounts receivable" on our condensed consolidated balance sheets. Of the remaining claims balance of \$125 million, \$117 million is recorded in "claims and accounts receivable" and the remaining is recorded in "CIE" on our condensed consolidated balance sheets. The claims recorded in CIE represent costs for which incremental funding is pending in the normal course of business. The claims outstanding at June 30, 2014 are considered to be probable of collection and have been previously recognized as revenues.

Note 12. Other Commitments, Contingencies and Disputes

Litigation and regulatory matters related to the Company's restatement of its 2013 annual financial statements. After the Company announced it would be restating its 2013 annual financial statements, three complaints were filed in the federal district court for the Southern District of Texas seeking class action status on behalf of our shareholders and alleging damages on their behalf arising from the matters that led to the restatement. Two of those complaints were voluntarily dismissed by the plaintiffs. The defendants in the remaining case, Kohut v. KBR, Inc et al, are the Company, our former chief executive officer and our current and former chief financial officers. The complaint alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 arising out of the restatement of our 2013 annual financial statements and seeks undisclosed damages. Four parties, including the plaintiff in the Kohut lawsuit, have moved to be appointed as lead plaintiff. The court has not appointed a lead plaintiff, and we have not yet answered or otherwise responded to the complaint. As this matter is at a very early stage, we are not able at this time to determine the likelihood of loss, if any, arising from this matter.

In addition, a shareholder derivative complaint, Butorin v. Blount et al, has been filed in the federal district court for the Southern District of Texas on behalf of the Company naming certain current and former members of the Company's board of directors as defendants and the Company as a nominal defendant. The complaint alleges that the named directors breached their fiduciary duties by permitting the Company's internal controls to be inadequate. We have not answered or otherwise responded to the complaint. As this matter is at a very early stage, we are not able at this time to determine the likelihood of loss, if any, arising from this matter.

We have also received requests for information from the Securities Exchange Commission regarding the restatement of our 2013 annual financial statements. We have been and intend to continue providing our full cooperation with the Commission.

Foreign Corrupt Practices Act ("FCPA") Investigations

In February 2009, KBR LLC, entered a guilty plea to violations of the FCPA in the United States District Court, Southern District of Texas, Houston Division, related to the Bonny Island investigation. The plea agreement reached with the DOJ resolved all criminal charges in the DOJ's investigation and called for the payment of a criminal penalty. In addition, we settled a civil enforcement action by the U.S. Securities and Exchange Commission. We also agreed to a period of probation for a three year period that ended on February 17, 2012, after which the monitor certified that KBR's current anti-corruption compliance program has been appropriately designed and implemented to ensure future compliance with the FCPA and other applicable anti-corruption laws.

In February 2011, M.W. Kellogg Limited (“MWKL”) reached a settlement with the U.K. Serious Fraud Office (“SFO”) in which the SFO accepted that MWKL was not party to any unlawful conduct and assessed a civil penalty. 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.

On March 18, 2013, we received a letter from the African Development Bank Group (“ADBG”) stating they are in the process of opening a formal investigation into corruption related to the Bonny Island project discussed above. We have entered into a Negotiated Resolution Agreement with the ADBG that includes a financial penalty equivalent to approximately \$6.6 million of which \$0.3 million has been paid and the remainder is in progress, having been delayed awaiting approval from the National Bank of Ethiopia. We have also agreed to a three-year debarment from ADBG-sponsored contracts of three inactive Madeira, Portugal-based companies that KBR and its three joint venture partners used to participate in the Bonny Island project.

PEMEX and PEP Arbitration

In 1997 and 1998, we entered into three contracts with PEP, the project owner, to build offshore platforms, pipelines and related structures in the Bay of Campeche, offshore Mexico. PEP is part of PEMEX, the national oil company of 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. During 2008, we were successful in litigating and collecting on valid international arbitration awards against PEP on the EPC 22 and EPC 28 projects.

EPC 1

U.S. Proceedings. PEP took 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. As a result of the ensuing dispute, we filed for arbitration with the International Chamber of Commerce ("ICC") in 2004 claiming recovery of damages of approximately \$323 million for the EPC 1 project. PEP subsequently filed counterclaims totaling \$157 million. 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. PEP was awarded approximately \$6 million on counterclaims, plus interest on a portion of that sum. In connection with this award, we recognized a gain of \$117 million net of tax in 2009.

Our collection efforts have been ongoing and have involved multiple actions. On November 2, 2010, we received a judgment in our favor in the U.S. District Court for the Southern District of New York to recognize the award in the U.S. of approximately \$356 million plus Mexican value added tax and interest thereon until paid. PEP initiated an appeal to the U.S. Court of Appeals for the Second Circuit. On February 16, 2012, the Second Circuit issued an order remanding the case to the District Court to consider if the decision of the Collegiate Court in Mexico, described below, would have affected the trial court's ruling. The District Court Judge held a three day hearing on April 10 -12, 2013 to hear evidence about the Collegiate Court decision, which annulled the arbitration award and about whether we have a full and fair remedy in Mexico.

On August 27, 2013, the District Court entered an order stating it would confirm the award even though it had been annulled in Mexico. On September 25, 2013, the District Court entered the signed final judgment of \$465 million to be recovered, which includes the original confirmation of the arbitration award and approximately \$106 million for performance bonds discussed below, plus interest. The judgment also requires that each party pay value added tax on the amounts each has been ordered to pay. PEP filed a notice of appeal to the U.S. Court of Appeals for the Second Circuit on October 16, 2013 and posted cash for the judgment pending appeal. The case is now on appeal before the U.S. Court of Appeals. Briefing is now closed and we are awaiting scheduling of oral argument.

Mexico Proceedings. PEP's attempt to nullify the award in Mexico was rejected by the Mexican trial court in June 2010. PEP then filed an "amparo" action on the basis that its constitutional rights had been violated and this action was denied by the Mexican court in October 2010. PEP subsequently appealed the adverse decision with the Collegiate Court in Mexico on the grounds that the arbitration tribunal did not have jurisdiction and that the award violated the public order of Mexico. Although these arguments were presented in the initial nullification and amparo action, and were rejected in both cases, in September 2011, the Collegiate Court ruled that PEP, by administratively rescinding the contract in 2004, deprived the arbitration panel of jurisdiction thereby nullifying the arbitration award. The Collegiate Court's decision is contrary to the ruling received from the ICC as well as the other Mexican courts which have denied PEP's repeated attempts to nullify the arbitration award. We also believe the Collegiate Court's decision is contrary to Mexican law governing contract arbitration. However, we do not expect the Collegiate Court's decision to affect our ability to ultimately collect the ICC arbitration award in the U.S. due to the posting of cash for the judgment

pending appeal and significant assets of PEP in the U.S.

Luxembourg Collection Proceedings. In 2013, we petitioned the Luxembourg court to issue two seizure orders on the assets of PEP and PEMEX that have been served on a number of banks and financial institutions in that country, as we believe these institutions may have PEP and PEMEX assets that are subject to seizure which could be used to satisfy our award. However, under Luxembourg procedure, we will not find out the value of the seized assets until the proceeding is validated. The first seizure order is for the New York award confirmation; the second seizure order is for the performance bonds payment discussed below. PEP and PEMEX contested the first seizure order and the matter was heard on May 27, 2013 where their petition to lift the seizure order was denied. PEP and PEMEX filed an appeal and on December 18, 2013, the Luxembourg Court of Appeals stated it was dissolving the first seizure order against both PEP and PEMEX. This decision is being appealed to the Luxembourg Supreme Court.

Concurrent with our filing of the seizure order, we filed an action in Luxembourg seeking to enforce the ICC award.
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March 2013, we received an order from the Luxembourg court recognizing the award. On June 25, 2013, PEMEX and PEP filed an appeal challenging the enforcement order. We are awaiting scheduling of the hearing on the appeal. We cannot begin the validation proceeding until the appeal is concluded.

North American Free Trade Agreement ("NAFTA") Collection Proceedings. We filed arbitration under NAFTA against Mexico and asserted a claim to have our award paid. The parties have selected the arbitrators, a chairman has been named and the first procedural order has been entered.

We will continue to pursue our remedies in the U.S., Luxembourg and other jurisdictions where we determine have assets which can be used to pay the award.

Performance Bonds

In connection with the EPC 1 project, we had approximately \$80 million in outstanding performance bonds furnished to PEP when the project was awarded. The bonds were written by a Mexican bond company and backed by a U.S. insurance company which is indemnified by KBR. As a result of the ICC arbitration award in December 2009, the panel determined that KBR had performed on the project, and we believe recovery on the bonds by PEP was precluded by the ICC Award. PEP filed an action in Mexico in June 2010 against the Mexican bond company to collect the bonds even though the arbitration award determined the limited amounts to be paid to PEP on their counterclaims and offset those claims against the award in favor of KBR.

On June 17, 2013, after multiple proceedings in various Mexican courts and following a demand for payment, we paid \$108 million to the Mexican bond company. The \$108 million consists of the \$80 million in outstanding bonds, plus \$26 million in related interest and other expenses and \$2 million in legal and banking fees.

On June 21, 2013, we filed a supplemental writ in Luxembourg to cover the amounts paid to the bonding company on the performance bonds. That writ was granted and served on Luxembourg banks. PEP and PEMEX have refused service in Luxembourg and we are currently serving that writ on PEP and PEMEX. Since the decision by the Luxembourg Court of Appeals dissolved the first writ as to PEMEX, we have lifted the second writ as to PEMEX. The second writ remains in effect as to PEP.

On September 25, 2013, the U.S. District Court for the Southern District of New York entered the signed final judgment which included the amount paid on the bonds plus interest. We will pursue reimbursement of the sums paid in the current enforcement action in the U.S. District Court for the Southern District of New York, the courts of Luxembourg, or by our recently filed NAFTA arbitration seeking to recover the bonds as an unlawful expropriation of assets by the government of Mexico.

Consistent with our treatment of claims, we have recorded \$401 million, net of advances, in "claims and accounts receivable" as we believe it is probable we will recover the amounts awarded to us, including interest, expenses and the amounts we paid on the bonds. PEP has sufficient assets in the U.S. and Luxembourg, which we believe we will be able to attach as a result of the recognition of the ICC arbitration award. Although it is possible we could resolve and collect the amounts due from PEP in the next 12 months, we believe the timing of the collection of the award is uncertain; therefore, consistent with our prior practice, as of June 30, 2014, we continue to classify the amount due from PEP, including the amounts paid on the performance bonds as long term.

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 was the parent to the Roberts & Schaefer Company, a privately held EPC services company acquired

by us in 2010. The purchase price was \$280 million plus estimated 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. As of June 30, 2014, the remaining escrowed holdback was \$25 million and primarily related to security for indemnification obligations.

Delaware Litigation. KBR withheld the \$25 million in escrow due to KBR's claims under the indemnification provisions of the stock purchase agreement. In December 2012, ENI filed a lawsuit in Delaware Chancery Court alleging KBR is wrongfully withholding the escrowed funds. KBR filed a counterclaim for indemnity and fraud under the terms of the stock purchase agreement. In March 2013, ENI filed a motion to dismiss. The Court denied in part ENI's motion to dismiss KBR's counterclaims in their entirety. The case is proceeding and expected to be schedule for trial in mid-2015.

Note 13. 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, 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 business 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 for the Barracuda-Caratinga project and for other litigation matters related to Halliburton's business. See Note 12 for further discussion on the FCPA and related corruption allegations. 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.

During the fourth quarter of 2011, Halliburton provided notice and demanded payment for \$256 million that it alleged we owed under the tax sharing agreement for various other tax-related transactions pertaining to periods prior to our separation from Halliburton. We believe that the master separation agreement precludes the filing of this claim.

On July 3, 2012, KBR requested an arbitration panel be appointed to resolve certain intercompany issues arising under the master separation agreement before issues in dispute under the tax sharing agreement were submitted to the designated accounting referee as provided for under the terms of the tax sharing agreement. We believe these intercompany issues were settled and released as a result of our separation from Halliburton in 2007. Halliburton subsequently challenged the arbitration panel's jurisdiction over this dispute in Texas State Court. The Texas State Court denied Halliburton's request and Halliburton filed an appeal which is awaiting a decision.

In May 2013, an arbitration hearing was held on the matters related to the master separation agreement. On June 24, 2013 the arbitration panel ruled that claims brought by Halliburton against KBR under the tax sharing agreement were required to have been brought before an arbitration panel within two years of the date the claim arose or would reasonably have been discovered by the claimant and that the parties were to return to the accounting referee within thirty days for determination of the remaining claims under the tax sharing agreement. The remaining tax-related issues in dispute were referred to the accounting referee as provided for under the terms of the tax sharing agreement.

On October 9, 2013, the accounting referee issued a report stating that KBR owed Halliburton approximately \$105 million with each party bearing its own costs related to the matter. As a result, we increased our tax provision by \$38 million, reduced paid-in capital by \$7 million and recognized a deferred tax asset of \$29 million for available foreign tax credits. Halliburton has filed a motion requesting the Texas State Court to confirm the accounting referee's decision and KBR has responded requesting that the decision be vacated. KBR also filed a motion requesting the Texas State Court to confirm the arbitration panel's June 24, 2013 ruling and Halliburton has responded requesting that the arbitration panel's ruling be vacated. The decisions on these motions are pending. As of June 30, 2014, we have recorded \$107 million to our "Payable to former parent" on our condensed consolidated balance sheets, which is net of \$22 million awarded to KBR by the accounting referee.

As discussed above, the arbitration panel had found several of Halliburton's unspecified claims to be time barred. On January 16, 2014, we asked this arbitration panel to determine if any of Halliburton's claims submitted to the referee were time barred and to correctly interpret the relevant agreements. On March 14, 2014, the arbitration panel ruled that it no longer had jurisdiction to hear this dispute and that a new arbitration demand was required. We intend to institute another arbitration proceeding once the Texas Court of Appeals rules on Halliburton's challenge to the

arbitration panel's jurisdiction.

Barracuda-Caratinga Project Tax Dispute

In June 2000, we entered into a contract with Barracuda & Caratinga Leasing Company B.V. ("BCLC"), the project owner and claimant, 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.

In March 2006, Petrobras notified us they had submitted a claim to arbitration of \$220 million plus interest for the cost of monitoring and replacing defective stud bolts and, in addition, all of the costs and expenses of the arbitration including the cost of attorneys' fees. The arbitration was conducted in New York under the guidelines of the United Nations Commission on International Trade Law. In September 2011, the arbitration panel awarded the claimant approximately \$193 million.

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In January 2013, Halliburton paid \$219 million to the claimant in payment of the award plus interest and the matter is considered concluded. We believe the arbitration award to Petrobras is deductible by KBR for tax purposes and the indemnification payment will be treated by KBR for tax purposes as a contribution to capital and accordingly is not taxable. In 2011 and 2012, we recorded discrete tax benefits of \$71 million and \$8 million, respectively. We have reviewed this matter in light of the direct payment by Halliburton to BCLC and its public announcement that they have recorded a tax benefit related to this transaction. Based on advice from outside legal counsel, we have determined that it is more likely than not that we are the proper taxpayer to recognize this benefit although the underlying uncertainties with respect to the tax treatment of the transaction may ultimately lead to alternate outcomes.

Note 14. Shareholders' Equity

The following tables summarize our activity in shareholders' equity:

Millions of dollars	Total	PIC	Retained Earnings	Treasury Stock	AOCL	NCI
Balance at December 31, 2013	\$2,439	\$2,065	\$1,748	\$(610)	\$(740)	\$(24)
Share-based compensation	11	11	—	—	—	—
Common stock issued upon exercise of stock options	4	4	—	—	—	—
Tax benefit increase related to share-based plans	1	1	—	—	—	—
Dividends declared to shareholders	(24)	—	(24)	—	—	—
Repurchases of common stock	(96)	—	—	(96)	—	—
Issuance of ESPP shares	2	—	—	2	—	—
Investments by noncontrolling interests	8	—	—	—	—	8
Distributions to noncontrolling interests	(33)	—	—	—	—	(33)
Net income (loss)	(12)	—	(51)	—	—	39
Other comprehensive income, net of tax	39	—	—	—	39	—
Balance at June 30, 2014	\$2,339	\$2,081	\$1,673	\$(704)	\$(701)	\$(10)

Millions of dollars	Total	PIC	Retained Earnings	Treasury Stock	AOCL	NCI
Balance at December 31, 2012	\$2,511	\$2,049	\$1,709	\$(606)	\$(610)	\$(31)
Share-based compensation	10	10	—	—	—	—
Common stock issued upon exercise of stock options	5	5	—	—	—	—
Dividends declared to shareholders	(12)	—	(12)	—	—	—
Repurchases of common stock	(7)	—	—	(7)	—	—
Issuance of ESPP shares	2	—	—	2	—	—
Investments by noncontrolling interests	9	—	—	—	—	—