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Less 62 and 26 shares of treasury stock, at cost	1,577	374
Total shareholders’ equity	7,376	6,372
Total liabilities and shareholders’ equity	$ 16,820	$ 15,048

See notes to consolidated financial statements.

HALLIBURTON COMPANY
Consolidated Statements of Shareholders' Equity

Millions of dollars and shares	2006	2005	2004
Balance at January 1	$ 6,372	$ 3,932	$ 2,547
Dividends and other transactions with shareholders	(1)	202	(123)
Common share repurchase program	(1,323)	-	-
Sale of stock by a subsidiary	117	-	-
Common shares to be contributed to asbestos trust - 119 shares	-	-	2,335
Adoption of SFAS 158	(218)	-	-
Other	34	-	-
Comprehensive income (loss):			
Net income (loss)	2,348	2,358	(979)
Cumulative translation adjustments	48	(48)	33
Realization of (gains) losses included in net income (loss)	(14)	7	(1)
Net cumulative translation adjustments	34	(41)	32
Pension liability adjustments	2	(54)	115
Unrealized gains (losses) on investments and derivatives	12	(12)	5
Realization of gains on investments and derivatives	(1)	(13)	-
Net unrealized gains (losses) on investments and derivatives	11	(25)	5
Total comprehensive income (loss)	2,395	2,238	(827)
Balance at December 31	$ 7,376	$ 6,372	$ 3,932

See notes to consolidated financial statements.

HALLIBURTON COMPANY
Consolidated Statements of Cash Flows

	Years ended December 31		
Millions of dollars	2006	2005	2004
Cash flows from operating activities:			
Net income (loss)	$ 2,348	$ 2,358	$ (979)
Adjustments to reconcile net income (loss) to net cash from operations:			
(Income) loss from discontinued operations	10	(1)	1,364
Depreciation, depletion, and amortization	527	504	509
Provision (benefit) for deferred income taxes, including $21, $0, and $(167) related to discontinued operations	682	(235)	(176)
Distributions from (advances to) related companies, net of equity in (earnings) losses	(77)	39	(39)
Gain on sale of assets	(123)	(192)	(62)
Asbestos and silica liability payment related to Chapter 11 filing	-	(2,345)	(119)
Collection of asbestos- and silica-related insurance receivables	167	1,032	-
Other changes:			
Receivables and unbilled work on uncompleted contracts	19	423	(506)
Accounts receivable facilities transactions	-	(519)	519
Inventories	(308)	(152)	(33)
Accounts payable	(91)	(317)	439
Reserve for loss on contracts	133	(97)	(77)
Accrued employee benefits	121	184	73
Contributions to pension plans	(190)	(81)	(85)
Advanced billings	209	113	(209)
Other	230	(13)	309
Total cash flows from operating activities	3,657	701	928
Cash flows from investing activities:			
Capital expenditures	(891)	(651)	(575)
Sales of property, plant, and equipment	158	132	166
Dispositions of business assets, net of cash disposed	374	299	127
Acquisitions of business assets, net of cash acquired	(27)	(108)	(25)
Proceeds from sales of securities	10	15	22
Sales (purchases) of short-term investments in marketable securities, net	(20)	891	(180)
Investments - restricted cash	-	1	89
Other investing activities	(30)	(69)	(30)
Total cash flows from investing activities	(426)	510	(406)
Cash flows from financing activities:			
Proceeds from the sale of KBR, Inc. common stock, net of offering costs	508	-	-
Proceeds from long-term debt, net of offering costs	8	24	496
Proceeds from exercises of stock options	159	342	63

Payments to reacquire common stock	(1,339)	(12)	(7)
Borrowings (repayments) of short-term debt, net	(16)	10	(7)
Payments on long-term debt	(349)	(823)	(20)
Payments of dividends to shareholders	(306)	(254)	(221)
Tax benefit from exercise of options and restricted stock	53	-	-
Other financing activities	2	(7)	(21)
Total cash flows from financing activities	(1,280)	(720)	283
Effect of exchange rate changes on cash	37	(17)	8
Increase in cash and equivalents	1,988	474	813
Cash and equivalents at beginning of year	2,391	1,917	1,104
Cash and equivalents at end of year	$ 4,379	$ 2,391	$ 1,917
Supplemental disclosure of cash flow information:			
Cash payments during the year for:			
Interest	$ 175	$ 210	$ 211
Income taxes	$ 345	$ 282	$ 265

See notes to consolidated financial statements.

HALLIBURTON COMPANY
Notes to Consolidated Financial Statements

Note 1. Description of Company and Significant Accounting Policies

Description of Company

Halliburton Company's predecessor was established in 1919 and incorporated under the laws of the State of Delaware in 1924. We are one of the world's largest oilfield services companies and a leading provider of engineering and construction services. Our six business segments are: Production Optimization, Fluid Systems, Drilling and Formation Evaluation, and Digital and Consulting Solutions, collectively, the Energy Services Group (ESG); and Energy and Chemicals and Government and Infrastructure, collectively known as KBR. Through the ESG, we provide a comprehensive range of services and products for the exploration, development, and production of oil and gas. We serve major, national, and independent oil and gas companies throughout the world. KBR provides a wide range of services to energy, chemical, and industrial customers and to governmental entities worldwide.

Use of estimates

Our financial statements are prepared in conformity with accounting principles generally accepted in the United States, requiring us to make estimates and assumptions that affect:

- the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements; and
- the reported amounts of revenue and expenses during the reporting period.

Ultimate results could differ from those estimates.

Basis of presentation

The consolidated financial statements include the accounts of our company and all of our subsidiaries that we control or variable interest entities for which we have determined that we are the primary beneficiary (see Note 19). All material intercompany accounts and transactions are eliminated. Investments in companies in which we have significant influence are accounted for using the equity method. If we do not have significant influence, we use the cost method.

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

Common share and earnings per share amounts have been restated for all periods presented to reflect the increased number of common shares outstanding resulting from the two-for-one common stock split, in the form of a stock dividend, paid on July 14, 2006 to shareholders of record as of June 23, 2006.

Revenue recognition

Overall. Our service and products are generally sold based upon purchase orders or contracts with our customers that do not include right of return provisions or other significant post-delivery obligations. Our products are produced in a standard manufacturing operation, even if produced to our customer's specifications. We recognize revenue from product sales when title passes to the customer, the customer assumes risks and rewards of ownership, and collectibility is reasonably assured. Service revenue, including training and consulting services, are recognized when the services are rendered and collectibility is reasonably assured. Rates for services are typically priced on a per day, per meter, per man-hour, or similar basis.

Software sales. Sales of perpetual software licenses, net of any deferred maintenance and support fees, are recognized as revenue upon shipment. Sales of time-based licenses are recognized as revenue over the license period. Maintenance and support fees are recognized as revenue ratably over the contract period, usually a one-year duration.

Percentage-of-completion. Revenue from contracts to provide construction, engineering, design, or similar services, almost all of which relates to KBR, is reported on the percentage-of-completion method of accounting. Progress is generally based upon physical progress, man-hours, or costs incurred, depending on the type of job. Physical percent complete is determined as a combination of input and output measures as deemed appropriate by the circumstances. All known or anticipated losses on contracts are provided for when they become evident. Claims and change orders that are in the process of being negotiated with customers for extra work or changes in the scope of work are included in revenue when collection is deemed probable.

Accounting for government contracts. Most of the services provided to the United States government are governed by cost-reimbursable contracts. Services under our LogCAP, PCO Oil South, and Balkans support contracts are examples of these types of arrangements. Generally, these contracts contain both a base fee (a fixed profit percentage applied to our actual costs to complete the work) and an award fee (a variable profit percentage applied to definitized costs, which is subject to our customer's discretion and tied to the specific performance measures defined in the contract, such as adherence to schedule, health and safety, quality of work, responsiveness, cost performance, and business management). Similar to many cost-reimbursable contracts, these government contracts are typically subject to audit and adjustment by our customer.

Base fee revenue is recorded at the time services are performed, based upon actual project costs incurred, and includes a reimbursement fee for general, administrative, and overhead costs. The general, administrative, and overhead cost reimbursement fees are estimated periodically in accordance with government contract accounting regulations and may change based on actual costs incurred or based upon the volume of work performed. Revenue is reduced for our estimate of costs that are either in dispute with our customer or have been identified as potentially unallowable per the terms of the contract or the federal acquisition regulations.

Award fees are generally evaluated and granted periodically by our customer. For contracts entered into prior to June 30, 2003, award fees are recognized during the term of the contract based on our estimate of amounts to be awarded. Once award fees are granted and task orders underlying the work are definitized, we adjust our estimate of award fees to actual amounts earned. Our estimates are often based on our past award experience for similar types of work.

For contracts containing multiple deliverables entered into subsequent to June 30, 2003 (such as PCO Oil South), we analyze each activity within the contract to ensure that we adhere to the separation guidelines of Emerging Issues Task Force Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," and the revenue recognition guidelines of Staff Accounting Bulletin No. 104, "Revenue Recognition." For service-only contracts and service elements of multiple deliverable arrangements, award fees are recognized only when definitized and awarded by the customer. Award fees on government construction contracts are recognized during the term of the contract based on our estimate of the amount of fees to be awarded.

Sale of stock by a subsidiary

When, as part of a broader corporate reorganization, a subsidiary or affiliate sells unissued shares in a public offering, we treat the transaction as a capital transaction. Therefore, the increase or decrease in the carrying amount of our subsidiary's stock would not be reflected as a gain or loss on our consolidated statements of operations, but as an increase or decrease to Paid-in capital in excess of par value.

Research and development

Research and development expenses are charged to income as incurred. Research and development expenses were $256 million in 2006, $220 million in 2005, and $234 million in 2004, of which over 97% was company-sponsored in each year.

Software development costs

Costs of developing software for sale are charged to expense as research and development when incurred until technological feasibility has been established for the product. Once technological feasibility is established, software development costs are capitalized until the software is ready for general release to customers. We capitalized costs related to software developed for resale of $21 million in 2006, $21 million in 2005, and $16 million in 2004. Amortization expense of software development costs was $21 million for 2006 and $22 million for both 2005 and 2004. Once the software is ready for release, amortization of software development costs begins. Capitalized software development costs are amortized over periods not exceeding five years.

Cash equivalents

We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Inventories

Inventories are stated at the lower of cost or market. Cost represents invoice or production cost for new items and original cost less allowance for condition for used material returned to stock. Production cost includes material, labor, and manufacturing overhead. Some domestic manufacturing and field service finished products and parts inventories for drill bits, completion products, and bulk materials are recorded using the last-in, first-out method. The remaining inventory is recorded on the average cost method.

Allowance for bad debts

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

Property, plant, and equipment

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

Goodwill

The reported amounts of goodwill for each reporting unit are reviewed for impairment on an annual basis and more frequently when negative conditions such as significant current or projected operating losses exist. The annual impairment test for goodwill is a two-step process and involves comparing the estimated fair value of each reporting unit to the reporting unit’s carrying value, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired, and the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test would be performed to measure the amount of impairment loss to be recorded, if any. Our annual impairment tests resulted in no goodwill impairment.

Evaluating impairment of long-lived assets

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

Income taxes

We recognize the amount of taxes payable or refundable for the year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will not be realized.

In assessing the realizability of deferred tax assets, 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, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that we will realize the benefits of these deductible differences, net of the existing valuation allowances.

We generally do not provide income taxes on the undistributed earnings of non-United States subsidiaries because such earnings are intended to be reinvested indefinitely to finance foreign activities. Taxes are provided as necessary with respect to earnings that are not permanently reinvested. The American Job Creations Act of 2004 introduced a special dividends received deduction with respect to the repatriation of certain foreign earnings to a United States taxpayer under certain circumstances. Based on our analysis of the Act, we decided not to utilize the special deduction.

Derivative instruments

At times, we enter into derivative financial transactions to hedge existing or projected exposures to changing foreign currency exchange rates, interest rates, and commodity prices. We do not enter into derivative transactions for speculative or trading purposes. We recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges are adjusted to fair value and reflected through the results of operations. If the derivative is designated as a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against:

- the change in fair value of the hedged assets, liabilities, or firm commitments through earnings; or
- recognized in other comprehensive income until the hedged item is recognized in earnings.

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

Foreign currency translation

Foreign entities whose functional currency is the United States dollar translate monetary assets and liabilities at year-end exchange rates, and nonmonetary items are translated at historical rates. Income and expense accounts are translated at the average rates in effect during the year, except for depreciation, cost of product sales and revenue, and expenses associated with nonmonetary balance sheet accounts, which are translated at historical rates. Gains or losses from changes in exchange rates are recognized in consolidated income in the year of occurrence. Foreign entities whose functional currency is not the United States dollar translate net assets at year-end rates and income and expense accounts at average exchange rates. Adjustments resulting from these translations are reflected in the consolidated statements of shareholders’ equity as cumulative translation adjustments.

Halliburton stock-based compensation

Effective January 1, 2006, we adopted the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment” (SFAS No. 123(R)), using the modified prospective application. Accordingly, we are recognizing compensation expense for all newly granted awards and awards modified, repurchased, or cancelled after January 1, 2006. Compensation cost for the unvested portion of awards that were outstanding as of January 1, 2006 is being recognized ratably over the remaining vesting period based on the fair value at date of grant. Also, beginning with the January 1, 2006 purchase period, compensation expense for our 2002 Employee Stock Purchase Plan (ESPP) is being recognized. The cumulative effect of this change in accounting principle related to stock-based awards was immaterial. Prior to January 1, 2006, we accounted for these plans under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, “Accounting for Stock Issued to Employees,” and related interpretations. Under APB No. 25, no compensation expense was recognized for stock options or the ESPP. Compensation expense was recognized for restricted stock awards. As a result of adopting SFAS No. 123(R), the incremental pretax expense related to employee stock option awards and our ESPP totaled approximately $41 million in 2006, or $0.02 per diluted share after tax.

Total stock-based compensation expense, net of related tax effects, was $60 million in 2006. Total income tax benefit recognized in net income for stock-based compensation arrangements was $33 million in 2006, $17 million in 2005, and $9 million in 2004. Total incremental compensation cost resulting from modifications of previously granted stock-based awards was $16 million in 2006, $19 million in 2005, and $12 million in 2004. These modifications allowed certain employees to retain their awards after leaving the company.

The following table summarizes the pro forma effect on net income (loss) and income (loss) per share for 2005 and 2004 as if we had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

Millions of dollars except per share data	Years ended December 31 2005	2004
Net income (loss), as reported	$ 2,358	$ (979)
Add: Total stock-based compensation expense included in net income, net of related tax effects	31	16
Less: Total stock-based compensation expense determined under fair-value-based method for all awards, net of related tax effects	(61)	(44)
Net income (loss), pro forma	$ 2,328	$ (1,007)
Basic income (loss) per share:		
As reported	$ 2.34	$ (1.12)
Pro forma	$ 2.31	$ (1.16)
Diluted income (loss) per share:		
As reported	$ 2.27	$ (1.11)
Pro forma	$ 2.25	$ (1.14)

The fair value of options at the date of grant was estimated using the Black-Scholes option pricing model. The expected volatility of options granted in 2006 was a blended rate based upon implied volatility calculated on actively traded options on our common stock and upon the historical volatility of our common stock. The expected volatility of options granted in 2005 and 2004 was based upon the historical volatility of our common stock. The expected term of options granted in 2006, 2005, and 2004 was based upon historical observation of actual time elapsed between date of grant and exercise of options for all employees. The assumptions and resulting fair values of options granted were as follows:

	Years ended December 31 2006	2005	2004
Expected term (in years)	5.24	5.00	5.00
Expected volatility	42.20%	51.06 - 52.79%	54.30 - 57.47%
Expected dividend yield	0.76 - 1.06%	0.73 - 1.16%	1.27 - 1.65%
Risk-free interest rate	4.30 - 5.03%	3.77 - 4.33%	2.71 - 3.89%
Weighted average grant-date fair value per share	$ 14.20	$ 11.42	$ 6.69

The fair value of ESPP shares was estimated using the Black-Scholes option pricing model. The expected volatility was a one-year historical volatility of our common stock. The assumptions and resulting fair values were as follows:

	Offering period July 1 through December 31 2006	2005	2004
Expected term (in years)	0.5	0.5	0.5
Expected volatility	37.77%	30.46%	55.50%
Expected dividend yield	0.80%	0.73%	1.48%
Risk-free interest rate	5.29%	3.89%	3.29%
Weighted average grant-date fair value per share	$ 9.32	$ 5.50	$ 4.31

	Offering period January 1 through June 30		
	2006	2005	2004
Expected term (in years)	0.5	0.5	0.5
Expected volatility	35.65%	26.93%	57.47
Expected dividend yield	0.75%	1.16%	1.65
Risk-free interest rate	4.38%	3.15%	2.71
Weighted average grant-date fair value per share	$ 7.91	$ 4.15	$ 3.74

KBR, Inc. stock-based compensation

For KBR, Inc. options granted in 2006, the fair value of options at the date of grant was estimated using the Black-Scholes option pricing model. The expected volatility of KBR, Inc. options granted in 2006 is based upon a blended rate that uses the historical and implied volatility of common stock for selected peers. The expected term of KBR, Inc. options granted in 2006 is based upon the average of the life of the option and the vesting period of the option. The assumptions and resulting fair values of options granted were as follows:

	2006
Expected term (in years)	6
Expected volatility	35.0%
Expected dividend yield	0.0%
Risk-free interest rate	4.6%
Weighted average grant-date fair value per share	$ 9.34

The KBR, Inc. stock-based compensation expense relating to restricted stock and stock option awards under the KBR, Inc. 2006 Stock and Incentive Plan was immaterial.

See Note 15 for further detail on stock incentive plans.

Note 2. KBR, Inc. Initial Public Offering

Our Energy and Chemicals and Government and Infrastructure segments are part of KBR, Inc. (KBR), which was formed in March 2006. In November 2006, KBR, Inc. completed an initial public offering (IPO), in which it sold approximately 32 million shares of KBR, Inc. common stock, at $17.00 per share. We received proceeds of approximately $508 million from the IPO, net of underwriting discounts and commissions and offering expenses. As the IPO was a result of a broader corporate reorganization, the increase in the carrying amount of our investment in KBR, Inc. was recorded in "Paid-in capital in excess of par value" in our consolidated balance sheet as of December 31, 2006. We now hold an approximate 81% interest in KBR, Inc., which we consolidate for financial reporting purposes, represented by 135.6 million shares of KBR, Inc. common stock.

We have entered into various agreements relating to the separation of KBR from us, including, among others, a master separation agreement, a registration rights agreement, a tax sharing agreement, transition services agreements, and an employee matters agreement. The master separation agreement provides for, among other things, KBR's responsibility for liabilities related to its business and Halliburton's responsibility for liabilities unrelated to KBR's business. Halliburton provided indemnification in favor of KBR under the master separation agreement for contingent liabilities, including Halliburton's indemnification of KBR and any of its greater than 50%-owned subsidiaries as of November 20, 2006, the date of the master separation agreement, for:

- fines or other monetary penalties or direct monetary damages, including disgorgement, as a result of a claim made or assessed by a governmental authority in the United States, the United Kingdom, France, Nigeria, Switzerland and/or Algeria, or a settlement thereof, related to alleged or actual violations occurring prior to November 20, 2006 of the United States Foreign Corrupt Practices Act (FCPA) or particular, analogous applicable foreign statutes, laws, rules, and regulations in connection with current investigations, including with respect to the construction and subsequent expansion by TSKJ of a natural gas liquefaction complex and related facilities at Bonny Island in Rivers State, Nigeria; and

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- all out-of-pocket cash costs and expenses, or cash settlements or cash arbitration awards in lieu thereof, KBR may incur after the effective date of the master separation agreement as a result of the replacement of the subsea flowline bolts installed in connection with the Barracuda-Caratinga project.

The Halliburton performance guarantees and letter of credit guarantees that are currently in place in favor of KBR’s customers or lenders will continue after the separation of KBR until these guarantees expire at the earlier of: (1) the termination of the underlying project contract or KBR obligations thereunder or (2) the expiration of the relevant credit support instrument in accordance with its terms or release of such instrument by the customer. KBR will compensate Halliburton for these guarantees and indemnify Halliburton if Halliburton is required to perform under any of these guarantees. The tax sharing agreement provides for allocations of United States income tax liabilities and other agreements between us and KBR with respect to tax matters. Under the transition services agreements, we will continue to provide various interim corporate support services to KBR, and KBR continues to provide various interim corporate support services to us. The fees will be determined on a basis generally intended to approximate the fully allocated direct and indirect costs of providing the services, without any profit. Under an employee matters agreement, Halliburton and KBR have allocated liabilities and responsibilities related to current and former employees and their participation in certain benefit plans. KBR’s final prospectus for its initial public offering dated November 15, 2006 contains a more detailed description of these separation agreements.

In conjunction with the closing of the KBR, Inc. IPO, KBR, Inc. granted stock options, restricted stock, and restricted stock unit awards under the KBR, Inc. 2006 Stock and Incentive Plan. See Note 15 for further detail on KBR, Inc. stock incentive plans.

We are now working toward the separation of KBR, Inc. which we expect to complete no later than the end of April 2007.

On February 26, 2007, our Board of Directors approved a plan under which we will dispose of our remaining interest in KBR, Inc. through a tax-free exchange with Halliburton shareholders pursuant to an exchange offer and, following the completion or termination of the exchange offer, a special pro rata dividend distribution of any and all of our remaining KBR, Inc. shares. In January 2007, we received a ruling from the Internal Revenue Service that, among other things, no gain or loss will be recognized by Halliburton or its shareholders as a result of a distribution of KBR, Inc. stock by means of a pro rata dividend. We have requested a supplemental ruling from the Internal Revenue Service that no gain or loss will be recognized by Halliburton or its shareholders as a result of a distribution of KBR, Inc. stock by means of an exchange offer whereby holders of Halliburton stock may tender their shares and receive KBR, Inc. shares in exchange, followed by a dividend distribution of any remaining shares of KBR, Inc. stock held by Halliburton to its shareholders. The exchange offer and any subsequent distribution of KBR, Inc. stock will not be conditioned on receipt of such a supplemental ruling from the Internal Revenue Service. We have also obtained an opinion of counsel related to the tax-free nature of the exchange offer and any subsequent spin-off distribution.

Note 3. Percentage-of-Completion Contracts

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

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

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

When calculating the amount of total profit or loss on a percentage-of-completion contract, we include unapproved claims in total estimated contract value when the collection is deemed probable based upon the four criteria for recognizing unapproved claims under the American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." Including unapproved claims in this calculation increases the operating income (or reduces the operating loss) that would otherwise be recorded without consideration of the probable unapproved claims. Probable unapproved claims are recorded to the extent of costs incurred and include no profit element. In all cases, the probable unapproved claims included in determining contract profit or loss are less than the actual claim that will be or has been presented to the customer.

When recording the revenue and the associated unbilled receivable for unapproved claims, we only accrue an amount equal to the costs incurred related to probable unapproved claims. Therefore, the difference between the probable unapproved claims included in determining contract profit or loss and the probable unapproved claims accrued revenue recorded in unbilled work on uncompleted contracts relates to forecasted costs which have not yet been incurred. The amounts included in determining the profit or loss on contracts and the amounts booked to "Unbilled work on uncompleted contracts" or "Other assets" as of December 31 for each period are as follows:

Millions of dollars	2006	2005	2004
Probable unapproved claims	$ 189	$ 175	$ 182
Probable unapproved claims accrued revenue	187	172	182
Probable unapproved claims from unconsolidated related companies	78	92	51

As of December 31, 2006, the probable unapproved claims, including those from unconsolidated related companies relate to eight contracts, most of which are complete or substantially complete. See Note 12 for a discussion of United States government contract claims, which are not included in the table above.

A significant portion of the probable unapproved claims as of December 31, 2006 ($148 million related to our consolidated entities and $45 million related to our unconsolidated related companies) arose from three completed projects with Petroleos Mexicanos (PEMEX) that are currently subject to arbitration proceedings. In addition, we have "Other assets" of $64 million for previously approved services that are unpaid by PEMEX and have been included in these arbitration proceedings. Actual amounts we are seeking from PEMEX in the arbitration proceedings are in excess of these amounts. The arbitration proceedings are expected to extend through 2007. PEMEX has asserted unspecified counterclaims in each of the three arbitrations; however, it is premature based upon our current understanding of those counterclaims to make any assessment of their merits. As of December 31, 2006, we had not accrued any amounts related to the counterclaims in the arbitrations.

We have contracts with probable unapproved claims that will likely not be settled within one year totaling $175 million at December 31, 2006 and $172 million at December 31, 2005 included in the table above, which are reflected as "Other assets" on the consolidated balance sheets. The remaining $12 million at December 31, 2006 is included in "Unbilled work on uncompleted contracts" since the contracts are expected to be settled within one year. Our unconsolidated related companies include probable unapproved claims as revenue to determine the amount of profit or loss for their contracts. Probable unapproved claims from our related companies are included in "Equity in and advances to related companies."

Unapproved change orders

We have other contracts for which we are negotiating change orders to the contract scope and have agreed upon the scope of work but not the price. These change orders amounted to $81 million at December 31, 2006. Unapproved change orders at December 31, 2005 were $61 million. Our share of change orders from unconsolidated related companies totaled $3 million at December 31, 2006 and $5 million at December 31, 2005.

In the second quarter of 2006, we identified a $148 million charge, before income taxes and minority interest, related to KBR's consolidated 50%-owned GTL project in Escravos, Nigeria. This charge was primarily attributable to increases in the overall estimated cost to complete the project. The project, which was awarded in April 2005, has experienced delays relating to civil unrest and security on the Escravos River, near the project site. Further delays have resulted from scope changes, engineering and construction modifications due to necessary front-end engineering design changes and increases in procurement costs due to project delays. As of September 30, 2006, we had approximately $269 million in unapproved change orders related to this project. In the fourth quarter of 2006, we reached agreement with the project owner to settle $264 million of these change orders. As a result, portions of the remaining work now have a lower risk profile, particularly with respect to security and logistics. Since we completed our first check estimate in the second quarter of 2006, the project has continued to estimate significant additional cost increases. We currently expect to recover these recently identified cost increases through change orders. As of December 31, 2006, we have recorded $43 million of unapproved change orders which primarily relate to these cost increases. Because of the civil unrest and security issues that currently exist in Nigeria, uncertainty regarding soil conditions at the property site and other matters, we could experience substantial additional cost increases on the Escravos project in the future. We believe that future cost increases attributed to civil unrest, security matters and potential differences in actual rather than anticipated soil conditions should ultimately be recoverable through future change orders pursuant to the terms of our contract as amended in 2006. However, should this occur, there could be timing differences between the recognition of cost and recognition of offsetting potential recoveries from our client, if any. We recorded an additional $9 million loss in the fourth quarter of 2006 related to non-billable engineering services for the Escravos joint venture. These services were in excess of the contractual limit of total engineering costs each partner can bill to the joint venture.

Barracuda-Caratinga project

Following is the status, as of December 31, 2006, of our Barracuda-Caratinga project, a multiyear construction project to develop the Barracuda and Caratinga crude oilfields located off the coast of Brazil:

- the Barracuda and Caratinga vessels are both fully operational. In April 2006, we executed an agreement with Petrobras that enabled us to achieve conclusion of the Lenders' Reliability Test and final acceptance of the FPSOs. These acceptances eliminate any further risk of liquidated damages being assessed but do not address the bolt arbitration discussed below;
- in the first quarter of 2006, we recorded a loss of $15 million related to additional costs to finalize the project and warranty matters. We have recorded inception-to-date losses on this project of approximately $785 million; and
- our remaining obligation under the April 2006 agreement is primarily for warranty on the two vessels.

In addition, at Petrobras' direction, we have replaced certain bolts located on the subsea flowlines that failed through mid-November 2005, and we understand that additional bolts have failed thereafter, which were replaced by Petrobras. These failed bolts were identified by Petrobras when it conducted inspections of the bolts. The original design specification for the bolts was issued by Petrobras, and as such, we believe the cost resulting from any replacement is not our responsibility. Petrobras has indicated, however, that they do not agree with our conclusion. We have notified Petrobras that this matter is in dispute. We believe several possible solutions may exist, including replacement of the bolts. Estimates indicate that costs of these various solutions range up to $140 million. Should Petrobras instruct us to replace the subsea bolts, the prime contract terms and conditions regarding change orders require that Petrobras make progress payments for our costs incurred. Petrobras could, however, perform any replacement of the bolts and seek reimbursement from KBR. In March 2006, Petrobras notified KBR

that they have submitted this matter to arbitration claiming $220 million plus interest for the cost of monitoring and replacing the defective stud bolts and all related costs and expenses of the arbitration, including the cost of attorneys fees. We disagree with the Petrobras claim because the bolts met Petrobras' design specification, and we do not believe there is any basis for the amount claimed by Petrobras. We intend to vigorously defend ourselves and pursue recovery of the costs we have incurred to date through the arbitration process. The arbitration hearing is not expected to begin until the first quarter of 2008. We agreed to indemnify KBR under the master separation agreement for all out-of-pocket cash costs and expenses, or cash settlements or cash arbitration awards in lieu thereof, KBR may incur after November 20, 2006 as a result of the replacement of the subsea flowline bolts. As of December 31, 2006, we have not accrued any amounts related to this arbitration.

Note 4. Acquisitions and Dispositions

Ultraline Services Corporation

In January 2007, we acquired all intellectual property, current assets, and existing business associated with Calgary-based Ultraline Services Corporation, a division of Savanna Energy Services Corp. Ultraline is a provider of wireline services in Canada. We paid approximately $177 million, subject to adjustment for working capital purposes. Ultraline will be included in our Drilling and Formation Evaluation segment.

Production Services

In the second quarter of 2006, we completed the sale of KBR's Production Services group, which was part of our Energy and Chemicals segment. In connection with the sale, we received net proceeds of $265 million. The sale of Production Services resulted in an adjusted pretax gain, net of post-closing adjustments, of $120 million, which is reflected in discontinued operations. Production Services operations and assets and liabilities are classified as discontinued operations for all periods presented. At December 31, 2005, Production Services assets were $207 million, of which $140 million were classified as current, and liabilities were $64 million, of which $54 million were classified as current.

Dulles Greenway Toll Road

As part of our infrastructure projects, we occasionally take an ownership interest in the constructed asset, with a view toward monetization of that ownership interest after the asset has been operating for some period and increases in value. In September 2005, KBR sold its 13% interest in a joint venture that owned the Dulles Greenway Toll Road in Virginia. We received $85 million in cash from the sale. Because of unfavorable early projections of traffic to support the toll road after it had opened, we wrote down our investment in the toll road in 1996. At the time of the sale, our investment had a net book value of zero, and therefore, we recorded the entire $85 million of cash proceeds to operating income in our Government and Infrastructure segment.

Subsea 7, Inc.

In January 2005, we completed the sale of our 50% interest in Subsea 7, Inc. to our joint venture partner, Siem Offshore (formerly DSND Subsea ASA), for approximately $200 million in cash. As a result of the transaction, we recorded a gain of approximately $110 million during the first quarter of 2005. We accounted for our 50% ownership of Subsea 7, Inc. using the equity method in our Production Optimization segment.

Surface Well Testing

In August 2004, we sold our surface well testing and subsea test tree operations within our Production Optimization segment to Power Well Service Holdings, LLC, an affiliate of First Reserve Corporation, for approximately $129 million, of which we received $126 million in cash. During 2004, we recorded a $54 million gain on the sale.

Note 5. Business Segment Information

We have six business segments: Production Optimization, Fluid Systems, Drilling and Formation Evaluation, Digital and Consulting Solutions, Energy and Chemicals, and Government and Infrastructure. The segments mirror the way our chief operating decision maker regularly reviews the operating results, assesses performance, and allocates resources.

During the second quarter of 2006, we moved slickline services, tubing conveyed perforating, and underbalanced applications from the Production Optimization segment to the Drilling and Formation Evaluation segment, as these services are more closely aligned with the Drilling and Formation Evaluation segment. Prior period balances were reclassified to reflect this change. Because of this change, what we previously referred to as "logging services" within the Drilling and Formation Evaluation segment we now refer to as "wireline and perforating services." In addition, for internal management purposes we combined our Drilling and Formation Evaluation and Digital and Consulting Solutions divisions, resulting in three Energy Services Group internal divisions. However, we continue to disclose four segments for the Energy Services Group.

KBR's Production Services operations were moved into discontinued operations for reporting purposes in the first quarter of 2006. All prior period amounts were reclassified to discontinued operations.

Energy Services Group

Following is a summary of our Energy Services Group segments.

Production Optimization. The Production Optimization segment provides products and services for completion of wells, testing and monitoring performance of wells and reservoirs, and treatments to improve well productivity and increase recoverable reserves. This segment consists of production enhancement services and completion tools and services.

Production enhancement services include stimulation services, pipeline process services, sand control services, and well intervention services. Stimulation services optimize oil and gas reservoir production through a variety of pressure pumping services, nitrogen services, and chemical processes, commonly known as hydraulic fracturing and acidizing. Pipeline process services include pipeline and facility testing, commissioning, and cleaning via pressure pumping, chemical systems, specialty equipment, and nitrogen, which are provided to the midstream and downstream sectors of the energy business. Sand control services include fluid and chemical systems and pumping services for the prevention of formation sand production. Well intervention services enable live well intervention and continuous pipe deployment capabilities through the use of hydraulic workover systems and coiled tubing tools and services.

Completion tools and services include subsurface safety valves and flow control equipment, surface safety systems, packers and specialty completion equipment, intelligent completion systems, expandable liner hanger systems, sand control systems, well servicing tools, and reservoir performance services. Reservoir performance services include testing tools, real-time reservoir analysis, and data acquisition services. Additionally, completion tools and services include WellDynamics, an intelligent well completions joint venture, which we consolidate for accounting purposes. Until January 2005 when it was sold, subsea operations conducted by Subsea 7, Inc., of which we formerly owned 50%, were included in this segment. Subsea 7, Inc. was accounted for by the equity method.

Fluid Systems. The Fluid Systems segment focuses on providing services and technologies to assist in the drilling and construction of oil and gas wells. This segment consists of cementing services and Baroid Fluid Services.

Cementing services involve bonding the well and well casing while isolating fluid zones and maximizing wellbore stability. Our cementing service line also provides casing equipment.

Baroid Fluid Services provide drilling fluid systems, performance additives, solids control, and waste management services for oil and gas drilling, completion, and workover operations.

Drilling and Formation Evaluation. The Drilling and Formation Evaluation segment is primarily involved in the drilling and formation evaluation process during bore-hole construction. Major services and products offered include Sperry Drilling Services, Security DBS Drill Bits, and wireline and perforating services.

Sperry Drilling Services provide drilling systems and services. These services include directional and horizontal drilling, measurement-while-drilling, logging-while-drilling, multilateral systems, underbalanced applications, and rig site information systems. Our drilling systems offer directional control while providing important measurements about the characteristics of the drill string and geological formations while drilling directional wells. Real-time operating capabilities enable the monitoring of well progress and aid decision-making processes.

Security DBS Drill Bits provide roller cone rock bits, fixed cutter bits, and related downhole tools used in drilling oil and gas wells. In addition, coring equipment and services are provided to acquire cores of the formation drilled for evaluation.

Wireline and perforating services include open-hole wireline services that provide information on formation evaluation, including resistivity, porosity, and density, rock mechanics, and fluid sampling. Also offered are cased-hole and slickline services, which provide cement bond evaluation, reservoir monitoring, pipe evaluation, pipe recovery, mechanical services, well intervention, and perforating. Perforating services include tubing-conveyed perforating services and products.

Digital and Consulting Solutions. The Digital and Consulting Solutions segment provides integrated exploration, drilling, and production software information systems, consulting services, real-time operations, value-added oilfield project management, and other integrated solutions. Included in this business segment is Landmark, a supplier of integrated exploration, drilling, and production software information systems, as well as professional and data management services for the upstream oil and gas industry.

KBR

KBR provides a wide range of services to energy, chemical, and industrial customers and government entities worldwide. Management focuses on major projects within its two reportable segments, Energy and Chemicals and Government and Infrastructure. The nature of these two segments can result in a relatively small number of projects and joint ventures representing a substantial portion of operations. Following is a summary of our KBR segments.

Energy and Chemicals. The Energy and Chemicals segment designs and constructs energy and petrochemical projects, including large, technically complex projects in remote locations around the world. Our expertise includes onshore and offshore oil and gas production facilities (including platforms, floating production and subsea facilities), onshore and offshore pipelines, LNG and GTL gas monetization facilities, refineries, and petrochemical plants and Syngas. We provide a complete range of engineering, procurement, construction, and commissioning start-up (EPC-CS) services, as well as program and project management, consulting, and technology services.

TSKJ is a joint venture formed to design and construct large-scale projects in Nigeria. TSKJ’s members are Technip, SA of France, Snamprogetti Netherlands B.V., which is a subsidiary of Saipem SpA of Italy, JGC Corporation of Japan, and us, each of which has a 25% ownership interest. TSKJ has completed five LNG production facilities on Bonny Island, Nigeria and is currently working on a sixth such facility. We account for this investment using the equity method of accounting.

M.W. Kellogg Limited (MWKL) is a London-based joint venture that provides full EPC-CS related services for LNG, GTL, and onshore oil and gas projects. MWKL is owned 55% by KBR and 45% by JGC Corporation. We consolidate MWKL for financial accounting purposes.

Brown & Root-Condor Spa (BRC), a joint venture with Sonatrach and another Algerian company, enhances our ability to operate in Algeria by providing access to local resources. BRC executes work for Algerian and international customers, including Sonatrach. BRC has built oil and gas production facilities and civil infrastructure projects, including hospitals and office buildings. KBR has a 49% interest in the joint venture. We account for this investment using the equity method of accounting.

Government and Infrastructure. The Government and Infrastructure segment delivers on-demand support services across the full military cycle from contingency logistics and field support to operations and maintenance on military bases. The civil infrastructure market operates in diverse sectors, including transportation, waste and water treatment, and facilities maintenance. It provides program and project management, contingency logistics, operations and maintenance, construction management, engineering, and other services to military and civilian branches of governments and private clients worldwide. KBR is the majority owner of DML, which owns and operates Devonport Royal Dockyard, Western Europe’s largest naval dockyard complex. We consolidate DML for financial accounting purposes.

In addition, this segment includes the Alice-Springs-Darwin railroad. The Alice Springs-Darwin railroad is a privately financed project that was formed in 2001 to build, operate and own transcontinental railroad from Alice Springs to Darwin. Australia was granted a 50-year concession period by the Australian government. Government and Infrastructure provides engineering, procurement, and construction (EPC) services for the project and are the largest equity holder in the project with a 36.7 % interest, with the remaining equity held by eleven other participants. We account for this investment using the equity method of accounting.

Also included in this segment is Aspire Defence/Allenby-Connaught a joint venture between us, Mowlem Plc. and a financial investor formed to contract with the MoD to upgrade and service certain United Kingdom military facilities. In addition to a package of ongoing services to be delivered over 35 years, the project includes a nine-year construction program. KBR indirectly owns a 45% interest in Aspire Defence, the project company that is the holder of the 35-year concession contract. In addition, KBR owns a 50% interest in each of the two joint ventures that provide the construction and related support services to Aspire Defence. We account for this investment using the equity method of accounting.

General corporate. General corporate represents assets not included in a business segment and is primarily composed of cash and cash equivalents, deferred tax assets, and insurance for asbestos and silica litigation claims.

Other. Intersegment revenue and revenue between geographic areas are immaterial. Our equity in earnings and losses of unconsolidated affiliates that are accounted for on the equity method is included in revenue and operating income of the applicable segment.

Revenue from the United States Government, which was derived almost entirely from our Government and Infrastructure segment, totaled $5.8 billion or 26% of consolidated revenue in 2006, $6.6 billion or 32% of consolidated revenue in 2005, and $8.0 billion or 40% of consolidated revenue in 2004. No other customer represented more than 10% of consolidated revenue in any period presented.

The tables below present information on our business segments.

Operations by business segment

	Years ended December 31		
Millions of dollars	2006	2005	2004
Revenue:			
Production Optimization	$ 5,360	$ 3,990	$ 3,047
Fluid Systems	3,598	2,838	2,324
Drilling and Formation Evaluation	3,221	2,552	2,038
Digital and Consulting Solutions	776	720	589
Total Energy Services Group	12,955	10,100	7,998
Energy and Chemicals	2,373	2,008	2,490
Government and Infrastructure	7,248	8,132	9,390
Total KBR	9,621	10,140	11,880
Total	$ 22,576	$ 20,240	$ 19,878
Operating income (loss):			
Production Optimization	$ 1,530	$ 1,053	$ 588
Fluid Systems	795	544	348
Drilling and Formation Evaluation	818	536	270
Digital and Consulting Solutions	240	146	60
Total Energy Services Group	3,383	2,279	1,266
Energy and Chemicals	37	124	(443)
Government and Infrastructure	202	329	84
Total KBR	239	453	(359)
General corporate	(138)	(115)	(87)
Total	$ 3,484	$ 2,617	$ 820
Capital expenditures:			
Production Optimization	$ 324	$ 245	$ 203
Fluid Systems	175	94	74
Drilling and Formation Evaluation	313	210	189
Digital and Consulting Solutions	19	26	32
Total Energy Services Group	831	575	498
Energy and Chemicals	12	4	9
Government and Infrastructure	18	33	41
Shared KBR	27	39	27
Total KBR	57	76	77
General corporate	3	-	-
Total	$ 891	$ 651	$ 575

Within the Energy Services Group and KBR, not all assets are associated with specific segments. Those assets specific to segments include receivables, inventories, certain identified property, plant, and equipment (including field service equipment), equity in and advances to related companies, and goodwill. The remaining assets, such as cash are considered to be shared among the segments within the two groups. For segment operating income presentation, the depreciation expense associated with these shared KBR assets is allocated to the two segments under KBR.

Revenue by country is determined based on the location of services provided and products sold.

Operations by business segment (continued)

Millions of dollars	Years ended December 31 2006		2005		2004	
Depreciation, depletion, and amortization:						
Production Optimization	$	180	$	158	$	153
Fluid Systems		86		88		83
Drilling and Formation Evaluation		165		138		145
Digital and Consulting Solutions		49		64		75
Total Energy Services Group		480		448		456
Energy and Chemicals		7		9		11
Government and Infrastructure		22		32		27
Shared KBR		18		15		15
Total KBR		47		56		53
Total	$	527	$	504	$	509
Total assets:						
Production Optimization	$	2,812	$	2,349	$	1,945
Fluid Systems		1,834		1,438		1,230
Drilling and Formation Evaluation		1,854		1,445		1,221
Digital and Consulting Solutions		726		803		768
Shared energy services		1,216		494		452
Total Energy Services Group		8,442		6,529		5,616
Energy and Chemicals		1,906		1,967		1,709
Government and Infrastructure		2,071		2,643		3,261
Shared KBR		1,330		318		193
Total KBR		5,307		4,928		5,163
General corporate		3,071		3,591		5,085
Total	$	16,820	$	15,048	$	15,864

Operations by geographic area

Millions of dollars	Years ended December 31 2006		2005		2004	
Revenue:						
United States	$	7,216	$	5,590	$	4,395
Iraq		4,331		5,116		5,362
United Kingdom		1,594		1,440		1,239
Kuwait		330		416		1,841
Other countries		9,105		7,678		7,041
Total	$	22,576	$	20,240	$	19,878
Long-lived assets:						
United States	$	2,340	$	2,409	$	2,485
United Kingdom		539		563		697
Other countries		1,597		1,300		1,126
Total	$	4,476	$	4,272	$	4,308

Note 6. Receivables (Other than “Insurance for asbestos- and silica-related liabilities”)
Our receivables are generally not collateralized. At December 31, 2006, 27% of our consolidated receivables related to our United States government contracts, primarily for projects in the Middle East. Receivables from the United States government at December 31, 2005 represented 38% of consolidated receivables.
Under an agreement to sell United States Energy Services Group accounts receivable to a bankruptcy-remote limited-purpose funding subsidiary, new receivables were added on a continuous basis to the pool of receivables. Collections reduced previously sold accounts receivable. This funding subsidiary sold an undivided ownership interest in this pool of receivables to entities managed by unaffiliated financial institutions under another agreement. Sales to the funding subsidiary were structured as “true sales” under applicable bankruptcy laws. While the funding subsidiary was wholly owned by us, its assets were not available to pay any creditors of ours or of our subsidiaries or affiliates. The undivided ownership interest in the pool of receivables sold to the unaffiliated companies, therefore, was reflected as a reduction of accounts receivable in our consolidated balance sheets. The funding subsidiary retained the interest in the pool of receivables that were not sold to the unaffiliated companies and was fully consolidated and reported in our financial statements.
The amount of undivided interests which could be sold under the program varied based on the amount of eligible Energy Services Group receivables in the pool at any given time and other factors. The maximum amount that could be sold and outstanding under this agreement at any given time was $300 million. As of December 31, 2004, we had sold $256 million of undivided ownership interest to unaffiliated companies. During the fourth quarter of 2005, these receivables were collected and the balance retired. No further receivables were sold, and the facility was terminated subsequent to December 31, 2005.
In May 2004, we entered into an agreement to sell, assign, and transfer the entire title and interest in specified United States government accounts receivable of KBR to a third party. The face value of the receivables sold to the third party was reflected as a reduction of accounts receivable in our consolidated balance sheets. The amount of receivables that could be sold under the agreement varied based on the amount of eligible receivables at any given time and other factors, and the maximum amount that could be sold and outstanding under this agreement at any given time was $650 million. The total amount of receivables outstanding under this agreement as of December 31, 2004 was approximately $263 million. As of December 31, 2005, these receivables were collected, the balance was retired, and the facility was terminated.

Note 7. Inventories
Inventories are stated at the lower of cost or market. In the United States we manufacture certain finished products and parts inventories for drill bits, completion products, bulk materials, and other tools that are recorded using the last-in, first-out method, which totaled $58 million at December 31, 2006 and $42 million at December 31, 2005. If the average cost method had been used, total inventories would have been $20 million higher than reported at December 31, 2006 and $21 million higher than reported at December 31, 2005. The cost of the remaining inventory was recorded on the average cost method. Inventories consisted of the following:

	December 31	
Millions of dollars	2006	2005
Finished products and parts	$ 909	$ 715
Raw materials and supplies	256	181
Work in process	96	57
Total	$ 1,261	$ 953

Finished products and parts are reported net of obsolescence reserves of $80 million at December 31, 2006 and $98 million at December 31, 2005.

Note 8. Investments

Investments in marketable securities

Our investments in marketable securities are reported at fair value. At December 31, 2004, our investments in marketable securities consisted of auction rate securities classified as available-for-sale. The 2004 balance of the auction rate securities was previously classified as cash and equivalents due to our intent and ability to quickly liquidate these securities to fund current operations and due to their interest rate reset feature. The auction rate securities were subsequently reclassified as investments in marketable securities. There was no impact on net income or cash flow from operating activities as a result of the reclassification. These auction rate securities were liquidated in March 2005.

Restricted and committed cash

At December 31, 2006 we had restricted cash of $132 million, which primarily consisted of:

- $105 million as collateral for potential future insurance claim reimbursements included in "Other assets"; and
- $24 million related to cash collateral agreements for outstanding letters of credit for various construction projects included in "Other current assets".

At December 31, 2005, we had restricted cash of $123 million in "Other assets," which primarily consisted of similar items as above.

Cash and equivalents include cash from advanced payments related to contracts in progress held by ourselves or our joint ventures that we consolidate for accounting purposes. The use of these cash balances is limited to the specific projects or joint venture activities and is not available for other projects, general cash needs, or distribution to us without approval of the board of directors of the respective joint venture or subsidiary. At December 31, 2006 and December 31, 2005, cash and equivalents included approximately $527 million and $223 million, respectively, in cash from advanced payments held by ourselves or our joint ventures that we consolidate for accounting purposes.

Note 9. Property, Plant, and Equipment

Property, plant, and equipment at December 31, 2006 and 2005 were composed of the following:

Millions of dollars	2006	2005
Land	$ 70	$ 66
Buildings and property improvements	1,027	940
Machinery, equipment, and other	6,105	5,480
Total	7,202	6,486
Less accumulated depreciation	4,154	3,838
Net property, plant, and equipment	$ 3,048	$ 2,648

Machinery, equipment, and other included oil and gas properties of $302 million at December 31, 2006 and $309 million at December 31, 2005.

The percentages of total buildings and property improvements and total machinery, equipment, and other, excluding oil and gas investments, are depreciated over the following useful lives:

	Buildings and Property Improvements	
	2006	2005
1-10 years	24%	25%
11-20 years	43%	45%
21-30 years	15%	11%
31-40 years	18%	19%

	Machinery, Equipment, and Other	
	2006	2005
1-5 years	25%	25%
6-10 years	70%	69%
11-20 years	5%	6%

Note 10. Debt

Short-term notes payable consist primarily of overdraft and other facilities with varying rates of interest. Long-term debt at December 31, 2006 and 2005 consisted of the following:

Millions of dollars	2006	2005
3.125% convertible senior notes due July 2023	$ 1,200	$ 1,200
5.5% senior notes due October 2010	749	748
Medium-term notes due 2008 thru 2027	299	600
7.6% debentures of Halliburton due August 2096	294	294
8.75% debentures due February 2021	185	200
Other	104	132
Total long-term debt	2,831	3,174
Less current portion	45	361
Noncurrent portion of long-term debt	$ 2,786	$ 2,813

Convertible notes

In June 2003, we issued $1.2 billion of 3.125% convertible senior notes due July 15, 2023, with interest payable semiannually. The notes are our senior unsecured obligations ranking equally with all of our existing and future senior unsecured indebtedness.

The notes are convertible under any of the following circumstances:

- during any calendar quarter if the last reported sale price of our common stock for at least 20 trading days during the period of 30 consecutive trading days ending on the last trading day of the previous quarter is greater than or equal to 120% of the conversion price per share of our common stock on such last trading day;
- if the notes have been called for redemption;
- upon the occurrence of specified corporate transactions that are described in the indenture related to the offering; or
- during any period in which the credit ratings assigned to the notes by both Moody’s Investors Service and Standard & Poor’s are lower than Ba1 and BB+, respectively, or the notes are no longer rated by at least one of these rating services or their successors.

The conversion price is $18.825 per share and is subject to adjustment upon the occurrence of stock dividends in common stock, the issuance of rights or warrants, stock splits and combinations, the distribution of indebtedness, securities, or assets, or excess cash distributions. The stock conversion rate for the notes changed as a result of the July 2006 stock split and an increase to our quarterly dividend. As of December 31, 2006, the stock conversion rate was 53.20 shares of common stock per $1,000 principal amount of notes. The distribution of KBR, Inc. stock to our shareholders, if in the form of a spin-off, would cause the conversion rate to change. The amount of such change would be based on the relative valuation of KBR, Inc. at the time of distribution.

Upon conversion, we must settle the principal amount of the notes in cash, and for any amounts in excess of the aggregate principal we have the right to deliver shares of our common stock, cash, or a combination of cash and common stock.

See Note 16 for discussion of supplemental indenture on these notes.
The notes are redeemable for cash at our option on or after July 15, 2008. Holders may require us to repurchase the notes for cash on July 15 of 2008, 2013, or 2018 or, prior to July 15, 2008, in the event of a fundamental change as defined in the underlying indenture.

Senior notes due 2007

In January 2004, we issued $500 million aggregate principal amount of senior notes due 2007 bearing interest at a floating rate equal to three-month LIBOR (London interbank offered rates) plus 0.75%, payable quarterly. In April 2005, we redeemed, at par plus accrued interest, all $500 million of these senior notes.

Floating- and fixed-rate senior notes

In October 2003, we completed an offering of $1.05 billion of floating- and fixed-rate unsecured senior notes. The fixed-rate notes, with an aggregate principal amount of $750 million, will mature on October 15, 2010 and bear interest at a rate equal to 5.5%, payable semiannually. The fixed-rate notes were initially offered on a discounted basis at 99.679% of their face value. The discount is being amortized to interest expense over the life of the bonds. The floating-rate notes, with an aggregate principal amount of $300 million and interest at a rate equal to three-month LIBOR plus 1.5%, were repaid at par plus accrued interest in October 2005.

Medium-term notes

We have outstanding notes under our medium-term note program as follows:

Due	Rate	Amount *(in millions)*
12/2008	5.63%	$ 150
05/2017	7.53%	$ 45
02/2027	6.75%	$ 104

In August 2006, we repaid, at par plus accrued interest, our $275 million 6.0% medium-term notes that matured. During 2006 we have repurchased $41 million of our medium-term notes at a total cost of $49 million. The 5.63% medium-term notes are redeemable by us, in whole or in part, at any time subject to a redemption price equal to the greater of 100% of the principal amount of such notes or the sum of the present values of the remaining scheduled payments of principal and interest thereon discounted to the redemption date at the treasury rate plus 15 basis points. The 7.53% notes may not be redeemed prior to maturity. The medium-term notes do not have sinking fund requirements and rank equally with our existing and future senior unsecured indebtedness.

Revolving credit facilities

In March 2005, we entered into a $1.2 billion variable rate, five-year unsecured revolving credit agreement, which replaced a secured $700 million three-year revolving credit facility and a secured $500 million 364-day revolving credit facility. There were no cash drawings under the unsecured $1.2 billion revolving credit facility as of December 31, 2006.
KBR entered into an unsecured $850 million five-year revolving credit facility in the fourth quarter of 2005. Letters of credit that totaled $55 million were issued under the KBR revolving credit facility, thus reducing the availability under the credit facility to approximately $795 million at December 31, 2006. There were no cash drawings under the unsecured $850 million revolving credit facility as of December 31, 2006.

Debt covenants

Letters of credit related to our $1.2 billion revolving credit facility contain restrictive covenants, including covenants that require us to maintain a minimum debt-to-capitalization ratio under our $1.2 billion revolving credit facility. At December 31, 2006, we were in compliance with this requirement.
In addition, the unsecured $850 million five-year revolving letter of credit facility entered into by KBR contains covenants including a limitation on the amount KBR can invest in unconsolidated subsidiaries. KBR must also maintain certain financial ratios including a debt-to-capitalization ratio, a leverage ratio, and a fixed charge coverage ratio. At December 31, 2006, KBR was in compliance with these requirements.

Maturities
Our debt matures as follows: $45 million in 2007; $164 million in 2008; $5 million in 2009; $752 million in 2010; $3 million in 2011; and $1,862 million thereafter.

Note 11. Asbestos Insurance Recoveries
Several of our subsidiaries, particularly DII Industries and Kellogg Brown & Root, had been named as defendants in a large number of asbestos- and silica-related lawsuits. Effective December 31, 2004, we resolved all open and future claims in the prepackaged Chapter 11 proceedings of DII Industries, Kellogg Brown & Root, and our other affected subsidiaries (which were filed on December 16, 2003) when the plan of reorganization became final and nonappealable.
During 2004, we settled insurance disputes with substantially all the insurance companies for asbestos- and silica-related claims and all other claims under the applicable insurance policies and terminated all the applicable insurance policies. Under the terms of our insurance settlements, we would receive cash proceeds with a nominal amount of approximately $1.5 billion and with a then present value of approximately $1.4 billion for our asbestos- and silica-related insurance receivables. The present value was determined by discounting the expected future cash payments with a discount rate implicit in the settlements, which ranged from 4.0% to 5.5%. This discount is being accreted as interest income (classified as discontinued operations) over the life of the expected future cash payments. Cash payments of approximately $167 million related to these receivables were received in 2006. Under the terms of the settlement agreements, we will receive cash payments of the remaining amounts, totaling $261 million at December 31, 2006, in several installments through 2010.
The following table presents a rollforward of our asbestos- and silica-related insurance receivables.

Millions of dollars		
Insurance for asbestos- and silica-related liabilities:		
December 31, 2005 balance (of which $193 was current)	$	396
Payments received		(167)
Accretion		11
Insurance for asbestos- and silica-related liabilities - December 31, 2006 balance (of which $68 is current)	$	240

A significant portion of the insurance coverage applicable to Worthington Pump, a former division of DII Industries, was alleged by Federal-Mogul (and others who formerly were associated with Worthington Pump prior to its acquisition by DII Industries) to be shared with them. During 2004, we reached an agreement with Federal-Mogul, our insurance companies, and another party sharing in the insurance coverage to obtain their consent and support of a partitioning of the insurance policies. Under the terms of the agreement, DII Industries was allocated 50% of the limits of any applicable insurance policy, and the remaining 50% of limits of the insurance policies were allocated to the remaining policyholders. As part of the settlement, DII Industries agreed to pay $46 million in three annual installment payments beginning in January 2005. In 2004, we accrued $44 million, which represents the present value of the $46 million to be paid. The discount is accreted as interest expense (classified as discontinued operations) over the life of the expected future cash payments beginning in the fourth quarter of 2004.
DII Industries and Federal-Mogul agreed to share equally in recoveries from insolvent London-based insurance companies. To the extent that Federal-Mogul's recoveries from certain insolvent London-based insurance companies received on or before January 1, 2006 did not equal at least $4.5 million, DII Industries agreed to also pay to Federal-Mogul the difference between their recoveries from the insolvent London-based insurance companies and $4.5 million. Accordingly, DII Industries paid Federal-Mogul $1.6 million in January 2006. In the fourth quarter of 2006, we received a portion of this amount, and the remaining $1.3 million is expected to be received back from Federal-Mogul following recoveries received by Federal-Mogul from the insolvent London-based insurance companies.

Under the insurance settlements entered into as part of the resolution of our Chapter 11 proceedings, we have agreed to indemnify our insurers under certain historic general liability insurance policies in certain situations. We have concluded that the likelihood of any claims triggering the indemnity obligations is remote, and we believe any potential liability for these indemnifications will be immaterial. At December 31, 2006, we had not recorded any liability associated with these indemnifications.

Note 12. United States Government Contract Work

We provide substantial work under our government contracts to the United States Department of Defense and other governmental agencies. These contracts include our worldwide United States Army logistics contracts, known as LogCAP, and United States Army Europe. Our government services revenue related to Iraq totaled approximately $4.7 billion in 2006, $5.4 billion in 2005, and $7.1 billion in 2004.

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

DCAA audit issues

Our operations under United States government contracts are regularly reviewed and audited by the Defense Contract Audit Agency (DCAA) and other governmental agencies. The DCAA serves in an advisory role to our customer. When issues are found during the governmental agency audit process, these issues are typically discussed and reviewed with us. The DCAA then issues an audit report with its recommendations to our customer’s contracting officer. In the case of management systems and other contract administrative issues, the contracting officer is generally with the Defense Contract Management Agency (DCMA). We then work with our customer to resolve the issues noted in the audit report. If our customer or a government auditor finds that we improperly charged any costs to a contract, these costs are not reimbursable, or, if already reimbursed, the costs must be refunded to the customer. Our revenue recorded for government contract work is reduced for our estimate of costs that may be categorized as disputed or unallowable as a result of cost overruns or the audit process.

Security. In February 2007, we received a letter from the Department of the Army informing us of their intent to adjust payments under the LogCAP III contract associated with the cost incurred by the subcontractors to provide security to their employees. Based on this letter, the DCAA withheld the Army’s initial assessment of $20 million. The Army based its assessment on one subcontract wherein, based on communications with the subcontractor, the Army estimated 6% of the total subcontract cost related to the private security costs. The Army indicated that not all task orders and subcontracts have been reviewed and that they may make additional adjustments. The Army indicated that, within 60 days, they intend to begin making further adjustments equal to 6% of prior and current subcontractor costs unless we can provide timely information sufficient to show that such action is not necessary to protect the government’s interest. We are working with the Army to provide the additional information they have requested.

The Army indicated that they believe our LogCAP III contract prohibits us from billing costs of privately acquired security. We believe that, while LogCAP III contract anticipates that the Army will provide force protection to KBR employees, it does not prohibit any of our subcontractors from using private security services to provide force protection to subcontractor personnel. In addition, a significant portion of our subcontracts are

competitively bid lump sum or fixed price subcontracts. As a result, we do not receive details of the subcontractors' cost estimate nor are we legally entitled to it. Accordingly, we believe that we are entitled to reimbursement by the Army for the cost of services provided by our subcontractors, even if they incurred costs for private force protection services. Therefore, we believe that the Army's position that such costs are unallowable and that they are entitled to withhold amounts incurred for such costs is wrong as a matter of law.

If we are unable to demonstrate that such action by the Army is not necessary, a 6% suspension of all subcontractor costs incurred to date could result in suspended costs of approximately $400 million. The Army has asked us to provide information that addresses the use of armed security either directly or indirectly charged to LogCAP III. The actual costs associated with these activities cannot be accurately estimated at this time but we believe that they should be less than 6% of the total subcontractor costs. As of December 31, 2006, no amounts have been accrued for suspended security billings.

Laundry. Prior to the fourth quarter of 2005, we received notice from the DCAA that it recommended withholding $18 million of subcontract costs related to the laundry service for one task order in southern Iraq, for which it believed we and our subcontractors did not provide adequate levels of documentation supporting the quantity of the services provided. In the fourth quarter of 2005, the DCAA issued a notice to disallow costs totaling approximately $12 million, releasing $6 million of amounts previously withheld. In the second quarter of 2006, we successfully resolved this matter with the DCAA and received payment of the remaining $12 million.

Containers. In June 2005, the DCAA recommended withholding certain costs associated with providing containerized housing for soldiers and supporting civilian personnel in Iraq. The DCAA recommended that the costs be withheld pending receipt of additional explanation or documentation to support the subcontract costs. During the fourth quarter of 2006, we resolved approximately $25 million of the $55 million withheld as of December 31, 2006 with our contracting officer and received these amounts in the first quarter of 2007. Of the approximately $55 million withheld as of December 31, 2006, $17 million had been withheld from our subcontractors. We will continue working with the government and our subcontractors to resolve the remaining amounts.

Dining facilities. In September 2005, Eurest Support Services (Cyprus) International Limited, or ESS, filed suit against us alleging various claims associated with its performance as a subcontractor in conjunction with our LogCAP contract in Iraq. The case was settled during the first quarter of 2006 without material impact to us.

In the third quarter of 2006, the DCAA has raised questions regarding $95 million of costs related to dining facilities in Iraq. We have responded to the DCAA that our costs are reasonable.

Other issues. The DCAA is continuously performing audits of costs incurred for the foregoing and other services provided by us under our government contracts. During these audits, there have been questions raised by the DCAA about the reasonableness or allowability of certain costs or the quality or quantity of supporting documentation. The DCAA might recommend withholding some portion of the questioned costs while the issues are being resolved with our customer. Because of the intense scrutiny involving our government contracts operations, issues raised by the DCAA may be more difficult to resolve. We do not believe any potential withholding will have a significant or sustained impact on our liquidity.

Investigations

We provided information to the DoD Inspector General's office in February 2004 about contacts between former employees and our subcontractors. In the first quarter of 2005, the United States Department of Justice (DOJ) issued two indictments associated with overbilling issues we previously reported to the Department of Defense Inspector General's office as well as to our customer, the Army Materiel Command, against a former KBR procurement manager and a manager of La Nouvelle Trading & Contracting Company, W.L.L. In March 2006, one of these former employees pled guilty to taking money in exchange for awarding work to a Saudi Arabian subcontractor. The Inspector General's investigation of these matters may continue.

In October 2004, we reported to the Department of Defense Inspector General's office that two former employees in Kuwait may have had inappropriate contacts with individuals employed by or affiliated with two third-party subcontractors prior to the award of the subcontracts. The Inspector General's office may investigate whether these two employees may have solicited and/or accepted payments from these third-party subcontractors while they were employed by us.

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In October 2004, a civilian contracting official in the Army Corps of Engineers (COE) asked for a review of the process used by the COE for awarding some of the contracts to us. We understand that the Department of Defense Inspector General's office may review the issues involved.
We understand that the DOJ, an Assistant United States Attorney based in Illinois, and others are investigating these and other individually immaterial matters we have reported related to our government contract work in Iraq. If criminal wrongdoing were found, criminal penalties could range up to the greater of $500,000 in fines per count for a corporation or twice the gross pecuniary gain or loss. We also understand that current and former employees of KBR have received subpoenas and have given or may give grand jury testimony related to some of these matters.
The House Oversight and Government Reform Committee has conducted hearings on the U.S. military's reliance on civilian contractors, including with respect to military operations in Iraq. We have provided testimony and information for these hearings. We expect hearings with respect to operations in Iraq to continue in this and other Congressional committees, including the House Armed Services Committee, and we expect to be asked to testify and provide information for these hearings.
Claims
We had unapproved claims totaling $36 million at December 31, 2006 and $69 million at December 31, 2005 for the LogCAP and PCO Oil South contracts. The unapproved claims outstanding at December 31, 2006, are considered to be probable of collection and have been recognized as revenue. Similarly, of the $69 million of unapproved claims outstanding at December 31, 2005, $57 million were considered to be probable of collection and have been recognized as revenue. The remaining $12 million of unapproved claims were not considered probable of collection and have not been recognized as revenue. These unapproved claims related to contracts where our costs have exceeded the customer's funded value of the task order.
In addition, as of December 31, 2006, we had incurred approximately $159 million of costs under the LogCAP III contract that could not be billed to the government due to lack of appropriate funding on various task orders. These amounts were associated with task orders that had sufficient funding in total, but the funding was not appropriately allocated within the task order. We are in the process of preparing a request for a reallocation of funding to be submitted to the client for negotiation, and we anticipate the negotiations will result in an appropriate distribution of funding by the client and collection of the full amounts due.
DCMA system reviews
Report on estimating system. In December 2004, the DCMA granted continued approval of our estimating system, stating that our estimating system is "acceptable with corrective action." We are in the process of completing these corrective actions. Specifically, based on the unprecedented level of support that our employees are providing the military in Iraq, Kuwait, and Afghanistan, we needed to update our estimating policies and procedures to make them better suited to such contingency situations. Additionally, we have completed our development of a detailed training program and have made it available to all estimating personnel to ensure that employees are adequately prepared to deal with the challenges and unique circumstances associated with a contingency operation.
Report on purchasing system. As a result of a Contractor Purchasing System Review by the DCMA during the fourth quarter of 2005, the DCMA granted the continued approval of our government contract purchasing system. The DCMA's October 2005 approval letter stated that our purchasing system's policies and practices are "effective and efficient, and provide adequate protection of the Government's interest." During the fourth quarter of 2006, the DCMA granted, again, continued approval of our government contract purchasing system.
Report on accounting system. We received two draft reports on our accounting system, which raised various issues and questions. We have responded to the points raised by the DCAA, but this review remains open. In the fourth quarter of 2006, the DCAA finalized its report and submitted it to the DCMA, who will make a determination of the adequacy of our accounting systems for government contracting. We have prepared an action plan considering the DCAA recommendations and continue to meet with these agencies to discuss the ultimate resolution. The DCMA continues to approve KBR's accounting system as acceptable for accumulating costs incurred under United States government contracts.

The Balkans

We have had inquiries in the past by the DCAA and the civil fraud division of the DOJ into possible overcharges for work performed during 1996 through 2000 under a contract in the Balkans, for which inquiry has not been completed by the DOJ. Based on an internal investigation, we credited our customer approximately $2 million during 2000 and 2001 related to our work in the Balkans as a result of billings for which support was not readily available. We believe that the preliminary DOJ inquiry relates to potential overcharges in connection with a part of the Balkans contract under which approximately $100 million in work was done. We believe that any allegations of overcharges would be without merit. In the fourth quarter 2006, we reached a negotiated settlement with the DOJ. KBR was not accused of any wrongdoing and did not admit to any wrongdoing. The company is not suspended or debarred from bidding for or performing work for the US government. The settlement did not have a material impact on our results of operations.

Note 13. Other Commitments and Contingencies

Foreign Corrupt Practices Act investigations

The SEC is conducting a formal investigation into whether improper payments were made to government officials in Nigeria through the use of agents or subcontractors in connection with the construction and subsequent expansion by TSKJ of a multibillion dollar natural gas liquefaction complex and related facilities at Bonny Island in Rivers State, Nigeria. The DOJ is also conducting a related criminal investigation. The SEC has also issued subpoenas seeking information, which we are furnishing, regarding current and former agents used in connection with multiple projects, including current and prior projects, over the past 20 years located both in and outside of Nigeria in which the Halliburton energy services business, The M.W. Kellogg Company, M.W. Kellogg Limited, Kellogg Brown & Root or their or our joint ventures, are or were participants. In September 2006, the SEC requested that we enter into a tolling agreement with respect to its investigation. We anticipate that we will enter into an appropriate tolling agreement with the SEC.

TSKJ is a private limited liability company registered in Madeira, Portugal whose members are Technip SA of France, Snamprogetti Netherlands B.V. (a subsidiary of Saipem SpA of Italy), JGC Corporation of Japan, and Kellogg Brown & Root (a subsidiary of ours and successor to The M.W. Kellogg Company), each of which had an approximately 25% interest in the venture at December 31, 2006. TSKJ and other similarly owned entities entered into various contracts to build and expand the liquefied natural gas project for Nigeria LNG Limited, which is owned by the Nigerian National Petroleum Corporation, Shell Gas B.V., Cleag Limited (an affiliate of Total), and Agip International B.V. (an affiliate of ENI SpA of Italy). M.W. Kellogg Limited is a joint venture in which KBR had a 55% interest at December 31, 2006; and M.W. Kellogg Limited and The M.W. Kellogg Company were subsidiaries of Dresser Industries before our 1998 acquisition of Dresser Industries. The M.W. Kellogg Company was later merged with a subsidiary of ours to form Kellogg Brown & Root, one of our subsidiaries.

The SEC and the DOJ have been reviewing these matters in light of the requirements of the FCPA. In addition to performing our own investigation, we have been cooperating with the SEC and the DOJ investigations and with other investigations into the Bonny Island project in France, Nigeria and Switzerland. We also believe that the Serious Frauds Office in the United Kingdom is conducting an investigation relating to the Bonny Island project. Our Board of Directors has appointed a committee of independent directors to oversee and direct the FCPA investigations. Through our committee of independent directors, we will continue to oversee and direct the investigations, and KBR's directors who are independent of us and KBR, acting as a committee of KBR's Board of Directors, will monitor the continuing investigation directed by us.

The matters under investigation relating to the Bonny Island project cover an extended period of time (in some cases significantly before our 1998 acquisition of Dresser Industries and continuing through the current time period). We have produced documents to the SEC and the DOJ both voluntarily and pursuant to company subpoenas from the files of numerous officers and employees of Halliburton and KBR, including current and former executives of Halliburton and KBR, and we are making our employees available to the SEC and the DOJ for interviews. In addition, we understand that the SEC has issued a subpoena to A. Jack Stanley, who formerly served

as a consultant and chairman of KBR, and to others, including certain of our and KBR's current and former employees, former executive officers of KBR, and at least one subcontractor of KBR. We further understand that the DOJ has issued subpoenas for the purpose of obtaining information abroad, and we understand that other partners in TSKJ have provided information to the DOJ and the SEC with respect to the investigations, either voluntarily or under subpoenas. The SEC and DOJ investigations include an examination of whether TSKJ's engagements of Tri-Star Investments as an agent and a Japanese trading company as a subcontractor to provide services to TSKJ were utilized to make improper payments to Nigerian government officials. In connection with the Bonny Island project, TSKJ entered into a series of agency agreements, including with Tri-Star Investments, of which Jeffrey Tesler is a principal, commencing in 1995 and a series of subcontracts with a Japanese trading company commencing in 1996. We understand that a French magistrate has officially placed Mr. Tesler under investigation for corruption of a foreign public official. In Nigeria, a legislative committee of the National Assembly and the Economic and Financial Crimes Commission, which is organized as part of the executive branch of the government, are also investigating these matters. Our representatives have met with the French magistrate and Nigerian officials. In October 2004, representatives of TSKJ voluntarily testified before the Nigerian legislative committee.

We notified the other owners of TSKJ of information provided by the investigations and asked each of them to conduct their own investigation. TSKJ has suspended the receipt of services from and payments to Tri-Star Investments and the Japanese trading company and has considered instituting legal proceedings to declare all agency agreements with Tri-Star Investments terminated and to recover all amounts previously paid under those agreements. In February 2005, TSKJ notified the Attorney General of Nigeria that TSKJ would not oppose the Attorney General's efforts to have sums of money held on deposit in accounts of Tri-Star Investments in banks in Switzerland transferred to Nigeria and to have the legal ownership of such sums determined in the Nigerian courts.

As a result of these investigations, information has been uncovered suggesting that, commencing at least 10 years ago, members of TSKJ planned payments to Nigerian officials. We have reason to believe that, based on the ongoing investigations, payments may have been made by agents of TSKJ to Nigerian officials. In addition, information uncovered in the summer of 2006 suggests that, prior to 1998, plans may have been made by employees of The M.W. Kellogg Company to make payments to government officials in connection with the pursuit of a number of other projects in countries outside of Nigeria. We are reviewing a number of recently discovered documents related to KBR activities in countries outside of Nigeria with respect to agents for projects after 1998. Certain of the activities discussed in this paragraph involve current or former employees or persons who were or are consultants to us and our investigation continues.

In June 2004, all relationships with Mr. Stanley and another consultant and former employee of M.W. Kellogg Limited were terminated. The terminations occurred because of violations of our Code of Business Conduct that allegedly involved the receipt of improper personal benefits from Mr. Tesler in connection with TSKJ's construction of the Bonny Island project.

In 2006, we suspended the services of another agent who, until such suspension, had worked for KBR outside of Nigeria on several current projects and on numerous older projects going back to the early 1980s. The suspension will continue until such time, if ever, as we can satisfy ourselves regarding the agent's compliance with applicable law and our Code of Business Conduct. In addition, we suspended the services of an additional agent on a separate current Nigerian project with respect to which we have received from a joint venture partner on that project allegations of wrongful payments made by such agent.

If violations of the FCPA were found, a person or entity found in violation could be subject to fines, civil penalties of up to $500,000 per violation, equitable remedies, including disgorgement (if applicable) generally of profit, including prejudgment interest on such profits, causally connected to the violation, and injunctive relief. Criminal penalties could range up to the greater of $2 million per violation or twice the gross pecuniary gain or loss from the violation, which could be substantially greater than $2 million per violation. It is possible that both the SEC and the DOJ could assert that there have been multiple violations, which could lead to multiple fines. The

amount of any fines or monetary penalties that could be assessed would depend on, among other factors, the findings regarding the amount, timing, nature, and scope of any improper payments, whether any such payments were authorized by or made with knowledge of us or our affiliates, the amount of gross pecuniary gain or loss involved, and the level of cooperation provided the government authorities during the investigations. Agreed dispositions of these types of violations also frequently result in an acknowledgement of wrongdoing by the entity and the appointment of a monitor on terms negotiated with the SEC and the DOJ to review and monitor current and future business practices, including the retention of agents, with the goal of assuring compliance with the FCPA. Other potential consequences could be significant and include suspension or debarment of our ability to contract with governmental agencies of the United States and of foreign countries. During 2006, KBR and its affiliates had revenue of approximately $5.8 billion from its government contracts work with agencies of the United States or state or local governments. If necessary, we would seek to obtain administrative agreements or waivers from the United States Department of Defense (DoD) and other agencies to avoid suspension or debarment. In addition, we may be excluded from bidding on United Kingdom Ministry of Defence (MoD) contracts in the United Kingdom if we are convicted for a corruption offense or if the MoD determines that our actions constituted grave misconduct. During 2006, KBR had revenue of approximately $1.0 billion from its government contracts work with the MoD. Suspension or debarment from the government contracts business would have a material adverse effect on our business, results of operations, and cash flows.

These investigations could also result in third-party claims against us, which may include claims for special, indirect, derivative or consequential damages, damage to our business or reputation, loss of, or adverse effect on, cash flow, assets, goodwill, results of operations, business prospects, profits or business value, adverse consequences on our ability to obtain or continue financing for current or future projects or claims by directors, officers, employees, affiliates, advisors, attorneys, agents, debt holders, or other interest holders or constituents of us or our subsidiaries. In this connection, we understand that the government of Nigeria gave notice in 2004 to the French magistrate of a civil claim as an injured party in that proceeding. We are not aware of any further developments with respect to this claim. In addition, we could incur costs and expenses for any monitor required by or agreed to with a governmental authority to review our continued compliance with FCPA law.

As of December 31, 2006, we are unable to estimate an amount of probable loss or a range of possible loss related to these matters.

Bidding practices investigation

In connection with the investigation into payments relating to the Bonny Island project in Nigeria, information has been uncovered suggesting that Mr. Stanley and other former employees may have engaged in coordinated bidding with one or more competitors on certain foreign construction projects, and that such coordination possibly began as early as the mid-1980s.

On the basis of this information, we and the DOJ have broadened our investigations to determine the nature and extent of any improper bidding practices, whether such conduct violated United States antitrust laws, and whether former employees may have received payments in connection with bidding practices on some foreign projects.

If violations of applicable United States antitrust laws occurred, the range of possible penalties includes criminal fines, which could range up to the greater of $10 million in fines per count for a corporation, or twice the gross pecuniary gain or loss, and treble civil damages in favor of any persons financially injured by such violations. Criminal prosecutions under applicable laws of relevant foreign jurisdictions and civil claims by, or relationship issues with customers, are also possible.

As of December 31, 2006, we are unable to estimate an amount of probable loss or a range of possible loss related to these matters.

Possible Algerian investigation

We believe that an investigation by a magistrate or a public prosecutor in Algeria may be pending with respect to sole source contracts awarded to Brown & Root Condor Spa, a joint venture with Kellogg Brown & Root Ltd UK, Centre de Recherche Nuclear de Draria, and Holding Services para Petroliers Spa. KBR had a 49% interest in this joint venture as of December 31, 2006.

Securities and related litigation

In June 2002, a class action lawsuit was filed against us in federal court on behalf of purchasers of our common stock during the approximate period of May 1998 until May 2002 alleging violations of the federal securities laws in connection with the accounting change and disclosures involved in the SEC investigation related to a change in accounting for revenue on long-term construction projects and related disclosures, which we settled with the SEC in the second quarter of 2004. In addition, the plaintiffs allege that we overstated our revenue from unapproved claims by recognizing amounts not reasonably estimable or probable of collection. In the weeks that followed, approximately twenty similar class actions were filed against us. Several of those lawsuits also named as defendants Arthur Andersen LLP, our independent accountants for the period covered by the lawsuits, and several of our present or former officers and directors. The class action cases were later consolidated, and the amended consolidated class action complaint, styled *Richard Moore, et al. v. Halliburton Company, et al.,* was filed and served upon us in April 2003 (the "*Moore* class action").

In early May 2003, we announced that we had entered into a written memorandum of understanding setting forth the terms upon which the *Moore* class action would be settled. In June 2003, the lead plaintiffs in the *Moore* class action filed a motion for leave to file a second amended consolidated complaint, which was granted by the court. In addition to restating the original accounting and disclosure claims, the second amended consolidated complaint included claims arising out of the 1998 acquisition of Dresser Industries, Inc. by Halliburton, including that we failed to timely disclose the resulting asbestos liability exposure (the "Dresser claims"). The Dresser claims were included in the settlement discussions leading up to the signing of the memorandum of understanding and were among the claims the parties intended to have resolved by the terms of the proposed settlement of the consolidated *Moore* class action and the derivative action. The memorandum of understanding called for Halliburton to pay $6 million, which would be funded by insurance proceeds.

In June 2004, the court entered an order preliminarily approving the settlement. Following the transfer of the case to another district judge and a final hearing on the fairness of the settlement the court entered an order in September 2004 holding that evidence of the settlement's fairness was inadequate, denying the motion for final approval of the settlement in the *Moore* class action, and ordering the parties, among other things, to mediate. After the court's denial of the motion to approve the settlement, we withdrew from the settlement as we believe we were entitled to do by its terms. The mediation was held in January 2005, but was declared by the mediator to be at an impasse with no settlement reached.

In April 2005, the court appointed new co-lead counsel and a new lead plaintiff, directing that they file a third consolidated amended complaint and that we file our motion to dismiss. The court held oral arguments on that motion in August 2005, at which time the court took the motion under advisement. In March 2006, the court entered an order in which it granted the motion to dismiss with respect to claims arising prior to June 1999 and granted the motion with respect to certain other claims while permitting the plaintiffs to repled those claims to correct deficiencies in their earlier complaint. In April 2006, the plaintiffs filed their fourth amended consolidated complaint. We filed a motion to dismiss those portions of the complaint that had been repled. A hearing was held on that motion in July 2006, and we await the court's ruling. The lead plaintiff has filed a motion to discharge and replace co-lead counsel. That motion was granted on February 26, 2007.

As of December 31, 2006, we had not accrued any amounts related to this matter.

Newmont Gold

In July 1998, Newmont Gold, a gold mining and extraction company, filed a lawsuit over the failure of a blower manufactured and supplied to Newmont by Roots, a former division of Dresser Equipment Group. The plaintiff alleged that during the manufacturing process, Roots had reversed the blades of a component of the blower known as the inlet guide vane assembly, resulting in the blower's failure and the shutdown of the gold extraction mill for a period of approximately one month during 1996. In January 2002, a Nevada trial court granted summary judgment to Roots on all counts, and Newmont appealed. In February 2004, the Nevada Supreme Court reversed the summary judgment and remanded the case to the trial court, holding that fact issues existed requiring a trial. Based on pretrial reports, the damages claimed by the plaintiff were in the range of $33 million to $39 million, and trial was scheduled for February 2007. During the fourth quarter of 2006, the case was settled with no material impact on us.

Improper payments reported to the SEC

During the second quarter of 2002, we reported to the SEC that one of our foreign subsidiaries operating in Nigeria made improper payments of approximately $2.4 million to entities owned by a Nigerian national who held himself out as a tax consultant, when in fact he was an employee of a local tax authority. The payments were made to obtain favorable tax treatment and clearly violated our Code of Business Conduct and our internal control procedures. The payments were discovered during our audit of the foreign subsidiary. We conducted an investigation assisted by outside legal counsel, and, based on the findings of the investigation, we terminated several employees. None of our senior officers were involved. We are cooperating with the SEC in its review of the matter. We took further action to ensure that our foreign subsidiary paid all taxes owed in Nigeria. A preliminary assessment of approximately $4 million was issued by the Nigerian tax authorities in the second quarter of 2003. We are cooperating with the Nigerian tax authorities to determine the total amount due as quickly as possible.

Operations in Iran

We received and responded to an inquiry in mid-2001 from the Office of Foreign Assets Control (OFAC) of the United States Treasury Department with respect to operations in Iran by a Halliburton subsidiary incorporated in the Cayman Islands. The OFAC inquiry requested information with respect to compliance with the Iranian Transaction Regulations. These regulations prohibit United States citizens, including United States corporations and other United States business organizations, from engaging in commercial, financial, or trade transactions with Iran, unless authorized by OFAC or exempted by statute. Our 2001 written response to OFAC stated that we believed that we were in compliance with applicable sanction regulations. In the first quarter of 2004, we responded to a follow-up letter from OFAC requesting additional information. We understand this matter has now been referred by OFAC to the DOJ. In July 2004, we received a grand jury subpoena from an Assistant United States District Attorney requesting the production of documents. We are cooperating with the government's investigation and responded to the subpoena by producing documents in September 2004.

As of December 31, 2006, we had not accrued any amounts related to this investigation.

Separate from the OFAC inquiry, we completed a study in 2003 of our activities in Iran during 2002 and 2003 and concluded that these activities were in compliance with applicable sanction regulations. These sanction regulations require isolation of entities that conduct activities in Iran from contact with United States citizens or managers of United States companies. Notwithstanding our conclusions that our activities in Iran were not in violation of United States laws and regulations, we announced that, after fulfilling our current contractual obligations within Iran, we intend to cease operations within that country and withdraw from further activities there.

David Hudak and International Hydrocut Technologies Corp.

In October 2004, David Hudak and International Hydrocut Technologies Corp. (collectively, Hudak) filed suit against us in the United States District Court alleging civil Racketeer Influenced and Corporate Organizations Act violations, fraud, breach of contract, unfair trade practices, and other torts. The action, which seeks unspecified damages, arises out of Hudak's alleged purchase from us in early 1994 of certain explosive charges that were later alleged by the DOJ to be military ordnance, the possession of which by persons not possessing the requisite licenses and registrations is unlawful. As a result of that allegation by the government, Hudak was charged with, but later acquitted of, certain criminal offenses in connection with his possession of the explosive charges. As mentioned above, the alleged transaction(s) took place more than 10 years ago. The fact that most of the individuals that may have been involved, as well as the entities themselves, are no longer affiliated with us will complicate our investigation. For those reasons and because the litigation is in its most preliminary stages, it is premature to assess the likelihood of an adverse result. We filed a motion to dismiss and, alternatively, a motion to transfer venue. Those motions were denied during the first quarter of 2006. It is our intention to vigorously defend this action.

Amounts accrued related to this matter as of December 31, 2006 were not material.

Iraq overtime litigation

During the fourth quarter of 2005, a group of present and former employees working on the LogCAP contract in Iraq and elsewhere filed a class action lawsuit alleging that KBR wrongfully failed to pay time and a half for hours worked in excess of 40 per work week and that "uplift" pay, consisting of a foreign service bonus, an area

differential, and danger pay, was only applied to the first 40 hours worked in any work week. The class alleged by plaintiffs consists of all current and former employees on the LogCAP contract from December 2001 to present. The basis of plaintiffs' claims is their assertion that they are intended third-party beneficiaries of the LogCAP contract, and that the LogCAP contract obligated KBR to pay time and a half for all overtime hours. We moved to dismiss the case on a number of bases. On September 26, 2006, the court granted the motion to dismiss insofar as claims for overtime pay and "uplift" pay are concerned, leaving only a contractual claim for miscalculation of employees' pay. That claim remains open. It is premature to assess the probability of an adverse result on that remaining claim. However, because the LogCAP contract is cost-reimbursable, we believe that we could charge any adverse award to the customer. It is our intention to continue to vigorously defend the remaining claim.

As of December 31, 2006, we had not accrued any amounts related to this matter.

McBride qui tam suit

In September 2006, we became aware of a *qui tam* action filed against us by a former employee alleging various wrongdoings in the form of overbillings of our customer on the LogCAP III contract. This case was originally filed pending the government's decision whether or not to participate in the suit. In June 2006, the government formally declined to participate. The principal allegations are that our compensation for the provision of Morale, Welfare and Recreation (MWR) facilities under LogCAP III is based on the volume of usage of those facilities and that we deliberately overstated that usage. In accordance with the contract, we charged our customer based on actual cost, not based on the number of users. It was also alleged that during the period from November 2004 into mid-December 2004, we continued to bill the customer for lunches, although the dining facility was closed and not serving lunches. There are also allegations regarding housing containers and KBR's provision of services to its own employees and contractors. Our investigation is ongoing. However, we believe the allegations to be without merit, and we intend to vigorously defend this action.

As of December 31, 2006, we had not accrued any amounts in connection with this matter.

Wilson and Warren qui tam suit

During November 2006, we became aware of a *qui tam* action filed against us alleging that we overcharged the military $30 million by failing to adequately maintain trucks used to move supplies in convoys and by sending empty trucks in convoys. It was alleged that the purpose of these acts was to cause the trucks to break down more frequently than they would if properly maintained and to unnecessarily expose them to the risk of insurgent attacks, for the purpose of necessitating their replacement thus increasing our revenue. The suit also alleges that in order to silence the plaintiffs, who allegedly were attempting to report those allegations and other alleged wrongdoing, we unlawfully terminated them. On February 6, 2007, the court granted our motion to dismiss the plaintiffs' qui tam claims as legally insufficient and ordered the plaintiffs to arbitrate their claims that they were unlawfully discharged.

As of December 31, 2006, we had not accrued any amounts in connection with this matter.

M-I, LLC antitrust litigation

On February 16, 2007, we were informed that M-I, LLC, a competitor of ours in the drilling fluids market has sued us for allegedly attempting to monopolize the market for invert emulsion drilling fluids used in deep water and/or in cold water temperatures. The claims M-I asserts are based upon its allegation that the patent issued for our Accolade® drilling fluid was invalid as a result of its allegedly having been procured by fraud on the United States Patent and Trademark Office and that our subsequent prosecution of an infringement action against M-I amounted to predatory conduct in violation of Section 2 of the Sherman Antitrust Act. In October 2006, a federal court dismissed our infringement action based upon its holding that the claims in our patent were indefinite and the patent was, therefore, invalid. That judgment is now on appeal. M-I also alleges that we falsely advertised our Accolade® drilling fluid in violation of the Lanham Act and California law and that our earlier infringement action amounted to malicious prosecution in violation of Texas state law. M-I seeks compensatory damages, which it claims should be trebled, as well as punitive damages and injunctive relief. We believe that M-I's claims are without merit and intend to aggressively defend them.

As of December 31, 2006, we had not accrued any amounts in connection with this matter.

Environmental

We are subject to numerous environmental, legal, and regulatory requirements related to our operations worldwide. In the United States, these laws and regulations include, among others:

- the Comprehensive Environmental Response, Compensation, and Liability Act;
- the Resources Conservation and Recovery Act;
- the Clean Air Act;
- the Federal Water Pollution Control Act; and
- the Toxic Substances Control Act.

In addition to the federal laws and regulations, states and other countries where we do business often have numerous environmental, legal, and regulatory requirements by which we must abide. We evaluate and address the environmental impact of our operations by assessing and remediating contaminated properties in order to avoid future liabilities and comply with environmental, legal, and regulatory requirements. On occasion, we are involved in specific environmental litigation and claims, including the remediation of properties we own or have operated, as well as efforts to meet or correct compliance-related matters. Our Health, Safety and Environment group has several programs in place to maintain environmental leadership and to prevent the occurrence of environmental contamination.

We do not expect costs related to these remediation requirements to have a material adverse effect on our consolidated financial position or our results of operations. Our accrued liabilities for environmental matters were $43 million as of December 31, 2006 and $50 million as of December 31, 2005. The liability covers numerous properties and no individual property accounts for more than $5 million of the liability balance. We have subsidiaries that have been named as potentially responsible parties along with other third parties for 12 federal and state superfund sites for which we have established a liability. As of December 31, 2006, those 12 sites accounted for approximately $10 million of our total $43 million liability. In some instances, we have been named a potentially responsible party by a regulatory agency, but in each of those cases, we do not believe we have any material liability.

Letters of credit

In the normal course of business, we have agreements with banks under which approximately $1.0 billion of letters of credit or bank guarantees were outstanding as of December 31, 2006, including $676 million that relate to KBR. These KBR letters of credit or bank guarantees include $516 million that relate to their joint ventures' operations. Some of the outstanding letters of credit have triggering events which would entitle a bank to require cash collateralization.

Other commitments

As of December 31, 2006, we had commitments to fund approximately $156 million to related companies. These commitments arose primarily during the start-up of these entities or due to losses incurred by them. We expect approximately $13 million of the commitments to be paid during the next twelve months.

Liquidated damages

Many of our engineering and construction contracts have milestone due dates that must be met or we may be subject to penalties for liquidated damages if claims are asserted and we were responsible for the delays. These generally relate to specified activities within a project by a set contractual date or achievement of a specified level of output or throughput of a plant we construct. Each contract defines the conditions under which a customer may make a claim for liquidated damages. However, in most instances, liquidated damages are not asserted by the customer, but the potential to do so is used in negotiating claims and closing out the contract. We had not accrued for liquidated damages of $43 million at December 31, 2006 and $70 million at December 31, 2005 (including our share of amounts related to unconsolidated subsidiaries) that we could incur based upon completing the projects as forecasted.

Leases

We are obligated under operating leases, principally for the use of land, offices, equipment, field facilities, and warehouses. Total rentals, net of sublease rentals, were as follows:

Millions of dollars	2006	2005	2004
Rental expense	$ 580	$ 721	$ 693

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Future total rentals on noncancelable operating leases are as follows: $188 million in 2007; $145 million in 2008; $125 million in 2009; $110 million in 2010; $103 million in 2011; and $367 million thereafter.

Note 14. Income Taxes

The components of the provision for income taxes on continuing operations were:

	Years ended December 31		
Millions of dollars	2006	2005	2004
Current income taxes:			
Federal	$ (182)	$ (100)	$ (85)
Foreign	(289)	(190)	(153)
State	(12)	(9)	(6)
Total current	(483)	(299)	(244)
Deferred income taxes:			
Federal	(577)	305	3
Foreign	(64)	(56)	6
State	(20)	(14)	-
Total deferred	(661)	235	9
Provision for income taxes	$ (1,144)	$ (64)	$ (235)

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

	Years ended December 31		
Millions of dollars	2006	2005	2004
United States	$ 2,381	$ 1,713	$ 135
Foreign	1,068	734	499
Total	$ 3,449	$ 2,447	$ 634

The reconciliations between the actual provision for income taxes on continuing operations and that computed by applying the United States statutory rate to income from continuing operations before income taxes, minority interest, and change in accounting principle were as follows:

	Years ended December 31		
	2006	2005	2004
United States statutory rate	35.0%	35.0%	35.0%
State income taxes, net of federal income tax benefit	0.6	1.0	0.6
Impact of foreign operations	(1.3)	(1.4)	-
Adjustments of prior year taxes	(0.8)	0.1	(2.1)
Valuation allowance	(0.6)	(32.3)	-
Other items, net	0.3	0.2	3.6
Total effective tax rate on continuing operations	33.2%	2.6%	37.1%

The major component of the difference between the 2005 statutory tax rate compared to the effective tax rate is the release of a valuation allowance established in prior years. The remaining valuation allowance was released in 2006.

We generally do not provide income taxes on the undistributed earnings of non-United States subsidiaries because such earnings are intended to be reinvested indefinitely to finance foreign activities. Taxes are provided as necessary with respect to earnings that are not permanently reinvested. The American Job Creations Act of 2004 introduced a special dividends received deduction with respect to the repatriation of certain foreign earnings to a United States taxpayer under certain circumstances. Based on our analysis of the Act, we decided not to utilize the special deduction.
The primary components of our deferred tax assets and liabilities and the related valuation allowances, including deferred tax accounts associated with discontinued operations, were as follows:

	December 31			
Millions of dollars		2006		2005
Gross deferred tax assets:				
Employee compensation and benefits	$	455	$	299
Foreign tax credit carryforward		146		146
Construction contract accounting		88		41
Accrued liabilities		85		102
Net operating loss carryforwards		84		926
Alternative minimum tax credit carryforward		69		21
Capitalized research and experimentation		65		113
Insurance accruals		60		58
Other		204		264
Total gross deferred tax assets	$	1,256	$	1,970
Gross deferred tax liabilities:				
Depreciation and amortization	$	182	$	194
Other		27		20
Total gross deferred tax liabilities	$	209	$	214
Valuation allowances:				
Foreign tax credit carryforward	$	146	$	146
Future tax attributes related to United States				
net operating loss		-		137
Net operating loss carryforwards		50		43
Total valuation allowances	$	196	$	326
Net deferred income tax asset	$	851	$	1,430

We have $187 million of foreign net operating loss carryforwards that expire from 2007 through 2016 and additional foreign net operating loss carryforwards of $65 million with indefinite expiration dates. During 2005, our existing deferred tax asset related to asbestos and silica liabilities became a United States net operating loss, due to the tax deduction of the related costs in 2005. As a result, a domestic net operating loss carryforward of $2.1 billion was created and was fully utilized in 2006. The federal alternative minimum tax credits are available to reduce future United States federal income taxes on an indefinite basis.
We have established a valuation allowance against foreign tax credit carryovers and certain foreign operating loss carryforwards on the basis that we believe these assets will not be utilized in the statutory carryover period.
We had recorded a valuation allowance based on the anticipated impact of the United States net operating loss generated from asbestos and silica deductions on our ability to utilize future foreign tax credits in the United States. This valuation allowance was reassessed quarterly based on a number of estimates including future creditable foreign taxes and future taxable income. Factors such as actual operating results, material acquisitions or

dispositions, and changes to our operating environment could alter the estimates, which could have a material impact on the valuation allowance. For example, as a result of our strong 2005 earnings, coupled with an upward revision in our estimate of future domestic taxable income for 2006 and beyond, we recorded favorable adjustments to this valuation allowance in 2005. Given that we fully utilized the United States net operating loss in 2006 and expect to begin utilizing foreign tax credits in the United States for 2007, the valuation allowance balance has been reduced to zero as of the end of 2006.

Note 15. Shareholders' Equity and Stock Incentive Plans

The following tables summarize our common stock and other shareholders' equity activity:

Millions of dollars	Common Shares	Paid-in Capital in Excess of Par Value	Asbestos Trust Shares	Treasury Stock	Deferred Compensation	Retained Earnings	Accumulated Other Comprehensive Income
Balance at December 31, 2003	$ 2,284	$ (869)	$ -	$ (577)	$ (64)	$ 2,071	$ (298)
Cash dividends paid	-	-	-	-	-	(221)	-
Stock-based compensation and employee stock purchase, net	8	(7)	-	107	(10)	-	-
Treasury stock purchased	-	-	-	(7)	-	-	-
Tax benefit from exercise of options and restricted stock	-	7	-	-	-	-	-
Total dividends and other transactions with shareholders	8	-	-	100	(10)	(221)	-
Asbestos trust shares	-	-	2,335	-	-	-	-
Comprehensive income (loss):							
Net loss	-	-	-	-	-	(979)	-
Other comprehensive income:							
Cumulative translation adjustment	-	-	-	-	-	-	33
Realization of gains included in net income	-	-	-	-	-	-	(1)
Minimum pension liability adjustment, net of tax of $49	-	-	-	-	-	-	115
Net unrealized gains on investments and derivatives net of tax of $8	-	-	-	-	-	-	5
Total comprehensive loss	-	-	-	-	-	(979)	152
Balance at December 31, 2004	$ 2,292	$ (869)	$ 2,335	$ (477)	$ (74)	$ 871	$ (146)
Cash dividends paid	-	-	-	-	-	(254)	-
Stock-based compensation and employee stock purchase, net	44	258	-	115	(24)	-	-
Treasury stock purchased	-	-	-	(12)	-	-	-
Tax benefit from exercise of options and restricted stock	-	75	-	-	-	-	-
Total dividends and other transactions with shareholders	44	333	-	103	(24)	(254)	-
Asbestos trust shares	298	2,037	(2,335)	-	-	-	-
Comprehensive income (loss):							
Net income	-	-	-	-	-	2,358	-
Other comprehensive income:							

Cumulative translation							
adjustment	-	-	-	-	-	-	(48)
Realization of losses included							
in net income	-	-	-	-	-	-	7
Minimum pension liability							
adjustment, net of tax							
benefit of $23	-	-	-	-	-	-	(54)
Net unrealized losses on							
investments and							
derivatives,							
net of tax benefit of $15	-	-	-	-	-	-	(25)
Total comprehensive income	-	-	-	-	-	2,358	(120)
Balance at December 31, 2005	$ 2,634	$ 1,501	$ -	$ (374)	$ (98)	$ 2,975	$ (266)
Cash dividends paid	-	-	-	-	-	(306)	-
Stock-based compensation and							
employee stock purchase, net	16	116	-	136	-	-	-
Treasury stock purchased	-	-	-	(16)	-	-	-
Tax benefit from exercise of options							
and restricted stock	-	53	-	-	-	-	-
Total dividends and other							
transactions							
with shareholders	16	169	-	120	-	(306)	-

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Millions of dollars	Common Shares	Paid-in Capital in Excess of Par Value	Asbestos Trust Shares	Treasury Stock	Deferred Compensation	Retained Earnings	Accumulated Other Comprehensive Income
Common share repurchase program	-	-	-	(1,323)	-	-	-
Sale of stock by a subsidiary	-	117	-	-	-	-	-
Reclassification of deferred compensation	-	(98)	-	-	98	-	-
Adoption of SFAS 158, net of tax benefit of $146	-	-	-	-	-	-	(218)
Other	-	-	-	-	-	34	-
Comprehensive income (loss):							
Net income	-	-	-	-	-	2,348	-
Other comprehensive income:							
Cumulative translation adjustment	-	-	-	-	-	-	48
Realization of losses included in net income	-	-	-	-	-	-	(14)
Pension liability adjustment, net of tax benefit of $16	-	-	-	-	-	-	2
Net unrealized losses on investments and derivatives, net of tax of $7	-	-	-	-	-	-	11
Total comprehensive income	-	-	-	-	-	2,348	47
Balance at December 31, 2006	$ 2,650	$ 1,689	$ -	$ (1,577)	$ -	$ 5,051	$ (437)

Accumulated other comprehensive income	December 31		
Millions of dollars	2006	2005	2004
Cumulative translation adjustment	$ (38)	$ (72)	$ (31)
Pension liability adjustments	(400)	(184)	(130)
Unrealized gains (losses) on investments and derivatives	1	(10)	15
Total accumulated other comprehensive income	$ (437)	$ (266)	$ (146)

Shares of common stock	December 31		
Millions of shares	2006	2005	2004
Issued	1,060	1,054	916
In treasury	(62)	(26)	(32)
Total shares of common stock outstanding	998	1,028	884

In May 2006, the shareholders increased the number of authorized shares of common stock to two billion. Also in May 2006, our Board of Directors finalized the terms of a two-for-one common stock split, effected in the form of a stock dividend. As a result, the split was paid in the form of a stock dividend on July 14, 2006 to shareholders of record on June 23, 2006. The effect on the balance sheet was to reduce “Paid-in capital in excess of par value” by $1.3 billion and to increase “Common shares” by $1.3 billion. All prior period common stock and applicable share and per share amounts were retroactively adjusted to reflect the split.

In February 2006, our Board of Directors approved a share repurchase program up to $1.0 billion, which replaced our previous share repurchase program. In September 2006, our Board of Directors approved an increase to our existing

common share repurchase program of up to an additional $2.0 billion. The stock repurchase program does not require a specific number of shares to be purchased and the program may be effected through solicited or unsolicited transactions in the market or in privately negotiated transactions. The program may be terminated or suspended at any time. During 2006, we repurchased approximately 40 million shares of our common stock for approximately $1.3 billion or an average price per share of $32.93.

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Preferred Stock
Our preferred stock consists of five million total authorized shares at December 31, 2006, of which none were issued.

Halliburton Stock Incentive Plans
Our 1993 Stock and Incentive Plan, as amended (1993 Plan), provides for the grant of any or all of the following types of stock-based awards:

- stock options, including incentive stock options and nonqualified stock options;
- restricted stock awards;
- restricted stock unit awards;
- stock appreciation rights; and
- stock value equivalent awards.

There are currently no stock appreciation rights or stock value equivalent awards outstanding.
Under the terms of the 1993 Plan, 98 million shares of common stock have been reserved for issuance to employees and non-employee directors. The plan specifies that no more than 32 million shares can be awarded as restricted stock. At December 31, 2006, approximately 20 million shares were available for future grants under the 1993 Plan, of which approximately 11 million shares remained available for restricted stock awards. The stock to be offered pursuant to the grant of an award under the 1993 Plan may be authorized but unissued common shares or treasury shares.
In addition to the provisions of the 1993 Plan, we also have stock-based compensation provisions under our Restricted Stock Plan for Non-Employee Directors and our ESPP.
Once Halliburton's ownership interest in KBR, Inc. is 20% or less, outstanding awards to KBR, Inc. employees of options to purchase Halliburton stock and unvested Halliburton restricted stock under the 1993 Plan will be converted into similar KBR, Inc. awards under its new Transitional Stock Adjustment Plan, with the intention of preserving approximately the equivalent value of the previous awards under the 1993 Plan.
Each of the active stock-based compensation arrangements is discussed below.
Stock options
All stock options under the 1993 Plan are granted at the fair market value of our common stock at the grant date. Employee stock options vest ratably over a three- or four-year period and generally expire 10 years from the grant date. Stock options granted to non-employee directors vest after six months. Compensation expense for stock options is generally recognized on a straight line basis over the entire vesting period. No further stock option grants are being made under the stock plans of acquired companies.
The following table represents our stock options activity during 2006, and includes exercised, forfeited, and expired shares from our acquired companies' stock plans.

Stock Options	Number of Shares *(in millions)*		Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term *(years)*		Aggregate Intrinsic Value *(in millions)*
Outstanding at January 1, 2006	22.4	$	16.81			
Granted	1.9		34.32			
Exercised	(6.3)		17.35			
Forfeited	(0.3)		19.78			
Expired	(0.1)		15.45			
Outstanding at December 31, 2006	17.6	$	18.55	5.79	$	227
Exercisable at December 31, 2006	12.7	$	15.66	4.73	$	196

The total intrinsic value of options exercised was $123 million in 2006, $194 million in 2005, and $19 million in 2004. As of December 31, 2006, there was $37 million of unrecognized compensation cost, net of estimated forfeitures, related to nonvested stock options, which is expected to be recognized over a weighted average period of approximately 1.8 years.

Cash received from option exercises was $159 million during 2006, $342 million during 2005, and $63 million during 2004. The tax benefit realized from the exercise of stock options was $42 million in 2006.

Restricted stock

Restricted shares issued under the 1993 Plan are restricted as to sale or disposition. These restrictions lapse periodically over an extended period of time not exceeding 10 years. Restrictions may also lapse for early retirement and other conditions in accordance with our established policies. Upon termination of employment, shares on which restrictions have not lapsed must be returned to us, resulting in restricted stock forfeitures. The fair market value of the stock on the date of grant is amortized and charged to income on a straight line basis over the requisite service period for the entire award.

Our Restricted Stock Plan for Non-Employee Directors (Directors Plan) allows for each non-employee director to receive an annual award of 800 restricted shares of common stock as a part of compensation. These awards have a minimum restriction period of six months and the restrictions lapse upon termination of Board service. The fair market value of the stock on the date of grant is amortized. We reserved 200,000 shares of common stock for issuance to non-employee directors, which may be authorized but unissued common shares or treasury shares. At December 31, 2006, 106,400 shares had been issued to non-employee directors under this plan. There were 8,000 shares, 6,400 shares, and 8,000 shares of restricted stock awarded under the Directors Plan in 2006, 2005, and 2004. In addition, during 2006, our non-employee directors were awarded 30,168 shares of restricted stock under the 1993 Plan, which are included in the table below.

The following table represents our 1993 Plan and Directors Plan restricted stock awards and restricted stock units granted, vested, and forfeited during 2006.

Restricted Stock	Number of Shares *(in millions)*	Weighted Average Grant-Date Fair Value per Share
Nonvested shares at January 1, 2006	7.5	$ 17.07
Granted	2.5	34.39
Vested	(1.8)	17.04
Forfeited	(0.3)	20.70
Nonvested shares at December 31, 2006	7.9	$ 22.50

The weighted average grant-date fair value of shares granted during 2005 was $24.28 and during 2004 was $14.86. The total fair value of shares vested during 2006 was $64 million, during 2005 was $49 million, and during 2004 was $24 million. As of December 31, 2006, there was $139 million of unrecognized compensation cost, net of estimated forfeitures, related to nonvested restricted stock, which is expected to be recognized over a weighted average period of 4.3 years.

2002 Employee Stock Purchase Plan

Under the ESPP, eligible employees may have up to 10% of their earnings withheld, subject to some limitations, to be used to purchase shares of our common stock. Unless the Board of Directors shall determine otherwise, each six-month offering period commences on January 1 and July 1 of each year. The price at which common stock may be purchased under the ESPP is equal to 85% of the lower of the fair market value of the common stock on the commencement date or last trading day of each offering period. Under this plan, 24 million shares of common stock have been reserved for issuance. They may be authorized but unissued shares or treasury shares. As of December 31, 2006, 11.7 million shares have been sold through the ESPP.

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

- stock options, including incentive stock options and nonqualified stock options;
- stock appreciation rights, in tandem with stock options or freestanding;
- restricted stock;
- restricted stock units;
- performance awards; and
- stock value equivalent awards.

Under the terms of the KBR 2006 Plan, 10 million shares of KBR, Inc. common stock have been reserved for issuance to KBR, Inc. employees and non-employee directors. The plan specifies that no more than 3.5 million KBR, Inc. shares can be awarded as restricted stock or restricted stock units or pursuant to performance awards. At December 31, 2006, approximately 8 million KBR, Inc. shares were available for future grants under the KBR 2006 Plan, of which approximately 2.5 million KBR, Inc. shares remained available for restricted stock awards or restricted stock unit awards.

Stock Options
Under the KBR 2006 Plan, effective as of the closing date of the KBR, Inc. initial public offering, stock options are granted with an exercise price not less than the fair market value of the common stock on the date of the grant and a term no greater than 10 years. The term and vesting periods are established at the discretion of the Compensation Committee at the time of each grant.
The following table represents KBR, Inc. stock option activity during 2006.

Stock Options	Number of Shares *(in millions)*	Weighted Average Exercise Price per Share
Outstanding at January 1, 2006	-	-
Granted	1.0	$ 21.81
Exercised	-	-
Forfeited	-	-
Expired	-	-
Outstanding at December 31, 2006	1.0	$ 21.81

KBR, Inc. options outstanding at December 31, 2006 had a weighted average remaining contractual life of 9.9 years. None of the options outstanding were exercisable at December 31, 2006. As of December 31, 2006, net of estimated forfeitures, there was $8 million of unrecognized compensation cost related to nonvested KBR, Inc. stock options, expected to be recognized over a weighted average period of approximately 2.9 years. The aggregate intrinsic value attributable to these options was $4 million as of December 31, 2006.

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

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

Restricted Stock	Number of Shares *(in millions)*	Weighted Average Grant-Date Fair Value per Share
Nonvested shares at January 1, 2006	-	-
Granted	1.0	$ 21.16
Vested	-	-
Forfeited	-	-
Nonvested shares at December 31, 2006	1.0	$ 21.16

As of December 31, 2006, there was $19 million of unrecognized compensation cost, net of estimated forfeitures, related to KBR, Inc. nonvested restricted stock and restricted stock units, which is expected to be recognized over a weighted average period of 4.9 years.

Note 16. Income (Loss) per Share

Basic income (loss) per share is based on the weighted average number of common shares outstanding during the period and, effective January 1, 2005, includes the 119 million shares that were contributed to the trusts established for the benefit of asbestos claimants. Diluted income (loss) per share includes additional common shares that would have been outstanding if potential common shares with a dilutive effect had been issued. A reconciliation of the number of shares used for the basic and diluted income (loss) per share calculation is as follows:

Millions of shares	2006	2005	2004
Basic weighted average common shares outstanding	1,014	1,010	874
Dilutive effect of:			
Convertible senior notes premium	29	16	-
Stock options	9	10	4
Restricted stock	2	2	2
Other	-	-	2
Diluted weighted average common shares outstanding	1,054	1,038	882

In December 2004, we entered into a supplemental indenture that requires us to satisfy our conversion obligation for our convertible senior notes in cash, rather than in common stock, for at least the aggregate principal amount of the notes. This reduced the resulting potential earnings dilution to only include the conversion premium, which is the difference between the conversion price per share of common stock and the average share price. See the table above for the dilutive effect for 2006 and 2005. The conversion price of $18.825 per share of common stock was greater than our average share price in 2004 and, consequently, did not result in dilution.

Excluded from the computation of diluted income (loss) per share were options to purchase two million shares of common stock that were outstanding in 2006, two million shares of common stock that were outstanding in 2005, and 18 million shares of common stock outstanding in 2004. These options were outstanding during these years but were excluded because the option exercise price was greater than the average market price of the common shares.

Note 17. Financial Instruments and Risk Management

Foreign exchange risk

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

We manage our currency exposure through the use of currency derivative instruments as it relates to the major currencies, which are generally the currencies of the countries in which we do the majority of our international business. These contracts generally have an expiration date of two years or less. Forward exchange contracts, which are commitments to buy or sell a specified amount of a foreign currency at a specified price and time, are generally used to manage identifiable foreign currency commitments. Forward exchange contracts and foreign exchange option contracts, which convey the right, but not the obligation, to sell or buy a specified amount of foreign currency at a specified price, are generally used to manage exposures related to assets and liabilities denominated in a foreign currency. None of the forward or option contracts are exchange traded. While derivative instruments are subject to fluctuations in value, the fluctuations are generally offset by the value of the underlying exposures being managed. The use of some contracts may limit our ability to benefit from favorable fluctuations in foreign exchange rates. Foreign currency contracts are not utilized to manage exposures in some currencies due primarily to the lack of available markets or cost considerations (non-traded currencies). We attempt to manage our working capital position to minimize foreign currency commitments in non-traded currencies and recognize that pricing for the services and products offered in these countries should cover the cost of exchange rate devaluations. We have historically incurred transaction losses in non-traded currencies.

Assets, liabilities, and forecasted cash flows denominated in foreign currencies. We utilize the derivative instruments described above to manage the foreign currency exposures related to specific assets and liabilities that are denominated in foreign currencies; however, we have not elected to account for these instruments as hedges for accounting purposes. Additionally, we utilize the derivative instruments described above to manage forecasted cash flows denominated in foreign currencies generally related to long-term engineering and construction projects. Beginning in 2003, we designated these contracts related to engineering and construction projects as cash flow hedges. The ineffective portion of these hedges was included in operating income in the accompanying consolidated statements of operations and was not material in 2006, 2005, or 2004. As of December 31, 2006, we had unrealized gains and unrealized losses on these cash flow hedges that were not material, and as of December 31, 2005, we had approximately $18 million in unrealized net losses on these cash flow hedges. We included these unrealized gains and losses on these cash flow hedges in other comprehensive income in the accompanying consolidated balance sheets. We expect the unrealized net gains on these cash flow hedges to be reclassified into earnings within a year. Changes in the timing or amount of the future cash flows being hedged could result in hedges becoming ineffective, and, as a result, the amount of unrealized gain or loss associated with those hedges would be reclassified from other comprehensive income into earnings. At December 31, 2006, the maximum length of time over which we are hedging our exposure to the variability in future cash flows associated with foreign currency forecasted transactions is 12 months. The fair value of these contracts was not material as of December 31, 2006 and December 31, 2005, and was $27 million as of December 31, 2004.

Notional amounts and fair market values. The notional amounts of open forward contracts and option contracts were $489 million at December 31, 2006 and $666 million at December 31, 2005. The notional amounts of our foreign exchange contracts do not generally represent amounts exchanged by the parties and, thus, are not a measure of our exposure or of the cash requirements related to these contracts. The amounts exchanged are calculated by reference to the notional amounts and by other terms of the derivatives, such as exchange rates.

Credit risk
Financial instruments that potentially subject us to concentrations of credit risk are primarily cash equivalents, investments, and trade receivables. It is our practice to place our cash equivalents and investments in high quality securities with various investment institutions. We derive the majority of our revenue from our United States government contracts, primarily for projects in the Middle East, and from sales and services, including engineering and construction, to the energy industry. Within the energy industry, trade receivables are generated from a broad and diverse group of customers. There are concentrations of receivables in the United States and the United Kingdom. We maintain an allowance for losses based upon the expected collectibility of all trade accounts receivable. In addition, see Note 6 for discussion of United States government receivables.
There are no significant concentrations of credit risk with any individual counterparty related to our derivative contracts. We select counterparties based on their profitability, balance sheet, and a capacity for timely payment of financial commitments, which is unlikely to be adversely affected by foreseeable events.
Interest rate risk
We have several debt instruments outstanding that have both fixed and variable interest rates. We manage our ratio of fixed-rate to variable-rate debt through the use of different types of debt instruments and derivative instruments. As of December 31, 2006, we held no material interest rate derivative instruments.
Fair market value of financial instruments. The estimated fair market value of long-term debt was $3.7 billion at December 31, 2006 and $4.2 billion at December 31, 2005, as compared to the carrying amount of $2.8 billion at December 31, 2006 and $3.2 billion at December 31, 2005. The $4.2 billion fair value at December 31, 2005 was previously reported as $2.9 billion. In prior years, we did not consider the fair value of the conversion option in our convertible debentures. The fair market value of fixed-rate long-term debt is based on quoted market prices for those or similar instruments. The carrying amount of variable-rate long-term debt approximates fair market value because these instruments reflect market changes to interest rates. The carrying amount of short-term financial instruments, cash and equivalents, receivables, short-term notes payable, and accounts payable, as reflected in the consolidated balance sheets, approximates fair market value due to the short maturities of these instruments. The currency derivative instruments are carried on the balance sheet at fair value and are based upon third-party quotes.

Note 18. Retirement Plans
Our company and subsidiaries have various plans that cover a significant number of our employees. These plans include defined contribution plans, defined benefit plans, and other postretirement plans:

- our defined contribution plans provide retirement benefits in return for services rendered. These plans provide an individual account for each participant and have terms that specify how contributions to the participant’s account are to be determined rather than the amount of pension benefits the participant is to receive. Contributions to these plans are based on pretax income and/or discretionary amounts determined on an annual basis. Our expense for the defined contribution plans for both continuing and discontinued operations totaled $184 million in 2006, $164 million in 2005, and $147 million in 2004. Additionally, we participate in a Canadian multi-employer plan to which we contributed $7 million, $24 million, and $20 million in 2006, 2005, and 2004, respectively. The decrease in 2006 was attributable to a decrease in the number of employees due to the completion of a major project at the end of 2005;
- our defined benefit plans include both funded and unfunded pension plans, which define an amount of pension benefit to be provided, usually as a function of age, years of service, or compensation; and
- our postretirement medical plans are offered to specific eligible employees. These plans are contributory. For some plans, our liability is limited to a fixed contribution amount for each participant or dependent. The plan participants share the total cost for all benefits provided above our fixed contributions. Participants’ contributions are adjusted as required to cover benefit payments. We have made no commitment to adjust the amount of our contributions; therefore, for these plans the computed accumulated postretirement benefit obligation amount is not affected by the expected future health care cost inflation rate.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158 (SFAS No. 158), "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)." SFAS No. 158 requires an employer to:

- recognize on its balance sheet the funded status (measured as the difference between the fair value of plan assets and the benefit obligation) of pension and other postretirement benefit plans;
- recognize, through comprehensive income, certain changes in the funded status of a defined benefit and postretirement plan in the year in which the changes occur;
- measure plan assets and benefit obligations as of the end of the employer's fiscal year; and
- disclose additional information.

We adopted the requirement to recognize the funded status of a benefit plan and the additional disclosure requirements as of December 31, 2006.

The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end is effective for fiscal years ending after December 15, 2008 and we will adopt these requirements at that time.

Dresser Retiree Medical

Through 2003, we were responsible for the majority of the costs for the Dresser Retiree Medical Plan. An amendment was made to this plan at the end of 2003 to limit our share of the costs and eventually eliminate the plan in 2005. We presented the impact of this amendment in our 2003 notes to consolidated financial statements, which reduced our projected benefit obligation by $86 million and increased our unrecognized prior service benefit by the same amount, with no impact to our balance sheet or statement of operations. In December 2004, the United States District Court ruled that we must continue to maintain the Dresser Retiree Medical Plan as we had in the past. We revised our 2003 presentation of the projected benefit obligation and unrecognized prior service benefit to reflect the plan at its pre-amendment amounts. We also adjusted our annual postretirement benefit expense by $13 million in the fourth quarter of 2004.

Benefit obligation and plan assets

Plan assets, expenses, and obligation for retirement plans in the following tables include both continuing and discontinued operations. We use a September 30 measurement date for our international plans and an October 31 measurement date for our domestic plans.

	Pension Benefits				Other Postretirement Benefits	
Benefit obligation	United States	Int'l	United States	Int'l		
Millions of dollars	2006		2005		2006	2005
Change in benefit obligation						
Benefit obligation at beginning of period	$ 173	$ 3,600	$ 166	$ 3,127	$ 159	$ 175
Service cost	-	73	1	72	1	1
Interest cost	9	184	9	172	9	10
Plan participants' contributions	-	10	-	16	7	9
Effect of business combinations and new plans	-	-	-	1	-	-
Settlements/curtailments	-	-	-	(69)	-	-
Currency fluctuations	-	204	-	(41)	-	-
Actuarial (gain) loss	1	252	8	416	(6)	(19)
Transfers	-	3	-	-	-	-
Other	-	8	-	-	-	-
Benefits paid	(9)	(103)	(11)	(94)	(14)	(17)
Benefit obligation at end of period	$ 174	$ 4,231	$ 173	$ 3,600	$ 156	$ 159
Accumulated benefit obligation at end of period	$ 174	$ 3,583	$ 172	$ 3,014	$ -	$ -

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	Pension Benefits				Other Postretirement Benefits	
	United States	Int'l	United States	Int'l		
Millions of dollars	2006		2005		2006	2005
Change in plan assets						
Fair value of plan assets at beginning of period	$ 133	$ 3,077	$ 125	$ 2,576	$ -	$ -
Actual return on plan assets	17	301	12	541	-	-
Employer contributions	4	186	7	74	7	8
Settlements and transfers	-	-	-	(1)	-	-
Plan participants' contributions	-	10	-	16	7	9
Effect of business combinations and new plans	-	-	-	-	-	-
Currency fluctuations	-	178	-	(35)	-	-
Transfers	-	3	-	-	-	-
Other	-	10	-	-	-	-
Benefits paid	(9)	(103)	(11)	(94)	(14)	(17)
Fair value of plan assets at end of period	$ 145	$ 3,662	$ 133	$ 3,077	$ -	$ -
Funded status	$ (29)	$ (569)	$ (40)	$ (523)	$ (156)	$ (159)
Amounts not yet recognized	-	-	-	-	-	-
Employer contribution	-	27	-	21	1	1
Unrecognized transition asset	-	-	(1)	-	-	-
Unrecognized actuarial loss (gain)	-	-	76	602	-	(7)
Unrecognized prior service benefit	-	-	-	(8)	-	(3)
Purchase accounting adjustment	-	-	-	(78)	-	-
Net amount recognized	$ (29)	$ (542)	$ 35	$ 14	$ (155)	$ (168)

Millions of dollars	Pension Benefits United States 2006	Pension Benefits Int'l 2006	Pension Benefits United States 2005	Pension Benefits Int'l 2005	Other Postretirement Benefits 2006	Other Postretirement Benefits 2005
Amounts recognized on the consolidated balance sheet						
Other assets	$ -	$ 2	$ 37	$ 115	$ -	$ -
Accrued employee compensation and benefits	-	(9)	-	(6)	(13)	(9)
Employee compensation and benefits	(29)	(535)	(77)	(289)	(142)	(159)
Intangible asset	-	-	-	2	-	-
Accumulated other comprehensive income, net of tax	-	-	49	135	-	-
Noncurrent deferred tax asset	-	-	26	57	-	-
Net amount recognized	$ (29)	$ (542)	$ 35	$ 14	$ (155)	$ (168)
Pension plans in which accumulated benefit obligation exceeds plan assets at December 31						
Projected benefit obligation	$ 174	$ 1,767	$ 173	$ 1,997	$ -	$ -
Accumulated benefit obligation	174	1,630	173	1,779	-	-
Fair value of plan assets	145	1,506	133	1,623	-	-
Weighted-average assumptions used to determine benefit obligations at measurement date						
Discount rate	5.75%	2.25-8.75%	5.75%	2.25-8.0%	5.5%	5.75%
Rate of compensation increase	4.5%	2.0-10.0%	4.5%	2.0-5.0%	N/A	N/A
Assumed health care cost trend rates at December 31						
Health care cost trend rate assumed for next year	N/A	N/A	N/A	N/A	10.0%	10.0%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	N/A	N/A	N/A	N/A	5.0%	5.0%
Year that the rate reached the ultimate trend rate	N/A	N/A	N/A	N/A	2011	2008

Asset allocation at December 31

Asset category	Target allocation 2007						
Equity securities	50%-70%	63%	63%	63%	62%	N/A	N/A
Debt securities	30%-50%	36%	35%	36%	30%	N/A	N/A
Other	0%-5%	1%	2%	1%	8%	N/A	N/A
Total	100%	100%	100%	100%	100%	N/A	N/A

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Assumed long-term rates of return on plan assets, discount rates for estimating benefit obligations, and rates of compensation increases vary for the different plans according to the local economic conditions. The weighted average assumptions for the Nigerian and Indonesian plans are not included in the above tables as the plans were immaterial. The discount rate was determined based on the rates of return of high-quality fixed income investments as of the measurement date. For our United Kingdom pension plans, which constitute 95% of our international pension plans' projected benefit obligation, the discount rate was determined by comparing the terms of the plans to the yield curve of a portfolio of high quality debt instruments at the measurement date, and was 5.0% at September 30, 2006. The discount rate for 2005 was based on the annualized yield of the iBoxx AA corporate bonds, and was 5.0% at September 30, 2005.

The overall expected long-term rate of return on assets was determined based upon an evaluation of our plan assets, historical trends, and experience, taking into account current and expected market conditions.

Our investment strategy varies by country depending on the circumstances of the underlying plan. Typically, less mature plan benefit obligations are funded by using more equity securities, as they are expected to achieve long-term growth while exceeding inflation. More mature plan benefit obligations are funded using more fixed income securities, as they are expected to produce current income with limited volatility. Risk management practices include the use of multiple asset classes and investment managers within each asset class for diversification purposes. Specific guidelines for each asset class and investment manager are implemented and monitored.

We reduced our additional minimum pension liability by $72 million in 2005, of which $54 million was recorded as "Other comprehensive income." The additional minimum liability was equal to the excess of the accumulated benefit obligation over plan assets and accrued liabilities. A corresponding amount was recognized as either an intangible asset or a change to accumulated other comprehensive income.

The impact of adopting SFAS No. 158 on our consolidated balance sheet was to increase (decrease) certain accounts, as it relates to pension and other postretirement benefits, as follows:

	December 31, 2006		
Millions of dollars	Before Application of SFAS No. 158	Adjustments	After Application of SFAS No. 158
Noncurrent deferred income taxes	$ 82	$ 146	$ 228
Other assets	335	(333)	2
Employee compensation and benefits	550	157	707
Minority interest in consolidated subsidiaries	(36)	(126)	(162)
Accumulated other comprehensive income	(182)	(218)	(400)

Amounts recognized in accumulated other comprehensive income were as follows:

	Pension Benefits		Other Postretirement Benefits
	United States	Int'l	
Millions of dollars	2006		2006
Net actuarial loss (gain)	$ 38	$ 373	$ (8)
Prior service benefit	-	(1)	(2)
Total recognized in accumulated other comprehensive income	$ 38	$ 372	$ (10)

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Expected cash flows

Contributions. Funding requirements for each plan are determined based on the local laws of the country where such plan resides. In certain countries the funding requirements are mandatory, while in other countries they are discretionary. We currently expect to contribute $80 million to our international pension plans in 2007. For our domestic plans, we expect our contributions to be no more than $4 million in 2007. We do not have a required minimum contribution for our domestic plans; however, we may make additional discretionary contributions, which will be determined after the actuarial valuations are complete.

Benefit payments. The following table presents the expected benefit payments over the next 10 years.

	Pension Benefits		Other Postretirement Benefits	
Millions of dollars	United States	Int'l	Gross Benefit Payments	Gross Medicare Part D Receipts
2007	$ 23	$ 113	$ 13	$ 1
2008	10	113	14	1
2009	10	118	14	1
2010	10	125	15	1
2011	11	129	15	1
Years 2012 - 2016	56	774	72	2

Net periodic cost

	Pension Benefits						Other Postretirement Benefits		
	United States	Int'l	United States	Int'l	United States	Int'l			
Millions of dollars	2006		2005		2004		2006	2005	2004
Components of net periodic benefit cost									
Service cost	$ -	$ 73	$ 1	$ 72	$ 1	$ 92	$ 1	$ 1	$ 1
Interest cost	9	184	9	172	10	155	9	10	11
Expected return on plan assets	(10)	(207)	(10)	(186)	(11)	(173)	-	-	-
Transition amount	-	-	-	-	-	(1)	-	-	-
Amortization of prior service cost	-	(1)	-	-	-	-	(1)	(1)	(1)
Settlements/curtailments	-	1	-	5	1	(2)	-	-	-
Recognized actuarial loss	7	27	4	17	3	16	-	-	1
Net periodic benefit cost	$ 6	$ 77	$ 4	$ 80	$ 4	$ 87	$ 9	$ 10	$ 12
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31									
Discount rate	5.75%	2.25-8.0%	5.75%	2.5-8.0%	6.25%	2.5-9.0%	5.75%	5.75%	6.25%
Expected return on plan assets	8.25%	4.0-7.0%	8.5%	5.0-7.0%	8.5%	5.25-7.5%	N/A	N/A	N/A
Rate of compensation increase	4.5%	2.0-5.0%	4.5%	2.0-5.0%	4.5%	2.0-6.5%	N/A	N/A	N/A

Estimated amounts that will be amortized from accumulated other comprehensive income, net of tax, into net periodic benefit cost in 2007 are as follows:

	Pension Benefits		Other Postretirement
Millions of dollars	United States	International	Benefits
Actuarial (gain) loss	$ 4	$ 20	$ -
Prior service (benefit) cost	-	-	-
Total	$ 4	$ 20	$ -

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The majority of our postretirement benefit plans are not subjected to risk associated with fluctuations in the medical trend rates because the company subsidy is capped. However, for one plan in which the company subsidy is not capped, the assumed health care cost trend rates could have an impact on the amounts reported for the total of such health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	One-Percentage-Point	
Millions of dollars	Increase	(Decrease)
Effect on total of service and interest cost components	$ 0	$ 0
Effect on the postretirement benefit obligation	$ 8	$ (7)

Note 19. Related Companies

We conduct some of our operations through joint ventures that are in partnership, corporate, and other business forms and are principally accounted for using the equity method. Financial information pertaining to related companies for our continuing operations is set out in the following tables. This information includes the total related-company balances and not our proportional interest in those balances.

Combined summarized financial information for all jointly owned operations that are accounted for under the equity method was as follows:

Combined operating results	Years ended December 31		
Millions of dollars	2006	2005	2004
Revenue	$ 4,428	$ 3,230	$ 3,616
Operating income (loss)	$ 252	$ (51)	$ (16)
Net income (loss)	$ 276	$ (33)	$ (35)

Combined financial position	December 31	
Millions of dollars	2006	2005
Current assets	$ 6,174	$ 2,430
Noncurrent assets	3,593	3,262
Total	$ 9,767	$ 5,692
Current liabilities	$ 2,775	$ 2,251
Noncurrent liabilities	6,234	2,902
Shareholders’ equity	758	539
Total	$ 9,767	$ 5,692

The FASB issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51” (FIN 46), in January 2003. In December 2003, the FASB issued FIN 46R, a revision that supersedes the original interpretation. We adopted FIN 46R effective January 1, 2004.

FIN 46R requires the consolidation of entities in which a company absorbs a majority of another entity’s expected losses, receives a majority of the other entity’s expected residual returns, or both, as a result of ownership, contractual, or other financial interests in the other entity. Previously, entities were generally consolidated based upon a controlling financial interest through ownership of a majority voting interest in the entity.

The following details our variable interests in variable interest entities by business segment.

We perform many of our long-term energy-related construction projects through incorporated or unincorporated joint ventures. Typically, these ventures are dissolved upon completion of the project. Many of these ventures are funded by advances from the project owner and, accordingly, require no equity investment by the joint venture partners or shareholders. Occasionally, a venture incurs losses, which then requires funding by the joint venture partners or shareholders in proportion to their interest percentages. The ventures with little or no initial equity investment are considered variable interest entities. Our significant variable interest entities are:

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Energy and Chemicals segment:

- during 2005, we formed a joint venture to engineer and construct a gas monetization facility. KBR owns a 50% equity interest and determined that we are the primary beneficiary of the joint venture which is consolidated for financial reporting purposes. At December 31, 2006 and December 31, 2005, the joint venture had $756 million and $324 million in total assets and $877 million and $311 million in total liabilities, respectively. There are no consolidated assets that collateralize the joint venture's obligations. However, at December 31, 2006 and December 31, 2005, the joint venture had approximately $413 million and $173 million of cash, respectively, which mainly relate to advanced billings in connection with the joint venture's obligations under the EPC contract;
- KBR has equity ownership in three joint ventures to execute EPC projects. KBR's equity ownership ranges from 33% to 50%, and these joint ventures are considered variable interest entities. We are not the primary beneficiary and thus account for these joint ventures using the equity method of accounting. At December 31, 2006 and December 31, 2005, these joint ventures had aggregate assets of $1 billion and $863 million and aggregate liabilities of $1.1 billion and $914 million, respectively. Our aggregate maximum exposure to loss related to these entities was $77 million and $28 million at December 31, 2006 and December 31, 2005 and is comprised of our equity investments in and advances to the joint ventures in addition to our commitment to fund any future losses;
- we have an investment in a development corporation that has an indirect interest in the new Egypt Basic Industries Corporation (EBIC) ammonia plant project located in Egypt. We are performing the engineering, procurement, and construction (EPC) work for the project and operations and maintenance services for the facility. KBR owns 60% of this development company and consolidate it for financial reporting purposes within our Energy and Chemicals segment. The development corporation owns a 25% ownership interest in a company that consolidates the ammonia plant, which is considered a variable interest entity. The development corporation accounts for its investment in the company using the equity method of accounting. The variable interest entity is funded through debt and equity. We are not the primary beneficiary of the variable interest entity. As of December 31, 2006, the variable interest entity had total assets of $347 million and total liabilities of $199 million. Our maximum exposure to loss on our equity investments at December 31, 2006 is limited to our investment of $15 million and our commitment to fund an additional $3 million of stand-by equity. In August 2006, the lenders providing the construction financing notified EBIC that it was in default of the terms of its debt agreement, which effectively prevented the project from making additional borrowings until such time as certain security interests in the ammonia plant assets related to the export facilities, could be perfected. This default was cured on December 8, 2006 subject to submitting the remaining documentation in March 2007. Indebtedness under the agreement is non-recourse to us. No event of default has occurred pursuant to our EPC contract and we have been paid all amounts due from EBIC. In September 2006, we were instructed by EBIC to cease work on one location of the project on which the ammonia storage tanks were originally planned to be constructed due to a decision to relocate the tanks. The new location has been selected and the client and its lenders have agreed to compensate KBR for approximately $6 million in costs resulting from the relocation of the storage tanks. We resumed work on the ammonia tanks in February 2007; and
- in July 2006, KBR was awarded, through a 50%-owned joint venture, a contract with Qatar Shell GTL Limited to provide project management and cost-reimbursable engineering, procurement, and construction management services for the Pearl GTL project in Ras Laffan, Qatar. The project, which is expected to be completed by 2011, consists of gas production facilities and a GTL plant. The joint venture is considered a variable interest entity. We consolidate the joint venture for financial reporting purposes within our Energy and Chemicals segment because we are the primary beneficiary. As of December 31, 2006, the Pearl joint venture had total assets of $66 million and total liabilities of $56 million.

Government and Infrastructure segment:

- during 2001, we formed a joint venture, in which KBR owns a 50% equity interest with an unrelated partner, that owns and operates heavy equipment transport vehicles in the United Kingdom. This variable interest entity was formed to construct, operate, and service certain assets for a third party, and was funded with third party debt. The construction of the assets was completed in the second quarter of 2004, and the operating and service contract related to the assets extends through 2023. The proceeds from the debt financing were used to construct the assets and will be paid down with cash flow generated during the operation and service phase of the contract. As of December 31, 2006 and December 31, 2005, the joint venture had total assets of $161 million and $149 million and total liabilities of $147 million and $154 million, respectively. Our aggregate maximum exposure to loss as a result of our involvement with this joint venture is limited to our equity investment which was zero at December 31, 2006 and any future losses related to the operation of the assets. We are not the primary beneficiary. The joint venture is accounted for using the equity method of accounting;
- KBR are involved in four privately financed projects, executed through joint ventures, to design, build, operate, and maintain roadways for certain government agencies in the United Kingdom. KBR has a 25% ownership interest in these joint ventures and account for them using the equity method of accounting. The joint ventures have obtained financing through third parties that is not guaranteed by us. These joint ventures are considered variable interest entities; however, we are not the primary beneficiary of these joint ventures and, therefore, account for them using the equity method of accounting. As of December 31, 2006, these joint ventures had total assets of $2.2 billion and total liabilities of $2.1 billion. As of December 31, 2005, these joint ventures had total assets of $1.9 billion and total liabilities of $1.9 billion. Our maximum exposure to loss was $24 million at December 31, 2006. With respect to one of these roadways, we received a revised financial forecast during the second quarter of 2006, which takes into account sustained projected losses due to lower than anticipated long vehicle traffic and higher than forecasted lane availability deductions, which reduce project revenue. Because of this new information, we recorded an impairment charge of $10 million during the second quarter of 2006 in our equity investment in this roadway. As of December 31, 2006, our investment in this joint venture and the related company that performed the construction of the road was zero. In addition, at December 31, 2006, we had no additional funding commitments;
- we participate in a privately financed project formed for operating and maintaining a railroad freight business in Australia. KBR owns 36.7% of the joint venture and operating company and we account for these investments using the equity method of accounting. These joint ventures are funded through senior and subordinated debt and equity contributions from the joint ventures' partners. This joint venture has sustained losses since commencing operations due to lower than anticipated freight volume and a slowdown in the planned expansion of the Port of Darwin. At the end of the first quarter of 2006, the joint venture's revised financial forecast led us to record a $26 million impairment charge. In October 2006, the joint venture incurred an event of default under its loan agreement by failing to make an interest and principal payment. These loans are non-recourse to us. In light of the default, the joint venture's need for additional financing, and the realization that the joint venture efforts to raise additional equity from third parties were not successful, we recorded an additional $32 million impairment charge in the third quarter of 2006. We will receive no tax benefit as this impairment charge is not deductible for Australian tax purposes. In December 2006, the senior lenders agreed to waive existing defaults and concede certain rights under the existing indenture. Among these were a reduction in the joint venture's debt service reserve and the relinquishment of the right to receive principal payments for 27 months, through March 2009. In exchange for these concessions, the shareholders of the joint

venture committed approximately $12 million of new subordinated financing, of which $6 million was committed by us. These joint ventures are considered variable interest entities; however, we are not the primary beneficiary of the joint ventures. As of December 31, 2006 and December 31, 2005, the joint venture had total assets of $874 million and $796 million and total liabilities of $790 million and $672 million, respectively. At December 31, 2006, our maximum exposure to loss totaling $12 million is limited to our equity investments, senior operating notes, and equity owner notes;

- we participate in a privately financed project executed through certain joint ventures formed to design, build, operate, and maintain a viaduct and several bridges in southern Ireland. The joint ventures were funded through debt and were formed with minimal equity. These joint ventures are considered variable interest entities; however, we are not the primary beneficiary of the joint ventures. KBR has up to a 25% ownership interest in the project’s joint ventures, and we are accounting for this interest using the equity method of accounting. As of December 31, 2006 and December 31, 2005, the joint ventures had total assets of $301 million and $240 million and total liabilities of $293 million and $227 million, respectively. Our maximum exposure to loss was $8 million at December 31, 2006, and our share of any future losses resulting from the project. In addition, at December 31, 2006, we had remaining funding commitments of approximately $4 million; and
- in April 2006, Aspire Defence, a joint venture between us, Mowlem Plc. and a financial investor, was awarded a privately financed project contract, the Allenby & Connaught project, by the MoD to upgrade and provide a range of services to the British Army’s garrisons at Aldershot and around Salisbury Plain in the United Kingdom. In addition to a package of ongoing services to be delivered over 35 years, the project includes a nine-year construction program to improve soldiers’ single living, technical and administrative accommodations, along with leisure and recreational facilities. Aspire Defence will manage the existing properties and will be responsible for design, refurbishment, construction and integration of new and modernized facilities. KBR indirectly owns a 45% interest in Aspire Defence, the project company that is the holder of the 35-year concession contract. In addition, KBR owns a 50% interest in each of two joint ventures that provide the construction and the related support services to Aspire Defence. KBR’s performance through the construction phase is supported by $159 million in letters of credit and surety bonds totaling approximately $209 million as of December 31, 2006, both of which have been guaranteed by us. Furthermore, our financial and performance guarantees are joint and several, subject to certain limitations, with our joint venture partners. The project is funded through equity and subordinated debt provided by the project sponsors and the issuance of publicly held senior bonds. The entities we hold an interest in are considered variable interest entities; however, we are not the primary beneficiary of these entities. We account for our interests in each of the entities using the equity method of accounting. As of December 31, 2006, the aggregate total assets and total liabilities of the variable interest entities were $3.2 billion and $3.3 billion, respectively. Our maximum exposure to project company losses as of December 31, 2006 was $59 million. Our maximum exposure to construction and operating joint venture losses is limited to the funding of any future losses incurred by those entities.

Note 20. Reorganization of Business Operations

Effective October 1, 2004, we restructured KBR into two segments, Government and Infrastructure and Energy and Chemicals. In 2004, we recorded restructuring and related costs of $40 million related to the reorganization. The total restructuring charges consisted of $31 million in personnel termination benefits and $9 million in impairment charges on technology-related assets. For the year ended December 31, 2004, $32 million of the restructuring charge was included in “Cost of services” and $8 million was included in “General and administrative” on the consolidated statements of operations. As of December 31, 2005, all amounts related to the 2004 restructuring had been paid and the balance in the restructuring reserve account had been reduced to zero.

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Note 21. New Accounting Standards

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109." This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The interpretation prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We did not elect early adoption of this interpretation and adopted the provisions of FIN 48 beginning January 1, 2007. We have completed an initial evaluation of the impact of the January 1, 2007, adoption of FIN 48 and determined that such adoption is not expected to have a significant impact on our financial position or results from operations. We expect that any adjustment to reduce beginning-of-year retained earnings will not exceed $40 million.

During September 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108), "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statement". SAB 108 provides guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. This interpretation was effective for the first fiscal year ending after November 15, 2006. The adoption of this interpretation did not have an impact on our financial position or results of operations.

HALLIBURTON COMPANY

Selected Financial Data (1)

(Unaudited)

Millions of dollars and shares except per share and employee data	Years ended December 31				
	2006	2005	2004	2003	2002
Total revenue	$ 22,576	$ 20,240	$ 19,878	$ 15,797	$ 11,956
Total operating income (loss)	$ 3,484	$ 2,617	$ 820	$ 705	$ (137)
Nonoperating expense, net	(35)	(170)	(186)	(108)	(116)
Income (loss) from continuing operations before income taxes and minority interest	3,449	2,447	634	597	(253)
Provision for income taxes	(1,144)	(64)	(235)	(229)	(70)
Minority interest in net income of consolidated subsidiaries	(33)	(56)	(25)	(39)	(38)
Income (loss) from continuing operations	$ 2,272	$ 2,327	$ 374	$ 329	$ (361)
Income (loss) from discontinued operations	$ 76	$ 31	$ (1,353)	$ (1,141)	$ (637)
Net income (loss)	$ 2,348	$ 2,358	$ (979)	$ (820)	$ (998)
Basic income (loss) per share:					
Continuing operations	$ 2.24	$ 2.31	$ 0.43	$ 0.38	$ (0.42)
Net income (loss)	2.31	2.34	(1.12)	(0.95)	(1.16)
Diluted income (loss) per share:					
Continuing operations	2.16	2.24	0.42	0.38	(0.42)
Net income (loss)	2.23	2.27	(1.11)	(0.94)	(1.16)
Cash dividends per share	0.30	0.25	0.25	0.25	0.25
Return on average shareholders' equity	34.16%	45.76%	(30.22)%	(26.86)%	(24.02)%
Financial position:					
Net working capital	$ 6,456	$ 4,959	$ 2,898	$ 1,355	$ 2,288
Total assets	16,820	15,048	15,864	15,556	12,844
Property, plant, and equipment, net	3,048	2,648	2,545	2,518	2,619
Long-term debt (including current maturities)	2,831	3,174	3,940	3,437	1,476
Shareholders' equity	7,376	6,372	3,932	2,547	3,558
Total capitalization	10,208	9,568	7,887	6,002	5,083
Basic weighted average common shares outstanding	1,014	1,010	874	868	864
Diluted weighted average common shares outstanding	1,054	1,038	882	874	864
Other financial data:					
Capital expenditures	$ (891)	$ (651)	$ (575)	$ (515)	$ (764)
Long-term borrowings (repayments), net	(341)	(799)	476	1,896	(15)
Depreciation, depletion, and					

amortization expense	527	504	509	518	505
Payroll and employee benefits	(6,172)	(5,536)	(5,311)	(4,912)	(4,624)
Number of employees	104,000	100,000	94,000	99,000	82,000

(1) All periods presented reflect the reclassification of KBR's Production Services operations to discontinued operations, as well as the two-for-one common stock split, effected in the form of a stock dividend.

HALLIBURTON COMPANY
Quarterly Data and Market Price Information (1)
(Unaudited)

Millions of dollars except per share data	Quarter First	Second	Third	Fourth	Year
2006					
Revenue	$ 5,184	$ 5,545	$ 5,831	$ 6,016	$ 22,576
Operating income	755	718	968	1,043	3,484
Income from continuing operations	481	509	615	667	2,272
Income (loss) from discontinued operations	7	82	(4)	(9)	76
Net income	488	591	611	658	2,348
Earnings per share:					
Basic income (loss) per share:					
Income from continuing operations	0.47	0.50	0.61	0.67	2.24
Income (loss) from discontinued operations	0.01	0.08	-	(0.01)	0.07
Net income	0.48	0.58	0.61	0.66	2.31
Diluted income (loss) per share:					
Income from continuing operations	0.45	0.48	0.58	0.65	2.16
Income (loss) from discontinued operations	0.01	0.07	-	(0.01)	0.07
Net income	0.46	0.55	0.58	0.64	2.23
Cash dividends paid per share	0.075	0.075	0.075	0.075	0.30
Common stock prices (2)					
High	41.19	41.99	37.93	34.30	41.99
Low	31.35	33.92	27.35	26.33	26.33
2005					
Revenue	$ 4,783	$ 4,973	$ 4,912	$ 5,572	$ 20,240
Operating income	575	596	680	766	2,617
Income from continuing operations	359	384	492	1,092	2,327
Income from discontinued operations	6	8	7	10	31
Net income	365	392	499	1,102	2,358
Earnings per share:					
Basic income per share:					
Income from continuing operations	0.36	0.38	0.49	1.07	2.31
Income from discontinued operations	0.01	0.01	0.01	0.01	0.03
Net income	0.37	0.39	0.50	1.08	2.34
Diluted income per share:					
Income from continuing operations	0.36	0.37	0.47	1.03	2.24
Income from discontinued operations	-	0.01	0.01	0.01	0.03
Net income	0.36	0.38	0.48	1.04	2.27
Cash dividends paid per share	0.0625	0.0625	0.0625	0.0625	0.25
Common stock prices (2)					
High	22.65	24.70	34.89	34.69	34.89

Low	18.59	19.83	22.88	27.35	18.59

(1) All periods presented reflect the reclassification of KBR's Production Services operations to discontinued operations, as well as the two-for-one common stock split, effected in the form of a stock dividend.

(2) New York Stock Exchange - composite transactions high and low intraday price.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The information required for the directors of the Registrant is incorporated by reference to the Halliburton Company Proxy Statement for our 2007 Annual Meeting of Stockholders (File No. 1-3492), under the caption "Election of Directors." The information required for the executive officers of the Registrant is included under Part I on pages 12 and 13 of this annual report. The information required for a delinquent form required under Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference to the Halliburton Company Proxy Statement for our 2007 Annual Meeting of Stockholders (File No. 1-3492), under the caption "Section 16(a) Beneficial Ownership Reporting Compliance." The information for our code of ethics is incorporated by reference to the Halliburton Company Proxy Statement for our 2007 Annual Meeting of Stockholders (File No. 1-3492), under the caption "Corporate Governance."

Audit Committee financial experts

In the business judgment of the Board of Directors, all five members of the Audit Committee, Alan M. Bennett, Robert L. Crandall, J. Landis Martin, Jay A. Precourt, and Debra L. Reed are independent and have accounting or related financial management experience required under the listing standards and have been designated by the Board of Directors as "audit committee financial experts."

Item 11. Executive Compensation.

This information is incorporated by reference to the Halliburton Company Proxy Statement for our 2007 Annual Meeting of Stockholders (File No. 1-3492) under the captions "Compensation Discussion and Analysis," "Compensation Committee Report," "Summary Compensation Table," "Grants of Plan-Based Awards in Fiscal 2006," "Outstanding Equity Awards at Fiscal Year End (2006)," "2006 Option Exercises and Stock Vested," "2006 Nonqualified Deferred Compensation," "Pension Benefits Table," "Employment Contracts and Change-in-Control Arrangements," "Post-Termination Payments," "Equity Compensation Plan Information," and "Directors' Compensation."

Item 12(a). Security Ownership of Certain Beneficial Owners.

This information is incorporated by reference to the Halliburton Company Proxy Statement for our 2007 Annual Meeting of Stockholders (File No. 1-3492) under the caption "Stock Ownership of Certain Beneficial Owners and Management."

Item 12(b). Security Ownership of Management.

This information is incorporated by reference to the Halliburton Company Proxy Statement for our 2007 Annual Meeting of Stockholders (File No. 1-3492) under the caption "Stock Ownership of Certain Beneficial Owners and Management."

Item 12(c). Changes in Control.

Not applicable.

Item 12(d). Securities Authorized for Issuance Under Equity Compensation Plans.

This information is incorporated by reference to the Halliburton Company Proxy Statement for our 2007 Annual Meeting of Stockholders (File No. 1-3492) under the caption "Equity Compensation Plan Information."

Item 13. Certain Relationships and Related Transactions, and Director Independence.

This information is incorporated by reference to the Halliburton Company Proxy Statement for our 2007 Annual Meeting of Stockholders (File No. 1-3492) under the caption "Certain Relationships and Related Transactions" to the extent any disclosure is required.

Item 14. Principal Accounting Fees and Services.

This information is incorporated by reference to the Halliburton Company Proxy Statement for our 2007 Annual Meeting of Stockholders (File No. 1-3492) under the caption "Fees Paid to KPMG LLP."

PART IV

Item 15. Exhibits and Financial Statement Schedules.

1. Financial Statements:

The reports of the Independent Registered Public Accounting Firm and the financial statements of the Company as required by Part II, Item 8, are included on pages 70 and 71 and pages 72 through 126 of this annual report. See index on page (i).

2. Financial Statement Schedules:	Page No.
Report on supplemental schedule of KPMG LLP	138
Schedule II - Valuation and qualifying accounts for the three years ended December 31, 2006	139

Note: All schedules not filed with this report required by Regulation S-X have been omitted as not applicable or not required, or the information required has been included in the notes to financial statements.

3. Exhibits:

Exhibit Number	Exhibits

3.1 Restated Certificate of Incorporation of Halliburton Company filed with the Secretary of State of Delaware on May 30, 2006 (incorporated by reference to Exhibit 3.1 to Halliburton’s Form 8-K filed June 5, 2006, File No. 1-3492).

3.2 By-laws of Halliburton revised effective October 19, 2006 (incorporated by reference to Exhibit 3.1 to Halliburton’s Form 8-K filed October 19, 2006, File No. 1-3492).

4.1 Form of debt security of 8.75% Debentures due February 12, 2021 (incorporated by reference to Exhibit 4(a) to the Form 8-K of Halliburton Company, now known as Halliburton Energy Services, Inc. (the Predecessor) dated as of February 20, 1991, File No. 1-3492).

4.2 Senior Indenture dated as of January 2, 1991 between the Predecessor and Texas Commerce Bank National Association, as Trustee (incorporated by reference to Exhibit 4(b) to the Predecessor’s Registration Statement on Form S-3 (Registration No. 33-38394) originally filed with the Securities and Exchange Commission on December 21, 1990), as supplemented and amended by the First Supplemental Indenture dated as of December 12, 1996 among the Predecessor, Halliburton and the Trustee (incorporated by reference to Exhibit 4.1 of Halliburton’s Registration Statement on Form 8-B dated December 12, 1996, File No. 1-3492).

4.3 Resolutions of the Predecessor’s Board of Directors adopted at a meeting held on February 11, 1991 and of the special pricing committee of the Board of Directors of the Predecessor adopted at a meeting held on February 11, 1991 and the special pricing committee’s consent in lieu of meeting dated February 12, 1991 (incorporated by reference to Exhibit 4(c) to the Predecessor’s Form 8-K dated as of February 20, 1991, File No. 1-3492).

4.4 Second Senior Indenture dated as of December 1, 1996 between the Predecessor and Texas Commerce Bank National Association, as Trustee, as supplemented and amended by the First Supplemental Indenture dated as of December 5, 1996 between the Predecessor and the Trustee and the Second Supplemental Indenture dated as of December 12, 1996 among the Predecessor, Halliburton and the Trustee (incorporated by reference to Exhibit 4.2 of Halliburton's Registration Statement on Form 8-B dated December 12, 1996, File No. 1-3492).

4.5 Third Supplemental Indenture dated as of August 1, 1997 between Halliburton and Texas Commerce Bank National Association, as Trustee, to the Second Senior Indenture dated as of December 1, 1996 (incorporated by reference to Exhibit 4.7 to Halliburton's Form 10-K for the year ended December 31, 1998, File No. 1-3492).

4.6 Fourth Supplemental Indenture dated as of September 29, 1998 between Halliburton and Chase Bank of Texas, National Association (formerly Texas Commerce Bank National Association), as Trustee, to the Second Senior Indenture dated as of December 1, 1996 (incorporated by reference to Exhibit 4.8 to Halliburton's Form 10-K for the year ended December 31, 1998, File No. 1-3492).

4.7 Resolutions of Halliburton's Board of Directors adopted by unanimous consent dated December 5, 1996 (incorporated by reference to Exhibit 4(g) of Halliburton's Form 10-K for the year ended December 31, 1996, File No. 1-3492).

4.8 Form of debt security of 6.75% Notes due February 1, 2027 (incorporated by reference to Exhibit 4.1 to Halliburton's Form 8-K dated as of February 11, 1997, File No. 1-3492).

4.9 Resolutions of Halliburton's Board of Directors adopted at a special meeting held on September 28, 1998 (incorporated by reference to Exhibit 4.10 to Halliburton's Form 10-K for the year ended December 31, 1998, File No. 1-3492).

4.10 Copies of instruments that define the rights of holders of miscellaneous long-term notes of Halliburton and its subsidiaries, totaling $9 million in the aggregate at December 31, 2006, have not been filed with the Commission. Halliburton agrees to furnish copies of these instruments upon request.

4.11 Form of debt security of 7.53% Notes due May 12, 2017 (incorporated by reference to Exhibit 4.4 to Halliburton's Form 10-Q for the quarter ended March 31, 1997, File No. 1-3492).

4.12 Form of debt security of 5.63% Notes due December 1, 2008 (incorporated by reference to Exhibit 4.1 to Halliburton's Form 8-K dated as of November 24, 1998, File No. 1-3492).

4.13 Form of Indenture, between Dresser and Texas Commerce Bank National Association, as Trustee, for 7.60% Debentures due 2096 (incorporated by reference to Exhibit 4 to the Registration Statement on Form S-3 filed by Dresser as amended, Registration No. 333-01303), as supplemented and amended by Form of Supplemental Indenture, between Dresser and Texas Commerce Bank National Association, Trustee, for 7.60% Debentures due 2096 (incorporated by reference to Exhibit 4.1 to Dresser's Form 8-K filed on August 9, 1996, File No. 1-4003).

4.14 Second Supplemental Indenture dated as of October 27, 2003 between DII Industries, LLC and JPMorgan Chase Bank, as Trustee, to the Indenture dated as of April 18, 1996, as supplemented by the First Supplemental Indenture dated as of August 6, 1996 (incorporated by reference to Exhibit 4.15 to Halliburton's Form 10-K for the year ended December 31, 2003, File No. 1-3492).

4.15 Third Supplemental Indenture dated as of December 12, 2003 among DII Industries, LLC, Halliburton and JPMorgan Chase Bank, as Trustee, to the Indenture dated as of April 18, 1996, as supplemented by the First Supplemental Indenture dated as of August 6, 1996 and the Second Supplemental Indenture dated as of October 27, 2003 (incorporated by reference to Exhibit 4.16 to Halliburton's Form 10-K for the year ended December 31, 2003, File No. 1-3492).

4.16 Credit Facility in the amount of £80 million dated November 29, 2002 between Devonport Royal Dockyard Limited and Devonport Management Limited and The Governor and Company of the Bank of Scotland, HSBC Bank Plc and The Royal Bank of Scotland Plc (incorporated by reference to Exhibit 4.22 to Halliburton's Form 10-K for the year ended December 31, 2002, File No. 1-3492).

4.17 Senior Indenture dated as of June 30, 2003 between Halliburton and JPMorgan Chase Bank, as Trustee (incorporated by reference to Exhibit 4.1 to Halliburton's Form 10-Q for the quarter ended June 30, 2003, File No. 1-3492).

4.18 Form of note of 3.125% Convertible Senior Notes due July 15, 2023 (included as Exhibit A to Exhibit 4.17 above).

4.19 First Supplemental Indenture dated as of December 17, 2004 between Halliburton and JPMorgan Chase Bank, National Association (formerly JPMorgan Chase Bank), as trustee, to Indenture dated as of June 30, 2003, between Halliburton and JPMorgan Chase Bank, National Association (formerly JPMorgan Chase Bank), as trustee (incorporated by reference to Exhibit 4.1 to Halliburton's Form 8-K filed on December 21, 2004, File No. 1-3492).

4.20 Senior Indenture dated as of October 17, 2003 between Halliburton and JPMorgan Chase Bank, as Trustee (incorporated by reference to Exhibit 4.1 to Halliburton's Form 10-Q for the quarter ended September 30, 2003, File No. 1-3492).

4.21 First Supplemental Indenture dated as of October 17, 2003 between Halliburton and JPMorgan Chase Bank, as Trustee, to the Senior Indenture dated as of October 17, 2003 (incorporated by reference to Exhibit 4.2 to Halliburton's Form 10-Q for the quarter ended September 30, 2003, File No. 1-3492).

4.22 Form of note of 5.5% senior notes due October 15, 2010 (included as Exhibit B to Exhibit 4.21 above).

4.23 Second Supplemental Indenture dated as of December 15, 2003 between Halliburton and JPMorgan Chase Bank, as Trustee, to the Senior Indenture dated as of October 17, 2003, as supplemented by the First Supplemental Indenture dated as of October 17, 2003 (incorporated by reference to Exhibit 4.27 to Halliburton's Form 10-K for the year ended December 31, 2003, File No. 1-3492).

4.24 Form of note of 7.6% debentures due 2096 (included as Exhibit A to Exhibit 4.23 above).

4.25 Stockholder Agreement between Halliburton and the DII Industries, LLC Asbestos PI Trust dated January 20, 2005 (incorporated by reference to Exhibit 10.1 to Halliburton's Form 8-K filed January 25, 2005, File No. 1-3492).

4.26 Amendment to Stockholder Agreement dated March 17, 2005 between Halliburton Company and DII Industries, LLC Asbestos PI Trust (incorporated by reference to Exhibit 10.1 to Halliburton's Form 8-K filed March 18, 2005, File No. 1-3492).

10.1 Halliburton Company Career Executive Incentive Stock Plan as amended November 15, 1990 (incorporated by reference to Exhibit 10(a) to the Predecessor's Form 10-K for the year ended December 31, 1992, File No. 1-3492).

10.2 Retirement Plan for the Directors of Halliburton Company, as amended and restated effective May 16, 2000 (incorporated by reference to Exhibit 10.2 to Halliburton's Form 10-Q for the quarter ended September 30, 2000, File No. 1-3492).

10.3 Halliburton Company 1993 Stock and Incentive Plan, as amended and restated effective February 16, 2006 (incorporated by reference to Exhibit 10.3 to Halliburton's Form 10-K for the year ended December 31, 2005, File No. 1-3492).

10.4 Halliburton Company Restricted Stock Plan for Non-Employee Directors (incorporated by reference to Appendix B of the Predecessor's proxy statement dated March 23, 1993, File No. 1-3492).

10.5 Dresser Industries, Inc. Deferred Compensation Plan, as amended and restated effective January 1, 2000 (incorporated by reference to Exhibit 10.16 to Halliburton's Form 10-K for the year ended December 31, 2000, File No. 1-3492).

10.6 ERISA Excess Benefit Plan for Dresser Industries, Inc., as amended and restated effective June 1, 1995 (incorporated by reference to Exhibit 10.7 to Dresser's Form 10-K for the year ended October 31, 1995, File No. 1-4003).

10.7 ERISA Compensation Limit Benefit Plan for Dresser Industries, Inc., as amended and restated effective June 1, 1995 (incorporated by reference to Exhibit 10.8 to Dresser's Form 10-K for the year ended October 31, 1995, File No. 1-4003).

10.8 Supplemental Executive Retirement Plan of Dresser Industries, Inc., as amended and restated effective January 1, 1998 (incorporated by reference to Exhibit 10.9 to Dresser's Form 10-K for the year ended October 31, 1997, File No. 1-4003).

10.9 Amendment No. 1 to the Supplemental Executive Retirement Plan of Dresser Industries, Inc. (incorporated by reference to Exhibit 10.1 to Dresser's Form 10-Q for the quarter ended April 30, 1998, File No. 1-4003).

10.10 Dresser Industries, Inc. 1992 Stock Compensation Plan (incorporated by reference to Exhibit A to Dresser's Proxy Statement dated February 7, 1992, File No. 1-4003).

10.11 Amendments No. 1 and 2 to Dresser Industries, Inc. 1992 Stock Compensation Plan (incorporated by reference to Exhibit A to Dresser's Proxy Statement dated February 6, 1995, File No. 1-4003).

10.12 Amendment No. 3 to the Dresser Industries, Inc. 1992 Stock Compensation Plan (incorporated by reference to Exhibit 10.25 to Dresser's Form 10-K for the year ended October 31, 1997, File No. 1-4003).

10.13 Employment Agreement (David J. Lesar) (incorporated by reference to Exhibit 10(n) to the Predecessor's Form 10-K for the year ended December 31, 1995, File No. 1-3492).

10.14 Employment Agreement (Mark A. McCollum) (incorporated by reference to Exhibit 10.1 to Halliburton's Form 10-Q for the quarter ended September 30, 2003, File No. 1-3492).

10.15 Halliburton Company Benefit Restoration Plan, as amended and restated effective January 1, 2004 (incorporated by reference to Exhibit 10.2 to Halliburton's Form 10-Q for the quarter ended September 30, 2004, File No. 1-3492).

10.16 Halliburton Annual Performance Pay Plan, as amended and restated effective January 26, 2006 (incorporated by reference to Exhibit 10.17 to Halliburton's Form 10-K for the year ended December 31, 2005, File No. 1-3492).

10.17 Halliburton Company Performance Unit Program (incorporated by reference to Exhibit 10.2 to Halliburton's Form 10-Q for the quarter ended September 30, 2001, File No. 1-3492).

10.18 Form of Nonstatutory Stock Option Agreement for Non-Employee Directors (incorporated by reference to Exhibit 10.3 to Halliburton's Form 10-Q for the quarter ended September 30, 2000, File No. 1-3492).

10.19 Halliburton Elective Deferral Plan as amended and restated effective May 1, 2002 (incorporated by reference to Exhibit 10.1 to Halliburton's Form 10-Q for the quarter ended June 30, 2002, File No. 1-3492).

10.20 Halliburton Company 2002 Employee Stock Purchase Plan, as amended and restated May 17, 2005 (incorporated by reference to Exhibit 10.21 to Halliburton's Form 10-K for the year ended December 31, 2005, File No. 1-3492).

10.21 Halliburton Company Directors' Deferred Compensation Plan as amended and restated effective as of October 22, 2002 (incorporated by reference to Exhibit 10.1 to Halliburton's Form 10-Q for the quarter ended September 30, 2002, File No. 1-3492).

10.22 Employment Agreement (Albert O. Cornelison) (incorporated by reference to Exhibit 10.3 to Halliburton's Form 10-Q for the quarter ended June 30, 2002, File No. 1-3492).

10.23 Employment Agreement (David R. Smith) (incorporated by reference to Exhibit 10.39 to Halliburton's Form 10-K for the year ended December 31, 2002, File No. 1-3492).

10.24 Employment Agreement (C. Christopher Gaut) (incorporated by reference to Exhibit 10.1 to Halliburton's Form 10-Q for the quarter ended March 31, 2003, File No. 1-3492).

10.25 Employment Agreement (Andrew R. Lane) (incorporated by reference to Exhibit 10.3 to Halliburton's Form 10-Q for the quarter ended September 30, 2004, File No. 1-3492).

10.26 Five Year Revolving Credit Agreement dated as of March 10, 2005, among Halliburton, as Borrower, the Banks and the Issuing Banks party thereto, Citicorp North America, Inc. ("CNAI"), as Paying Agent, and CNAI and JPMorgan Chase Bank, N.A., as Co-Administrative Agents (incorporated by reference to Exhibit 10.1 to Halliburton's Form 8-K filed March 10, 2005, File No. 1-3492).

10.27 Underwriting Agreement dated March 17, 2005 among Halliburton Company, DII Industries, LLC Asbestos PI Trust, J.P. Morgan Securities Inc., Goldman, Sachs & Co., and Citigroup Global Markets Inc. (incorporated by reference to Exhibit 10.2 to Halliburton's Form 8-K filed March 18, 2005, File No. 1-3492).

10.28 Halliburton Company Supplemental Executive Retirement Plan as amended and restated effective December 7, 2005 (incorporated by reference to Exhibit 10.29 to Halliburton's Form 10-K for the year ended December 31, 2005, File No. 1-3492).

10.29 Master Separation Agreement between Halliburton Company and KBR, Inc. dated as of November 20, 2006 (incorporated by reference to Exhibit 10.1 to Halliburton's Form 8-K filed November 27, 2006, File No. 1-3492).

10.30 Tax Sharing Agreement, dated as of January 1 , 2006, by and between Halliburton Company, KBR Holdings LLC, and KBR, Inc. (incorporated by reference to Exhibit 10.2 to Halliburton's Form 8-K filed November 27, 2006, File No. 1-3492).

* 10.31 Employment Agreement (William P. Utt).

* 12 Statement of Computation of Ratio of Earnings to Fixed Charges.

* 21 Subsidiaries of the Registrant.

* 23.1 Consent of KPMG LLP.

* 24.1 Powers of attorney for the following directors signed in January 2007:

Alan M. Bennett
James R. Boyd
Milton Carroll
Robert L. Crandall
Kenneth T. Derr
S. Malcolm Gillis
W. R. Howell
Ray L. Hunt
J. Landis Martin
Jay A. Precourt
Debra L. Reed

* 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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*	31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
**	32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
**	32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed with this Form 10-K.
** Furnished with this Form 10-K.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON SUPPLEMENTAL SCHEDULE**

The Board of Directors and Shareholders
Halliburton Company:

Under date of February 26, 2007, we reported on the consolidated balance sheets of Halliburton Company and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006, which are included in the Company's Annual Report on Form 10-K. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related consolidated financial statement schedule (Schedule II) included in the Company's Annual Report on Form 10-K. The financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this consolidated financial statement schedule based on our audits.

In our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Notes 1 and 18, respectively, to the consolidated financial statements, the Company changed its method of accounting for stock-based compensation plans as of January 1, 2006, and its method of accounting for defined benefit and other postretirement plans as of December 31, 2006.

/s/ KPMG LLP
Houston, Texas
February 26, 2007

HALLIBURTON COMPANY
Schedule II - Valuation and Qualifying Accounts
(Millions of Dollars)

The table below presents valuation and qualifying accounts for continuing operations.

Descriptions	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Other Accounts	Deductions	Balance at End of Period
Year ended December 31, 2004:					
Deducted from accounts and notes receivable:					
Allowance for bad debts	$ 175	$ 22	$ 2	$ (72) (a)	$ 127
Accrued reorganization charges	$ 1	$ 40	$ -	$ (22)	$ 19
Reserve for disputed and unallowable costs					
incurred under government contracts	$ 48	$ -	$ 83 (b)	$ -	$ 131
Year ended December 31, 2005:					
Deducted from accounts and notes receivable:					
Allowance for bad debts	$ 127	$ 64	$ -	$ (101) (a)	$ 90
Accrued reorganization charges	$ 19	$ -	$ -	$ (19)	$ -
Reserve for disputed and unallowable costs					
incurred under government contracts	$ 131	$ -	$ 11 (b)	$ (9)	$ 133
Year ended December 31, 2006:					
Deducted from accounts and notes receivable:					
Allowance for bad debts	$ 90	$ 104	$ 2	$ (99) (a)	$ 97
Reserve for disputed and unallowable costs					
incurred under government contracts	$ 133	$ -	$ 51 (b)	$ (107)	$ 77

(a) Receivable write-offs, net of recoveries, and reclassifications.
(b) Reserves have been recorded as reductions of revenue, net of reserves no longer required.

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SIGNATURES

As required by Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has authorized this report to be signed on its behalf by the undersigned authorized individuals on this 27th day of February, 2007.

HALLIBURTON COMPANY

By /s/ David J. Lesar
David J. Lesar
Chairman of the Board,
President, and Chief Executive Officer

As required by the Securities Exchange Act of 1934, this report has been signed below by the following persons in the capacities indicated on this 27th day of February, 2007.

Signature	Title
/s/ David J. Lesar David J. Lesar	Chairman of the Board, President, Chief Executive Officer, and Director
/s/ C. Christopher Gaut C. Christopher Gaut	Executive Vice President and Chief Financial Officer
/s/ Mark A. McCollum Mark A. McCollum	Senior Vice President and Chief Accounting Officer

Signature	Title
* Alan M. Bennett Alan M. Bennett	Director
* James R. Boyd James R. Boyd	Director
* Milton Carroll Milton Carroll	Director
* Robert L. Crandall Robert L. Crandall	Director
* Kenneth T. Derr Kenneth T. Derr	Director
* S. Malcolm Gillis S. Malcolm Gillis	Director
* W. R. Howell W. R. Howell	Director
* Ray L. Hunt Ray L. Hunt	Director
* J. Landis Martin J. Landis Martin	Director
* Jay A. Precourt Jay A. Precourt	Director
* Debra L. Reed Debra L. Reed	Director

* /s/ Sherry D. Williams
Sherry D. Williams, Attorney-in-fact

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