

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 10516 / July 2, 2018**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 83578 / July 2, 2018**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 3946 / July 2, 2018**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-18569**

<p><b>In the Matter of</b></p> <p style="text-align:center"><b>KBR, Inc.</b></p> <p><b>Respondent.</b></p>
--

**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”) and Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against KBR, Inc. (“KBR” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-And-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-And-Desist Order (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

#### **Summary**

1. KBR is a global engineering, construction, and services company based in Houston, Texas. On May 30, 2014, KBR filed a Form 10-K/A that: (a) restated and amended earnings in its consolidated financial statements for the fiscal year ended December, 31, 2013, and its unaudited consolidated financial statements for the third quarter of 2013; (b) reduced its disclosed backlog as of the fiscal year ended December 31, 2013; and (c) identified a material weakness in its internal control over financial reporting.

2. The restated earnings, which resulted in charges of \$156 million, primarily arose from failures in KBR's Canada business ("KBR Canada") to make accurate and reliable estimates of the costs to complete seven pipe fabrication and modular assembly contracts in Canada. KBR Canada experienced rapid growth in 2012 and 2013, and it did not have sufficient resources or sufficiently trained project managers, project controls personnel, and accounting and executive management professionals to perform cost estimates and project oversight reviews. KBR's internal accounting controls were not properly designed to identify or prevent the errors in the estimates of the costs to complete the company used to recognize revenue on these contracts.

3. The reduction in backlog relates to one of the seven contracts, a multi-year, multi-use agreement with a Canadian energy company (the "MUA contract"). In the second quarter of 2012, KBR included \$459 million in its disclosed backlog for the MUA contract, despite the fact that KBR had yet to receive, and the Canadian energy company was not obligated to provide, KBR any orders under the contract. The backlog recording remained in place during the next six quarters, including after it became clear that KBR was receiving far fewer work authorizations under the contract than anticipated. KBR's disclosed backlog for the MUA contract was not consistent with its disclosures, which attributed all of KBR's backlog to "firm orders." As a result, KBR overstated the amount of its backlog in reports filed with the Commission.

#### **Respondent**

4. KBR, Inc. is a Delaware company headquartered in Houston, Texas. KBR's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act, and its stock trades on the New York Stock Exchange under the symbol KBR. KBR files periodic reports, including Forms 10-K and 10-Q, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

## **Facts**

### **A. KBR's Restatement**

5. On May 30, 2014, KBR filed a Form 10-K/A (the "Restatement") restating earnings in its consolidated financial statements for the fiscal year ended December 31, 2013, and amending its unaudited consolidated financial statements for the third quarter of 2013.

6. KBR determined that a restatement was necessary due to additional estimated costs to complete seven Canadian pipe fabrication and modular assembly contracts in its Services business. According to the Restatement, the additional projected costs to complete the Canadian projects resulted in charges of \$156 million in 2013, consisting of the reversal of \$24 million in previously recognized pre-tax profits, the recognition of approximately \$97 million in pre-tax losses at completion, and a \$35 million reduction in previously recognized revenue. The \$156 million charge represented 91% of KBR's 2013 net income (as restated). For the third quarter of 2013, the impact of the Restatement was 32% of KBR's nine-month net income and 480% of KBR's three-month net income (as restated).

7. As part of the Restatement, KBR also disclosed a reduction to a 2013 increase in backlog, which included a backlog reduction of approximately \$360 million for the MUA contract. This reduction for the MUA contract represented the original \$459 million backlog value for the MUA contract less currency adjustments and work off of orders received since the original recording.

8. Following an investigation led by the Audit Committee, KBR concluded that a material weakness in internal control over financial reporting existed in the Canadian pipe fabrication and modular assembly business within its Services segment resulting from insufficiently trained personnel. It further determined that there was an ineffective control environment, because the culture at the Canadian pipe fabrication and modular assembly business facilitated delayed identification and communication of project concerns and the proper preparation of complete and accurate estimates.

### **B. KBR Canada's Cost to Complete Estimates**

9. KBR Canada is headquartered in Edmonton, Alberta. During the relevant time period, KBR Canada primarily provided construction, turnaround and maintenance, and pipe fabrication and modular assembly services to energy industry customers.

10. KBR Canada entered into the seven contracts at issue during 2012 and 2013, a period of rapid growth. The contracts called for KBR Canada to fabricate pipe and then assemble standing modules used in connection with oil and gas projects. The contracts were "unit-rate" contracts, which meant that payment to KBR was based on the actual quantity of work performed measured against a book of agreed upon unit prices. KBR treated the unit-rate contracts as "fixed-price" contracts for estimating purposes, because, unlike "reimbursable" contracts, KBR bore risk to produce quantities at pre-agreed prices. The contracts were accounted for using the percentage-

of-completion method in accordance with Accounting Standards Codification Topic 605-35-25, "Revenue Recognition," which was the accounting guidance in effect during the relevant period for long-term construction contracts.

11. KBR Canada prepared an estimate for each contract that was updated monthly as the contracts progressed towards completion. At year-end 2013, the estimates showed positive margins in the 8% to 17.6% range for the seven contracts. But during the first quarter of 2014, after KBR had filed its 2013 Form 10-K, KBR management in Houston learned, in connection with an internal review of unbilled revenues, that the costs incurred on the MUA contract exceeded actual authorized revenue and that there were potentially other issues with the module contracts in Canada. Thereafter, KBR investigated the status of the contracts, and determined that the contract cost estimates were not accurate and would have to be reforecast.

12. The revised estimated costs to complete, which were issued in April 2014 after KBR filed its original 2013 Form 10-K, showed that all seven contracts were actually projecting a loss position with margins as low as -58%. The common theme: costs were much higher than previously estimated by personnel at KBR Canada, due to reduced productivity and growing overhead, subcontract, and labor expenses in Canada.

13. KBR also determined that much of the additional costs should have been included in the contract estimates by the third quarter of 2013 or year-end 2013. Before the close of the third quarter of 2013, new, higher labor rates were available that KBR Canada should have been using in the estimates for all seven of the module projects. KBR Canada also had information in the third and fourth quarters of 2013 that should have alerted KBR Canada to project delays and cost overruns that were negatively impacting productivity on the projects. If this information had been included in the cost estimates, all of the projects would have been in a loss position at year-end 2013 or in the third quarter 2013, but no provisions for losses on contracts was accrued as required under ASC 605-35-25-45.

14. A combination of factors contributed to the inaccurate estimates of costs to complete. KBR Canada's estimating was not sufficiently rigorous, and it did not actually reforecast the project costs as new information was obtained. In many instances, project controls personnel at KBR Canada would update the initial estimates by applying the as sold margin to KBR's actual costs each month. In addition, the project managers, project controls, and accounting personnel in Canada did not have sufficient experience, training, or resources to monitor the projects and update the estimates. Finally, KBR's oversight from Houston of contract estimating in Canada was limited and did not identify the problems with the estimates before the Restatement.

15. The Canadian legal entities that comprised KBR Canada were controlled subsidiaries of KBR and were included in KBR's consolidated reporting as part of its Services business segment during the relevant time period. KBR used the monthly updated estimated costs to complete as the underlying support for recognizing revenue (or accruing contract losses) on the seven contracts. At least as early the third quarter of 2013, the contract estimated costs to complete contained inaccurate and unreliable cost estimates. As a result, KBR understated its costs, and overstated its earnings, in its consolidated financial statements for the fiscal year ended December

31, 2013, which KBR filed with the Commission on Form 10-K on February 27, 2014, and in its unaudited consolidated financial statements for the third quarter of 2013, which KBR filed with the Commission on Form 10-Q on October 24, 2013.

### **C. KBR's Backlog Disclosures**

16. The amount of work in backlog is an important metric of KBR's business. KBR discloses backlog in its press releases, and analysts cite to KBR's backlog when evaluating the company's performance.

17. Exchange Act Regulation S-K Item 101(c)(1)(viii) requires, where material to understanding the issuer's business, disclosure by reporting segment of:

The dollar amount of backlog orders believed to be firm, as of a recent date and as of a comparable date in the preceding fiscal year, together with an indication of the portion thereof not reasonably expected to be filled within the current fiscal year, and seasonal or other material aspects of the backlog.

18. During the relevant period, KBR disclosed backlog in its Description of Business at a company level and separately in its Managements' Discussion and Analysis disclosures for each reporting segment, including Services. KBR disclosed that its backlog is attributable to firm orders. For example, KBR's Form 10-K for 2013 states:

Backlog represents the dollar amount of revenue we expect to receive in the future as a result of performing work on contracts awarded. . . . All backlog is attributable to firm orders at December 31, 2013 and 2012. . . .

Certain contracts provide maximum dollar limits, with actual authorization to perform work under the contract agreed upon on a periodic basis with the customer. In these arrangements, only the amounts authorized are included in backlog.<sup>1</sup>

KBR's disclosures included risk factors describing the variability of backlog and amounts recoverable under its customer contracts.

19. KBR also has a documented backlog reporting policy. The policy states that "[i]n determining the amount of Backlog to be recorded, the applicable Business Unit committee or party responsible for Booking considers whether it is probable that the amounts recorded will ultimately be realized in job revenue and income, and whether KBR will be compensated for the work performed." The policy also contains a section that addresses recording backlog for several types of contracts where the amount of work is not defined at the outset of the contract (the "MSA provision"). For contracts covered by the MSA provision, KBR only records the value of the initial work order into backlog on those contracts. The only exception to this limitation is when a

---

<sup>1</sup> The Forms 10-K, Forms 10-Q, and Forms 8-K (attaching earnings releases) that KBR filed with the Commission for periods during 2012 and 2013 all contain substantially similar language about KBR's backlog.

clear pattern of work releases has been established with the customer that KBR is able to use to assess probable contract revenue and job income over some future time period.

20. KBR Canada entered into the MUA contract in May 2012. The contract had a five year term, and it required KBR Canada to reserve enough capacity to produce 20 modules a month. The counterparty Canadian energy company did not pay for the reservation of capacity. And though it had reserved the KBR capacity, the counterparty Canadian energy company was not obligated to provide any orders to KBR Canada, and did not provide any orders to KBR Canada at the inception of the contract. Instead, the MUA contract provided a framework for future orders for module work that could be awarded pursuant to written work authorizations.

21. Despite having no commitment for any firm orders, KBR assigned a \$459 million backlog value to the MUA contract. KBR computed this figure using two primary components. First, KBR estimated that it would generate \$400,000 per module built. Second, KBR multiplied 20—its monthly module reservation capacity—*times* \$400,000 *times* the number of months under the term of the contract, excluding a sixth month “ramp-up” period.

22. KBR recorded the entire \$459 million figure into its reported backlog during the second quarter of 2012. This was inconsistent with KBR’s disclosures, which attributed all backlog to firm orders. The recording was also not consistent with a recording under the MSA provision of KBR’s backlog reporting policy. Because there was no pattern of work releases with the Canadian energy company that could have been used to establish an estimate, and the MSA provision, if it had been applied, would have therefore required that only the amount of any actual work authorizations be recorded as backlog. KBR personnel determined not to apply the MSA provision and instead considered the capacity reservation, the publicly disclosed capital commitments made by the counterparty, the lack of alternative capacity in the Edmonton module construction market, and the general high demand for module construction at that time.

23. Further, KBR reviewed the MUA contract backlog amount quarterly. In connection with these reviews, KBR received information inconsistent with the basis for the initial \$459 million recording. More specifically, the MUA contract was put in place and largely driven by the expectation that the Canadian energy company would need a significant number of modules for a large, publicly announced project. That project was cancelled in March 2013, but KBR personnel in Canada did not recommend an adjustment, advocating that contract revenues would be replaced with revenue from other projects. In August 2013, KBR Canada requested and was granted a partial release of the reservation capacity for a period of six months, because there was not enough work under the MUA contract to support it, and KBR Canada needed the capacity for other projects. The Canadian energy company did not award work to KBR Canada at the anticipated 20-module-per-month pace used in connection with the \$459 million initial backlog recording. By year-end 2013, which was approximately 20 months into the 60-month contract, the Canadian energy company had awarded KBR less than approximately \$55 million in work authorizations and a total of 117 modules. At year-end, KBR Canada was aware that there would be no new work under the MUA contract until March 2014 at the earliest.

24. During this time, KBR did not adjust the backlog recording, and the \$459 million recording, less the actual work-off and currency adjustments, remained in KBR's disclosed backlog for all periods until the Restatement. The MUA contract represented approximately 22% and 14% of Services disclosed backlog for 2012 and 2013, respectively, and 3.0% of the company's total disclosed backlog of approximately \$15 billion as of June 30, 2012. At year-end 2013, the MUA contract was KBR's fifth largest contract by funded backlog amount.

25. KBR's inclusion of the MUA contract in the company's backlog, initially and in the quarters that followed, occurred despite the review by numerous KBR personnel in Canada and Houston. As a result of this negligent failure, KBR's disclosures overstated disclosed backlog in the Forms 10-K that KBR filed with the Commission on February 20, 2013 and February 27, 2014, the Forms 10-Q that it filed with the Commission on July 25, 2012, October 24, 2012, April 25, 2013, July 25, 2013, and October 24, 2013, and the Forms 8-K that it filed with the Commission on July 25, 2012, October 24, 2012, February 20, 2013, April 25, 2013, July 25, 2013, October 24, 2013, and February 28, 2014.

#### **D. KBR's Internal Accounting Controls Were Not Sufficient**

26. At the end of the third quarter of 2013 and at year-end 2013, KBR's internal accounting controls relating to contract estimating were not sufficient to provide reasonable assurances that transactions were recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles. KBR Canada did not have proper controls over the completeness and accuracy of labor costs and other critical information used in the preparation of contract cost estimates. In addition, personnel in Canada were able to prepare contract estimates without reviewing manual cost accrual entries, reconciling subcontract costs with the subcontract register, and following policies and procedures for monitoring overhead costs. As a result of these insufficient controls, the cost estimates in Canada were not accurate or reliable. In addition, KBR's books and records did not accurately reflect its contract costs.

27. KBR reported a material weakness in its internal control over financial reporting in the Restatement, stating that:

We determined that a material weakness in internal control over financial reporting existed in our Canadian pipe fabrication and modular assembly business within our Services business segment resulting from the Company having insufficiently trained project managers, project controls, accounting and executive management professionals to perform project oversight reviews and monitor compliance with the Company's standard processes and controls. Furthermore, the control environment was ineffective in that the culture at the Canadian pipe fabrication and modular assembly business facilitated delayed identification and communication of project concerns and the proper preparation of complete and accurate estimates of revenues, costs and profit at completion. As a result, our controls over the completeness and accuracy of information used in our preparation of estimates and our control procedures over our preparation of

estimates to complete and our controls over the reviews of such estimates to complete for our Canadian pipe fabrication and modular assembly business also were not effective.

28. KBR's internal accounting controls were also not sufficient because its corporate oversight of estimating in Canada was limited and ineffective. Because five of the seven contracts fell below a certain threshold dollar amount, KBR's management in Houston did not have controls in place to validate the estimates for those contracts. Management in Houston did engage in a limited review of two of the larger contracts, but that review failed to reveal the significant problems with the cost estimates

### **KBR's Remedial Efforts**

29. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by KBR and cooperation afforded the Commission staff. KBR undertook to investigate contract estimating problems in Canada, identified the internal accounting controls failures relating to the contract estimating problems, reported to the Commission regarding its findings about its Canada operations, and implemented remedial measures to address the contract estimating failures. KBR clawed back bonuses from its employees who received bonus compensation as a result of overstated revenues at KBR Canada.

### **Violations**

30. As a result of the negligent conduct described above relating to the backlog recording and disclosures, KBR violated Sections 17(a)(2) and (3) of the Securities Act, which prohibit, in the offer or sale of any security (a) obtaining money or property by means of any untrue statement of a material fact or any omission of a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and (b) engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. Claims under Sections 17(a)(2) and (3) of the Securities Act do not require a showing of scienter. *Aaron v. SEC*, 446 U.S. 680, 697 (1980).

31. As a result of the conduct described above, KBR violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, 13a-13 and 12b-20 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

32. As a result of the conduct described above, KBR violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

33. As a result of the conduct described above, KBR violated Section 13(b)(2)(B) of the Exchange Act, which require all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent KBR's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent KBR cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

B. Respondent KBR shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$2,500,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

C. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying KBR as a Respondent in these proceedings, and the file number of these proceedings; a copy of

the cover letter and check or money order must be sent to Barbara L. Gunn, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 801 Cherry Street, Suite 1900, Fort Worth, TX 76102.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields  
Secretary