



# STANFORD

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## GRADUATE SCHOOL OF BUSINESS

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## HALLIBURTON COMPANY: ACCOUNTING FOR COST OVERRUNS AND RECOVERIES

### INTRODUCTION

In July 2002, a legal watchdog group, Judicial Watch, announced that it was suing Halliburton Company for overstating revenues during the period 1998 to 2001. The group's contention was that Halliburton used fraudulent accounting practices to boost revenues and hide a deteriorating financial position from investors.

Specifically, the lawsuit centered around the way the company recognized claims recoveries on long-term construction projects. Prior to 1998, the company's policy was to book cost overrun expenses as soon as they occurred, but not to book claims recoveries as revenue until the repayment amount was agreed to with the client. In 1998, the company changed policies to begin estimating future recoveries and recognizing them in the same period that overrun expenses were realized. The company, which had been suffering from a recent slowdown in business and large litigation losses from asbestos lawsuits, claimed that its accounting practices were permitted under generally accepted accounting principals (GAAP). Judicial Watch, however, claimed the accounting policy inflated revenues over the four-year period by as much as \$534 million.

Vice President Dick Cheney, who served as CEO of the company when the accounting change was made, was named as a defendant in the lawsuit. Given the recent slew of accounting scandals in the press and public debate over corporate responsibility, many parties took a strong interest in the Halliburton case. The Securities and Exchange Commission launched its own probe, stating that Cheney was "not immune."

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Brian Tayan prepared this case under the supervision of Professor Maureen McNichols as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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## **OIL & GAS INDUSTRY**

### **Oil Supply Chain**

Oil and natural gas are the most heavily used energy sources for industrial production. By 2002, worldwide demand for oil was approximately 76 million barrels per day with 25 percent of demand coming from the United States.

The supply of oil currently exists in natural reserves. Total worldwide reserves were estimated to be 1.03 trillion barrels. Of those reserves, 79 percent existed in OPEC countries<sup>1</sup>. Oil production was largely managed by state-run companies, whose revenues were a major source of income for local economies. These companies managed exploration and production on their lands or just offshore.

Another set of large publicly owned companies managed the refining, marketing, and distribution process. The largest of these companies were Exxon Mobil, Royal Dutch/Shell Group, BP, Total Fina Elf, and Chevron Texaco—often called the “supermajor” oil companies. These companies also explored for new oil, frequently in offshore locations. The North Sea was one of the most promising locations for new oil exploration.

Oil producing companies, both state-owned and publicly held, often contracted out much of the drilling process to equipment and oilfield service providers. These companies built oilrigs and drilling equipment, as well as provided services to help with production. Much of the construction work was contracted under long-term agreements. Because the process of oil location and production had so many steps, each of which required specific expertise, the oilfield equipment and services industry had several subsectors where specialty companies had carved out individual niches. Throughout much of its history, the industry had been highly fragmented. More recently, however, a handful of companies brought together a suite of construction and drilling services to form total-service providers. The largest three of these companies were Baker Hughes, Schlumberger, and Halliburton.

The amount of revenue these companies earned depended directly on the amount of money the oil producers invested in exploration and production. Oil producers generally cut back on capital investments when demand for oil was weak because of an economic slowdown or when the price of oil was low from overproduction. OPEC had agreed to an acceptable range of oil prices between \$22 and \$28 per barrel, with a target price of \$25 per barrel. However, prices had frequently fallen outside of this range, with low prices causing large losses throughout the oil industry and high prices leading to sharp increases in investment to expand production capacity. In 2002, global capital spending on exploration and production was expected to be \$100 billion.

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<sup>1</sup> The Organization of the Petroleum Exporting Countries (OPEC) was founded in 1960 to regulate the production of oil in the Middle East. Member nations, who are heavily reliant upon revenues from oil production, decided that regulation of supply was necessary for price stability and, in turn, stability for their national economies. Membership has since expanded beyond Middle Eastern nations, and by 2002 included Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates and Venezuela.

## HALLIBURTON COMPANY

Halliburton Company was one of the largest oilfield equipment and service companies in the world. The company was divided into two main divisions: Engineering & Construction and Energy Services Group. The Engineering & Construction Group provided both onshore and offshore equipment and technology for oil production. The Energy Services Group provided a wide range of products and services, including exploration services, contract drilling, drill systems and drill fluids, well recovery services, logging and data collection, onshore and offshore production facilities, and planning (Exhibits 1 and 2).

### Company History

In 1920, Erle Halliburton founded the Halliburton Oil Well Cementing Company to provide well cementing services. With a reputation for high quality service and the continuous invention and patenting of new processes, Halliburton's business steadily expanded, serving clients in the oil-rich lands of the southern United States. Two trends in the 1930s greatly increased the demand for oil and oilfield services: automobile production and domestic oil heating. The company also began providing drill equipment for barges in offshore oil production. In the 1940s, Halliburton increased its service offering to include data collection, drill fluids, and various well recovery services. In the 1950s, the company added more sophisticated logging services and well cleaning services. In 1957, Erle Halliburton died, after 28 years as president of the company.

The company's growth continued after Erle Halliburton's death. With the purchase of Brown & Roots in 1962, Halliburton was able to greatly increase its construction business, which became the company's growth engine throughout the next two decades. After 1973, the year of the Arab oil embargo, business for the oil industry as a whole surged as oil producers searched for new reserves outside the Middle East. By the 1980s, however, the industry had built up excess production capacity, and construction revenues plunged. To shore up revenues and profits, the company increased its service offerings by acquiring dozens of specialty service providers.

In 1995, Dick Cheney, former U.S. defense secretary, became CEO. For the first years under Cheney's management, revenues and profits increased as oil producers resumed capital spending. In 1997, Halliburton purchased a major oilfield equipment manufacturer, Dresser Industries, which led to a near-doubling of Halliburton's revenues. The next year, the company's revenues hit an all-time high of \$17.4 billion. In 2000, Cheney resigned as CEO when he was named vice presidential running mate to George W. Bush.

### Halliburton Today

Since 1998, however, the company has faced numerous business challenges. First, after a surge in oilfield spending by the supermajors in 1996 and 1997, capital investments were greatly scaled back in the latter part of 1998 following the Asian economic crisis. Halliburton, which had net income of \$454 million in 1997, recorded a loss of \$15 million the next year.<sup>2</sup> The

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<sup>2</sup> Current financial statements for Halliburton that include 1997 results on a historical basis report *pro forma* net income of \$772 million. This figure includes net income from Dresser as if the two companies had operated together throughout 1997. Prior to the merger, however, Halliburton's 1997 net income as a stand-alone company was \$454 million.

company began selling many of the equipment lines that it had acquired from Dresser and announced that it would lay off 9,000 employees.

At the same time, losses from unfavorable asbestos litigation verdicts exploded. In 2001, Halliburton had to increase its liability for asbestos litigation claims from \$80 million to \$737 million. Although the company insisted that current insurance policies would cover most of that figure, rumors began to circulate that Halliburton would be forced into bankruptcy. The stock plummeted to a 15-year low (Exhibit 3).<sup>3</sup> With a business-friendly White House and Dick Cheney as vice president, many industry experts expected that President Bush would ask Congress to limit asbestos liabilities for corporations. Indeed, rumors circulated that the president would make a special plea to Congress in his 2002 State of the Union address. However, just at that time, Congress had been deeply involved in the Enron investigation. News came out that Dick Cheney had met with Enron executives as part of an Energy Planning Commission soon after he entered the White House. To distance itself from potentially damaging accusations of inappropriate deal making, the Bush Administration let the issue of limiting asbestos claims languish.

In May 2002, Halliburton faced its most recent challenge when the *New York Times* released an article raising questions about a little-known accounting change that the company made in 1998. The article began:

During Vice President Dick Cheney's tenure as its chief executive, Halliburton Corporation altered its accounting policies so it could report as revenue more than \$100 million in disputed costs on big construction projects, public filings by the company show. Halliburton did not disclose the change to investors for over a year.<sup>4</sup>

The change came to the public's attention after Halliburton filed its 2001 10-K with the SEC. The company had increased the amount of information in its report in an effort to provide increased clarity about its financials to investors.

## ACCOUNTING FOR LONG-TERM PROJECTS

The Financial Accounting Standards Board (FASB) has set the general guideline that revenues on the sale of goods and services should be recognized (1) when they are realized or realizable and (2) when they are earned. Revenues are *realized* when goods or services have been exchanged for cash or an agreement to pay. In order for revenues to be *realizable*, the company providing the goods or services must be able to quantify the amount of future payment. Revenues are *earned* when the goods or services have been successfully provided.

For long-term projects that span multiple accounting periods, the issue of cost and revenue allocation arises. FASB recommends that the percentage-of-completion method be used to account for such projects, as outlined by AICPA *Statement of Position 81-1*:

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<sup>3</sup> Exposure to asbestos litigation came to Halliburton through Harbison-Walker, a subsidiary of Dresser that Dresser spun off in 1992, years before its merger with Halliburton. Complaints against Dick Cheney surfaced that Halliburton never should have bought Dresser, knowing that damages for asbestos exposure were steadily climbing in the late 1990s.

<sup>4</sup> Berenson, Alex and Lowell Bergman, "Under Cheney, Halliburton Altered Policy on Accounting," *New York Times*, May 22, 2002.

*The percentage-of-completion method* recognizes income as work on a contract progresses; recognition of revenues and profits generally is related to costs incurred in providing the services required under the contract.<sup>5</sup>

The percentage-of-completion method therefore involves the application of costs and revenues as agreed in the contract. Because percentage-of-completion is an accrual-based method, cost and revenue recognition do not depend on the billing cycle but instead the amount of work completed in a given period. If 50 percent of the expected total cost is completed in the first period, 50 percent of the payment as agreed in the contract is applied to that period. In this way, the profitability of the project remains consistent over all billing periods.

Generally, when costs differ materially from those estimated in the contract, the contractor initiates a *change order* whereby an increase in scope to the contract and increased billings are agreed to by both parties. If the additional work is agreed to by the client but additional billings are to be negotiated later, the change order is called *unpriced*. In the case of unpriced change orders, both costs and revenues are typically deferred until pricing has been resolved.

If a change order is unapproved in both scope and price, it is treated as a *claim*. SOP 81-1 states that revenue associated with a claim may be booked in the current period only if there is a legal basis for recovery and the amount can be reasonably estimated. Otherwise, the claim should be deferred until the collection amount is formally agreed upon with the customer (Exhibit 4).

### **Announcement of Accounting Changes**

*APB Opinion No. 20* outlines how companies should disclose the nature and the effect of accounting changes in the footnotes to their financial statements.<sup>6</sup> Disclosures should include justification for the changes as well as a quantification of the impact on relevant accounts, including earnings and revenues. Where relevant, companies should show what historical results would have been, had the accounting principle been applied in previous years for comparative purposes. The intention of *APB Opinion No. 20* is to allow readers of financial statements to understand fully why accounting methods were changed and how those changes impact current and prospective earnings (Exhibit 5).

### **Halliburton Accounting Change and Announcement of Change**

In 1998, Halliburton changed the method it used to account for claims on cost overruns in long-term projects. Before the change, the company did not book revenues associated with a claim until agreement with the client had been reached on the amount that would be collected. After the change, the company began estimating the amount of the claim in the period when cost overruns occurred. When the amount of the claim was finally agreed upon with the client, the difference between the estimate and the actual recovery would be credited to the income statement.

In its 1997 10-K, Halliburton described its revenue recognition policy on long-term construction contracts as follows:

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<sup>5</sup> "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," *Statement of Position 81-1* (New York: AICPA, 1981), par. 4.

<sup>6</sup> "Accounting Changes," *Opinions of the Accounting Principles Board No. 20* (New York: AICPA, 1971).

Revenues from construction contracts are reported on the percentage of completion method of accounting, using measurements of progress toward completion appropriate for the work performed. All known or anticipated losses on contracts are provided for currently. Claims for additional compensation are recognized during the period such claims are resolved.<sup>7</sup>

In 1998, the year the accounting change went into effect, Halliburton described its revenue recognition policy as follows:

Revenues from engineering and construction contracts are reported on the percentage of completion method of accounting using measurements of progress towards completion appropriate for the work performed. All known or anticipated losses on contracts are provided for currently.<sup>8</sup>

In 1999, 2000, and 2001, the company described its revenue recognition policy as follows:

Revenues from engineering and construction contracts are reported on the percentage of completion method of accounting, using measurements of progress towards completion appropriate for the work performed. All known or anticipated losses on contracts are provided for currently. Claims and change orders which 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.<sup>9</sup>

(See Exhibits 6 through 8.)

## ACCOUNTING IN THE PUBLIC SPOTLIGHT

For much of 2002, companies were coming under fire for lack of clarity in their financial statements. This issue came into the spotlight for three main reasons.

First, Enron, which had been one of the largest corporations in the United States, declared bankruptcy in December 2001. The company's failure came about despite the fact that Enron received an unqualified opinion from their auditors and showed no glaring signs of financial weakness in the months before bankruptcy. The resulting investigation revealed detailed fraudulent behavior by corporate officers, with the intent to hide information from investors and manipulate the company's stock price. The revelation a few months later that Worldcom Corporation had improperly capitalized billions of dollars in operating expenses indicated that the malfeasance was not limited to Enron. In July 2002, investors were selling shares of most companies with complex financials.

Second, the stock market was in the middle of a long period of decline. Investors, who had seen the value of their investment portfolios go down significantly, were angered by the losses. Proxy statements filed with the SEC indicated that even though individual shareholders were losing

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<sup>7</sup> Halliburton Company, 1997 form 10-K filed Feb. 24, 1998.

<sup>8</sup> Halliburton Company, 1998 form 10-K filed Mar. 23, 1999.

<sup>9</sup> Halliburton Company, 1999 form 10-K filed Mar. 14, 2000, 2000 form 10-K filed Mar. 27, 2001, 2001 form 10-K filed Mar. 12, 2002.

billions of dollars, corporate officers were continuing to receive millions of dollars in bonuses and stock options. Many corporate officers were selling out of their stock positions at the same time that they were promoting their stock to analysts and investors. Headlines of scandals led many investors to demand that corporate officers be held liable for losses and forced to pay damages.

Third, with a November election approaching, politicians from both parties were paying particular attention to any issue with broad public interest. The questions of how to restructure corporate oversight, the accounting industry, the SEC's enforcement process, and executive liability received much political debate.

### **Judicial Watch Lawsuit**

In July 2002, Judicial Watch, a nonprofit and nonpartisan legal organization, filed a complaint against Halliburton in the U.S. District Court of Northern Texas, claiming actions of fraud by the directors, officers, and auditors of the company. Vice President Dick Cheney, among others, was named a defendant in the lawsuit.

The lawsuit alleged the following:<sup>10</sup>

- Because of industry-wide trends in the oilfield construction business in the late 1990s, Halliburton was pressured to change its contracts from cost-plus-percentage terms to fixed-cost terms.
- Arthur Andersen, the company's auditor, recommended that Halliburton change its accounting methods as part of a "very aggressive, proactive, pro-client strategy" of boosting profitability.
- In the fourth quarter of 1998, the company adopted the new accounting method, which allowed it to report "\$175 million of pre-tax operating profits, more than half of which (\$89 million) resulted from the undisclosed Change in Accounting Principle in violation of GAAP."
- The company changed accounting practices not because the new practice better reflected the economics of the transaction, but because Halliburton was having a difficult operating year resulting from lower oil prices and asbestos-related litigation.
- No disclosure of the change was made in the company's 1998 financial reports in violation of *APB Opinion No. 20*. In 1999, 2000, and 2001 Halliburton included notice of its new revenue recognition policy but did not "try to justify the change, to explain why it was preferable, or to disclose its effect on net income."
- The company overstated revenues by as much as \$89 million in 1998, \$98 million in 1999, \$113 million in 2000, and \$234 million in 2001.

Halliburton's response to the allegations was that its accounting practices were in compliance with GAAP. "Furthermore," the company stated in a press release, "in instances where unapproved claims and change orders were recognized in revenue and accounts receivable, no profits at all were recognized on the related projects."<sup>11</sup> The company claimed that 10 of the 15

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<sup>10</sup> Quotations below from: Judicial Watch, Inc., "Stephen S. Stephens v. Richard B. Cheney, *et al.*," July 11, 2002, <http://www.judicialwatch.org/cases/92/complaint.htm> (June 11, 2003).

<sup>11</sup> "Halliburton Reports SEC Investigation of Accounting Practice," May 28, 2002, [http://www.halliburton.com/news/corpnws\\_052802b.jsp](http://www.halliburton.com/news/corpnws_052802b.jsp), (June 11, 2003).

largest construction companies used the same accounting method as Halliburton adopted in 1998. In response to questions as to why the company did not disclose the accounting change for a year, corporate officials stated that the \$89 million increase in 1998 was immaterial in comparison to total revenues of \$17 billion.

### **STUDY QUESTIONS**

1. What types of financial transactions are at issue in this case? What accounting treatments are allowable under SOP 81-1?
2. How did Halliburton account for claims recoveries before 1998? After 1998?
3. Which method is more appropriate from the standpoint of
  - Realized / realizability
  - Earned
  - Conservatism
  - Matching
4. Does Halliburton's accounting method have a material impact on their financials?
5. Which method do you think is more appropriate for Halliburton to use? Do you believe the accounting change was made to manipulate revenues, earnings, and the stock price - or as a better representation of the economics of the transactions?
6. What do you think of the way in which Halliburton disclosed the accounting change?
7. What is your reaction to Halliburton's responses to the allegations?
8. As an investor, do you think Halliburton management has credibility? Would you trust the rest of their financials?



## **Exhibit 1**

### **Explanation of Oil Formation**

What we call crude oil is a mixture of unrefined hydrocarbons found deep under the earth. Hydrocarbons begin to form when plant or animal matter die and are trapped under sedimentary rock or marine shale. The entrapment of organic material preserves the matter from decomposition by bacteria. As time progresses, sedimentary rock continues to pile up on top of older layers, leading to an increase in pressure and temperature. This slow application of both temperature and pressure causes the hydrogen and carbon molecules to undergo the natural chemical reactions that form hydrocarbons. Hydrocarbon molecules collect as isolated droplets in the pores of sedimentary rock and shale. Increased pressure or earthquakes eventually cause the rock to crack, allowing droplets to escape and migrate upward toward the earth's surface. These droplets may travel from 2 to 16 miles before they are eventually trapped under a non-porous cap rock. It is under the cap rock that the oil reservoir forms. Oil in the cap rock remains under high pressure. When the oilfield is tapped, the release in pressure results in a gusher.

Originally, hydrocarbons caught in the reservoir are dark and viscous and when produced form a thick crude oil. The longer and deeper the hydrocarbons are buried, however, the lighter they become in color, the lower their viscosity, and the greater their volatility. The more mature hydrocarbons form natural gases—methane, ethane, propane, and butane—which remain liquid only in their natural reserves. Once released from pressure, they become gaseous. As a result, crude oil is easier to produce and ship. Given the volatility of natural gas, it is dangerous and expensive to transport great distances. It is generally produced and sold for energy consumption near the natural source.

Source: Conaway, Charles F., *The Petroleum Industry: A Non-Technical Guide* (Tulsa, Oklahoma: PennWell Publishing Company, 1999).

## **Exhibit 2**

### **Products and Services Provided by Oilfield Equipment Industry**

#### **Oilfield Equipment and Services**

Oilfield companies provide a wide range of services and equipment to help with the exploration, drilling, and the production process.

#### ***Oil Exploration***

Oilfield service companies can be contracted to study surface rock formations, both on land and on the ocean floor, to locate possible drilling sites. They also model subsurface rock formations using advanced technologies. One method is three-dimensional seismic imaging, which involves using explosives or sudden releases of compressed air to create acoustic pulses. By measuring time lapses and the angle of reflection, geologists are able to locate structural traps where oil reserves may exist.

#### ***Oil Drilling***

Oilfield equipment companies construct the rigs and equipment used by the oil producers for both onshore and offshore drilling. The most heavy-duty onshore rigs are able to drill down to 30,000 feet below the earth's surface. Different types of offshore rigs include:

- Submersible rigs (used in shallow water, less than 550 feet). These rigs float on the water surface until they reach the drilling site. The ballasts are flooded and the submersible rig will sink to the water floor.
- Jackup rigs (used in shallow water, less than 550 feet). These rigs are built on concrete pylons that stand on the water floor while the rig itself sits on a platform elevated above the water surface.
- Semisubmersible rigs (used in intermediate to ultra-deep waters, 550 to 5,000+ feet). These rigs rest on steel pontoons that float a few feet below the surface. The rig platform is anchored to the ocean floor and automatic thrusters and an advanced tensioner system are used to keep the platform stable while drilling takes place.
- Drillships (used in offshore oil exploration). These ships are less stable but more maneuverable than rigs. Drillships can drill holes up to 30,000 feet in water up to 10,000 feet deep.

Products and services provided during the drilling process include:

- Diamond-tipped drill bits.
- Drill fluids. To reduce heat caused by friction and prevent blowout, mud or special chemicals are circulated through the drillstring. These fluids remove dirt and oil accumulation from the rock surface and increase the bit's penetration rate.
- Well cementing. To stabilize the well and protect fresh water veins from contamination, the walls are lined with cement. In case of blowout, the well can be sealed, cutting off oxygen to help extinguish underground fires. Electrical lines are also funneled down the cement shaft, allowing for data gathering during production.

**Oil Production**

Oil producers may also contract with oilfield companies to help with the production process. Well recovery services help to ensure that reservoirs are pumped efficiently and completely. These include:

- Gas-cap recovery. Gases are introduced under the cap rock to exert additional upward pressure on the oil.
- Waterflooding recovery. Salt water is introduced into the well. Because oil and water do not mix and because salt water is denser than oil, the oil floats to the surface.
- Thermal recovery. Heat is inserted into the well to reduce oil viscosity and ease the pumping process.

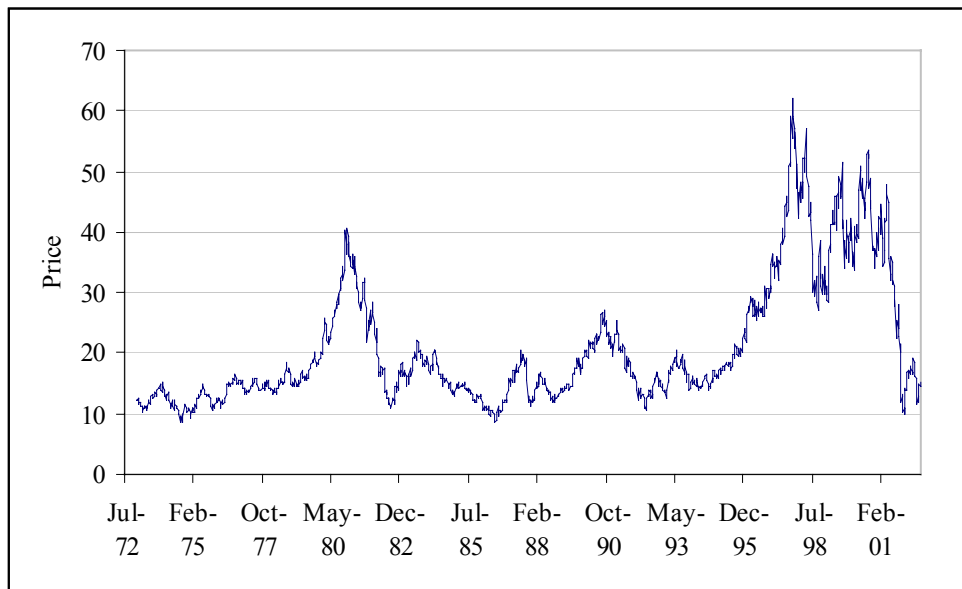
Data services during the production process include:

- Drilling data. Geologists measure the bit's penetration rate in minutes per foot to better map the underground rock formation.
- Mud data. Geologists test the mud stream during drilling for traces of natural gas.
- Logging. Geologists measure radioactive, acoustic, or electrical characteristics of the fluids in an open-hole well to measure the well's potential productivity. The detection of radioactive gamma ray emissions can indicate the presence of potentially promising shale. Through acoustic logging, geologists can measure the porosity of the rock layer and determine the potential for hydrocarbons. In resistivity logging, electricity is sent through underground rocks; because salt-water conducts electricity better than oil, gas or freshwater, geologists can use resistance measures to determine the likely liquid contained in rock pores.

Oilfield companies also design and build surface facilities for the refinement and transportation of oil, including pipelines.

Source: Conaway, Charles F., *The Petroleum Industry: A Non-Technical Guide* (Tulsa, Oklahoma: PennWell Publishing Company, 1999).

### Exhibit 3 Halliburton Stock Price (1972 – 2002)



Source: DataStream

**Exhibit 4**  
**AICPA Statement of Position 81-1: Accounting for Claims in Long-Term Contracts**

**Claims**

65. Claims are amounts in excess of the agreed contract price (or amounts not included in the original contract price) that a contractor seeks to collect from customers or others for customer-caused delays; errors in specifications and designs; contract terminations; change orders that are in dispute or unapproved as to both scope and price; or other causes of unanticipated costs. Recognition of amounts of additional contract revenue relating to claims is appropriate only if it is probable that the claim will result in additional contract revenue and if the amount can be reliably estimated. Those two requirements are satisfied by the existence of all the following conditions:

- a. The contract or other evidence provides a legal basis for the claim; or a legal opinion has been obtained, stating that under the circumstances there is a reasonable basis to support the claim.
- b. Additional costs are caused by circumstances that were unforeseen at the contract date and are not the result of deficiencies in the contractor's performance.
- c. Costs associated with the claim are identifiable or otherwise determinable, and are reasonable in view of the work performed.
- d. The evidence supporting the claim is objective and verifiable, not based on management's "feel" for the situation or on unsupported representations.

If the foregoing requirements are met, revenue from a claim should be recorded only to the extent that contract costs relating to the claim have been incurred. The amounts recorded, if material, should be disclosed in the notes to the financial statements. Costs attributable to the claims should be treated as costs of contract performance as they are incurred.

66. However, a practice such as recording revenues from claims only when the amounts have been received or awarded may be used. If that practice is followed, the amounts should be disclosed in the notes to the financial statements.

Source: "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," *Statement of Position 81-1* (New York: AICPA, 1981).

**Exhibit 5**  
**AICPA APB Opinion No. 20: Accounting Changes**

**Change in Accounting Principle**

7. A change in accounting principle results from adoption of a generally accepted accounting principle different from the one used previously for reporting purposes. The term *accounting principle* includes not only accounting principles and practices but also the methods of applying them.

**Justification for a Change in Accounting Principle**

15. The Board concludes that in the preparation of financial statements there is a presumption that an accounting principle once adopted should not be changed in accounting for events and transactions of a similar type. Consistent use of accounting principles from one accounting period to another enhances the utility of financial statements to users by facilitating analysis and understanding of comparative accounting data.

16. The presumption that an entity should not change an accounting principle may be overcome only if the enterprise justifies the use of an alternative acceptable accounting principle on the basis that it is preferable...

**General Disclosure – A Change in Accounting Principle**

17. The nature of and justification for a change in accounting principle and its effect on income should be disclosed in the financial statements of the period in which the change is made. The justification for the change should explain clearly why the newly adopted accounting principle is preferable.

**Materiality**

38. The Board concludes that a number of factors are relevant to the materiality of (a) accounting changes contemplated in this Opinion and (b) corrections of errors, in determining both the accounting treatment of these items and the necessity for disclosure. Materiality should be considered in relation to both the effects of each change separately and the combined effect of all changes. If a change or correction has a material effect on income before extraordinary items or on net income of the current period before the effect of the change, the treatments and disclosures described in this Opinion should be followed. Furthermore, if a change or correction has a material effect on the trend of earnings, the same treatments and disclosures are required. A change which does not have a material effect in the period of change but is reasonably certain to have a material effect in later periods should be disclosed whenever the financial statements of the period of change are presented.

Source: "Accounting Changes," *Opinions of the Accounting Principles Board No. 20* (New York: AICPA, 1971).

**Exhibit 6**  
**Halliburton Company: Selected Financial Data (1997 – 2001)**

Millions of dollars and shares except per share data	Years ended December 31				
	2001	2000	1999	1998	1997
Total revenues	\$ 13,046	\$ 11,944	\$ 14,898	\$ 17,353	\$ 8,819
Operating costs and expenses	\$ 11,962	\$ 11,482	\$ 14,248	\$ 16,957	\$ 8,021
Total operating income	1,084	462	650	397	798
Nonoperating income (expense), net	(130)	(127)	(95)	(118)	(32)
Income from continuing operations before income taxes and minority interest	954	335	555	279	766
Provision for income taxes	(384)	(129)	(214)	(244)	(300)
Minority interest in net income of consolidated subsidiaries	(19)	(18)	(43)	(49)	(12)
Income (loss) from continuing operations before accounting change	551	188	298	(15)	454
Discontinued operations:					
Income (loss) from discontinued operations, net	(42)	98	-	-	-
Gain on disposal of discontinued operations, net	299	215	159	-	-
Income from discontinued operations, net	257	313	159	-	-
Cumulative effect change in accounting, net	1	-	(19)	-	-
Net income (loss)	\$ 809	\$ 501	\$ 438	\$ (15)	\$ 454
Diluted income (loss) per share:					
Income from continuing operations before accounting change	\$ 1.28	\$ 0.42	\$ 0.67	\$ (0.03)	\$ 1.75
Income (loss) from discontinued operations	(0.10)	0.22	-	-	-
Gain on disposal of discontinued operations	0.70	0.48	0.36	-	-
Change in accounting method, net	-	-	(0.04)	-	-
Net income (loss) per share	\$ 1.88	\$ 1.12	\$ 0.99	\$ (0.03)	\$ 1.75

Sources: Halliburton Company 10-K filings with the Securities and Exchange Commission, fiscal years ending 1997 (filed February 24, 1998), 1998 (filed March 23, 1999), 1999 (filed March 14, 2000), 2000 (filed March 27, 2001), and 2001 (filed March 12, 2002). Note: Results are **as reported in the years shown**.

**Exhibit 6 (continued)**  
**Halliburton Company: Segment Financial Data (1996 – 1998)**

## Operations by Business Segment

Millions of dollars	Years ended December 31		
	1998	1997	1996
<S>	<C>	<C>	<C>
Revenues:			
Energy Services Group	\$ 9,009.5	\$ 8,504.7	\$ 6,515.4
Engineering and Construction Group	5,494.8	4,992.8	4,720.7
Dresser Equipment Group	2,848.8	2,779.0	2,710.5
Total	\$ 17,353.1	\$ 16,276.5	\$ 13,946.6
Operating income:			
Energy Services Group	\$ 971.0	\$ 1,019.4	\$ 698.0
Engineering and Construction Group	237.2	219.0	134.0
Dresser Equipment Group	247.8	248.3	229.3
Special charges and credits	(980.1)	(16.2)	(85.8)
General corporate	(79.4)	(71.8)	(72.3)
Total	\$ 396.5	\$ 1,398.7	\$ 903.2

Source: Halliburton Company 10-K filings with the Securities and Exchange Commission, fiscal year 1998 (filed March 23, 1999). Note: Results are **as reported in 1998**. Revenues and net operating income figures differ from those reported in each year due to the effect of acquisitions. Segment data not provided in same format prior to 1998.



## Exhibit 7 Halliburton Company: Excerpts from 10-K Filings

From Halliburton's 2001 10-K filing

### CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires the use of judgments and estimates. Our critical accounting policies are described below to provide a better understanding of how we develop our judgments about future events and related estimations and how they can impact our financial statements. A critical accounting policy is one that requires our most difficult, subjective or complex estimates and assessments and is fundamental to our results of operations. We identified our most critical accounting policies to be:

- percentage of completion accounting for our long-term engineering and construction contracts; and
- loss contingencies, primarily related to
- asbestos litigation; and
- other litigation.

This discussion and analysis should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report.

#### Percentage of completion

We account for our revenues on long-term engineering and construction contracts on the percentage of completion method. This method of accounting requires us to calculate job profit to be recognized in each reporting period for each job based upon our predictions of future outcomes which include:

- estimates of the total cost to complete the contract;
- estimates of project schedule and completion date;
- estimates of the percentage the project is complete; and
- amounts of any probable unapproved claims and change orders included in revenues.

At the onset of each contract, we prepare a detailed step-by-step analysis of our estimated cost to complete the project. Our project personnel continuously evaluate the estimated costs, claims and change orders, and percentage of completion at the project level. Significant projects are reviewed in detail by senior engineering and construction management at least quarterly. Preparing project cost estimates and percentages of completion is a core competency within our engineering and construction businesses. We have a long history of dealing with multiple types of projects and in preparing accurate cost estimates. However, there are many factors, including but not limited to weather, inflation, labor disruptions and timely availability of materials, and other factors as outlined in our "Forward-Looking Information" section. These factors can affect the accuracy of our estimates and impact our future reported earnings.

#### Notes to Annual Financial Statements

##### Note 1. Significant Accounting Policies

Receivables. Our receivables are generally not collateralized. With the exception of claims and change orders which are in the process of being negotiated with customers, unbilled work on uncompleted contracts generally represents work currently billable, and this work is usually billed during normal billing processes in the next several months. The claims and change orders, included in unbilled receivables, amounted to \$234 million at December

31, 2001 and \$113 million at December 31, 2000. Included in notes and accounts receivable are notes with varying interest rates totaling \$19 million at December 31, 2001 and \$38 million at December 31, 2000...

From Halliburton's 2000 10-K filing

Receivables. Our receivables are generally not collateralized. With the exception of claims and change orders which are in the process of being negotiated with customers, unbilled work on uncompleted contracts generally represents work currently billable, and this work is usually billed during normal billing processes in the next month. These claims and change orders, included in unbilled receivables, amounted to \$113 million and \$98 million at December 31, 2000 and 1999, respectively, and are generally expected to be collected in the following year...

From Halliburton's 1999 10-K filing

Receivables. Our receivables are generally not collateralized. With the exception of claims and change orders which are in the process of being negotiated with customers, unbilled work on uncompleted contracts generally represents work currently billable and this work is usually billed during normal billing processes in the next month. These claims and change orders, included in unbilled receivables, amounted to \$98 million and \$89 million at December 31, 1999 and 1998, respectively and are generally expected to be collected in the following year...

From Halliburton's 1998 10-K filing

Receivables. The Company's receivables are generally not collateralized. Notes and accounts receivable at December 31, 1998 include \$33.2 million (\$30.8 million at December 31, 1997) due from customers in accordance with applicable retainage provisions of engineering and construction contracts, which will become billable upon future deliveries or completion of such contracts. This amount is expected to be collected during 1999. Additionally, other noncurrent assets include \$7.1 million (\$7.3 million at December 31, 1997) of such retainage, which is expected to be collected in years subsequent to 1999. Unbilled work on uncompleted contracts generally represents work currently billable and such work is usually billed during normal billing processes in the next month...

From Halliburton's 1997 10-K filing

Receivables. The Company's receivables are generally not collateralized. Notes and accounts receivable at December 31, 1997 include \$30.4 million (\$24.9 million at December 31, 1996) due from customers in accordance with applicable retainage provisions of engineering and construction contracts, which will become billable upon future deliveries or completion of such contracts. This amount is expected to be collected during 1998. Additionally, other noncurrent assets include \$7.3 million (\$6.7 million at December 31, 1996) of such retainage, which is expected to be collected in years subsequent to 1998. Unbilled work on uncompleted contracts generally represents work currently billable and such work is usually billed during normal billing processes in the next month.