

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

(MARK ONE)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934
FOR THE TRANSITION PERIOD FROM _____ TO _____**

COMMISSION FILE NUMBER 000-26058

KFORCE INC.

(Exact name of Registrant as specified in its charter)

FLORIDA
(State or other jurisdiction of
incorporation or organization)

59-3264661
(IRS Employer
Identification No.)

1001 EAST PALM AVENUE, TAMPA, FLORIDA
(address of principal executive offices)

33605
(Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (813) 552-5000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS

NAME OF EACH EXCHANGE ON WHICH REGISTERED

None

None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

Common Stock, \$0.01 par value
(Title of Class)

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

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of Registrant's voting and non-voting stock held by nonaffiliates of Registrant, as of June 30, 2005 was \$323,799,783.

The number of shares outstanding of Registrant's Common Stock as of March 2, 2006, was 39,246,775.

DOCUMENTS INCORPORATED BY REFERENCE:

Parts of the Registrant's definitive proxy statement for the Annual Meeting of the Registrant's Shareholders to be held on June 21, 2006, are incorporated by reference into Part III of this Form.

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SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

References in this document to “the Registrant,” “Kforce,” “we,” “our” or “us” refer to Kforce Inc. and its subsidiaries, except where the context otherwise requires.

This document contains forward-looking statements, particularly with respect to Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MDA”). Additional written or oral forward-looking statements may be made by Kforce from time to time, in filings with the Securities and Exchange Commission (“SEC”) or otherwise. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such statements may include, but may not be limited to, projections of revenue, income, losses, cash flows, capital expenditures, integration of acquisitions, plans for future operations, effects of interest rate variations, financing needs or plans, plans relating to products or services of Kforce, estimates concerning the effects of litigation or other disputes, as well as assumptions to any of the foregoing. In addition, when used in this discussion, the terms “anticipates”, “estimates”, “expects”, “intends”, “plans”, “believes” and variations thereof and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are inherently subject to risks and uncertainties, some of which can not be predicted. Future events and actual results could differ materially from those set forth in or underlying the forward-looking statements. Readers are cautioned not to place undue reliance on any forward-looking statements contained in this report, which speak only as of the date of this report. Kforce undertakes no obligation to publicly publish the results of any adjustments to these forward-looking statements that may be made to reflect events on or after the date of this report or to reflect the occurrence of unexpected events.

PART I

ITEM 1. BUSINESS

Who We Are

We are a national provider of professional and technical specialty staffing services. Kforce was formed in August 1994 as a result of the combination of Romac & Associates, Inc. and three of its largest franchises. Following an Initial Public Offering in August 1995, Kforce grew to 31 offices in 18 major markets. On April 20, 1998, Kforce consummated a merger whereby Source Services Corporation (“Source”), was merged into Kforce. On June 7, 2004, we completed a transaction whereby Hall, Kinion and Associates, Inc. was merged into Kforce. On February 1, 2005, we completed a transaction whereby VistaRMS, Inc. was merged into Kforce. On January 31, 2006 we completed the acquisition of PCCI Holdings, Inc. These transactions are discussed in further detail later in Item 1. At December 31, 2005, we operated 71 field offices in 43 markets and we currently provide services in all 50 states and the District of Columbia through these offices or from our headquarters in Tampa, Florida. We provide our clients staffing services through three business segments: Technology (“Tech”), Finance and Accounting (“FA”), and Health and Life Sciences (“HLS”). Substantially all Tech and FA services are sold and delivered through our field offices. The HLS segment includes our Clinical Research (formerly Pharmaceutical), Scientific, Healthcare-Nursing (“Nursing”) and Health Information Management (“HIM”) specialties. The sales and delivery functions of substantial portions of HLS, particularly Clinical Research and HIM, are concentrated in our headquarters, with services being provided for certain clients through our field offices. Our headquarters provides support services to our field offices in areas such as human resources, nationwide recruiting, training, and national sales initiatives, in addition to the traditional “back office” support services such as payroll, billing, accounting, legal, tax, data processing and marketing, which are highly centralized.

Kforce is focused on providing “staffing” services to our clients. Our staffing services include Flexible Staffing Services (“Flex”) and Search Services (“Search”). Kforce anticipates continued growth which may be organic and/or through acquisition of other entities that enhance or expand our existing businesses. We believe that we are positioned to acquire and integrate other businesses that are strategically beneficial. Acquisitions entail significant risks which are described below.

Flex

Through Flex, we provide clients with qualified individuals (“consultants”) on a temporary basis. To be successful, our employees (“associates”) endeavor to (1) understand the clients’ needs, (2) determine and understand the capabilities of the consultants being recruited, and (3) deliver and manage the client-consultant relationship to the satisfaction of both the clients and the consultants. Typically, the better job Kforce and our consultants do, the longer the assignments last and the more often those clients turn to Kforce for additional needs.

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The Flex business comprised 93.2% of our revenues for the year ended December 31, 2005. Flex revenues are driven by hours billed and billing rates. Flex gross profit is determined by deducting consultant pay, benefits and other related costs from Flex revenues. Flex associate commissions, related taxes and other compensation and benefits as well as field management compensation are included in Selling, General and Administrative expenses (“SG&A”) along with administrative and corporate employee compensation. The Flex business model involves attempting to maximize consultant hours and billing rates while optimizing consultant pay and benefit costs, associate compensation and benefits, and the operating costs necessary to effectively support such activities.

Search

The Search business is a smaller, yet important part of our business that involves locating “permanent” or “direct hire” employees for our clients. We primarily perform such searches on a contingency basis, with fees being earned only if personnel are hired by our clients. Fees are typically structured as a percentage of the placed individual’s first-year annual compensation. We recruit Search employment candidates from our Flex consultant population, from internet job boards, and from candidates we identify who are currently employed and not actively seeking another position. Sometimes consultants initially work with clients on a Flex basis and then later are converted into permanent employees, for which we may also receive Search fees. There can be no assurance or expectation that Search revenues will increase if economic conditions improve, as has been the case in previous economic cycles. Typically, Search revenues decrease as economic conditions deteriorate. Clients and recruits are often targets for both Flex and Search services, and this common focus contributes to our objective of providing integrated solutions for all of our clients’ human capital needs.

Search revenues are driven by placements made and the fees billed. There are no consultant payroll costs associated with the placement and thus all Search revenue generally increases gross profit by a like amount. Search associate commissions, compensation and benefits are also included in SG&A. Search revenues comprised 6.8% of revenue in 2005.

Our Industry

We serve Fortune 1000 companies, as well as small and mid-size local and regional companies, with our top ten clients representing approximately 22% of revenues for the year ended December 31, 2005. The specialty staffing industry is made up of thousands of companies, most of which are small local firms providing a limited service offering to a small local client base. We believe Kforce is one of the ten largest specialty staffing firms in the United States, that the ten firms combined have a market share of less than 21% of the applicable market and that no single firm has larger than an approximate 5% market share. Competition in a particular market can come from many different companies, either large or small. We believe, however, that our geographic presence, diversified service offerings within our core businesses, and focus on consistent sales and delivery that is highly disciplined, provide a competitive advantage particularly with larger clients that have operations in multiple markets.

The staffing industry experienced declining revenues for the three years ending in 2003. Selected industry reports indicate the United States temporary staffing industry has shown revenue levels of approximately \$76 billion in 2003, \$81 billion in 2004 and \$107 billion in 2005. While no predictions can or should be made about the general economy, the staffing industry as a whole, or specialty staffing in particular, we believe that a sustained economic recovery will stimulate demand for substantial additional U.S. workers or, conversely, an economic slowdown will cause demand for additional U.S. workers to contract and that Flex demand generally increases before demand for permanent placements increases. We also believe that our three areas of focus, Tech, FA and HLS, will be among the higher growth categories in both the short and long-term and that over the long-term, temporary staffing may become a higher percentage of total jobs, particularly in the professional and technical areas. Further, we believe that the recent positive trends in our operating results, which we believe have been enhanced by the streamlining of our operations and centralizing of certain support functions, have positioned Kforce well for the future. In addition, according to a recent survey of board members of mostly global companies by the American Staffing Association, 90% now utilize temporary staffing services.

There can be no assurance that customer demand or pricing in Kforce’s specialty staffing sectors will return to previous historic levels. In addition, Kforce has a number of competitors that are increasingly utilizing a lower-priced staffing preferred-vendor model (VOP/VMS). Also, competition for skilled candidates, such as finance and accounting candidates, has increased. Each of these factors, among others, may impact the future growth and profitability of Kforce.

Acquisition of Hall, Kinion & Associates, Inc.

On June 7, 2004, Kforce acquired 100% of the outstanding common stock of Hall, Kinion and Associates Inc. (“Hall Kinion”) and its subsidiaries in exchange for approximately 5.7 million shares of Kforce stock. This acquisition was accounted for using the purchase method. Hall Kinion’s first quarter 2004 and full year 2003 revenues were \$30.3 million

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and \$156.9 million, respectively. The results of Hall Kinion's operations since the date of acquisition have been included in Kforce's consolidated financial statements. Hall Kinion specialized in providing technology and finance and accounting related talent on a temporary and permanent basis to its customers primarily in the United States. The results of the technology and finance and accounting businesses (previously provided by Hall Kinion's "OnStaff" group) are included in Kforce's Technology and Finance and Accounting business segments, respectively.

As a result of this acquisition, Kforce expanded its market presence by adding 18 offices, not including 25 offices that have been consolidated with existing Kforce offices. The acquisition also expanded Kforce's service offerings in technology and finance and accounting in certain market segments. We believe the integration of the operations of Hall Kinion into Kforce has had a positive effect on revenues, net income and earnings per share beginning in the third quarter of 2004. We have not compiled separate results for the former Hall Kinion operations because these operations have been fully integrated into Kforce and it is not feasible to track their results.

Details of the terms of the acquisition are included in a Registration Statement on Form S-4 that we filed on December 24, 2003, and amended on February 9, 2004, April 13, 2004, May 3, 2004 and May 5, 2004.

Acquisition of VistaRMS, Inc.

On February 1, 2005, Kforce completed the acquisition of substantially all of the assets of VistaRMS, Inc. ("Vista"), a privately held company based in Herndon, Virginia, in exchange for 2.3 million shares of Kforce common stock. This transaction was accounted for using the purchase method. The results of Vista's operations since the date of acquisition have been included in Kforce's consolidated financial statements. Vista had produced revenue of approximately \$50 million in technology staffing over the 12 months prior to the acquisition with approximately 40% of that revenue in the Federal government sector.

The acquisition expanded Kforce's service offerings in technology in the Federal government sector. We believe the integration of the operations of Vista into Kforce has had a positive effect on revenues, net income and earnings per share beginning in the first quarter of 2005. We have not compiled separate results for the former Vista operations because these operations have been fully integrated into Kforce and it is not feasible to track their results.

Acquisition of PCCI Holdings, Inc.

On January 31, 2006, Kforce acquired PCCI Holdings, Inc., pursuant to an Agreement and Plan of Merger (the "Merger Agreement") by and among Kforce, Trevoise Acquisition Corporation, a Delaware corporation and a wholly-owned subsidiary of Kforce ("Merger Sub"), PCCI Holdings, Inc., a Delaware corporation ("PCCP"), H.I.G. Pinkerton, Inc., a Cayman company, in its capacity as Representative, William D. Pinkerton and Richard J. Quigley. Under the terms of the Merger Agreement, Kforce acquired all of the outstanding stock of PCCI for approximately \$60,000,000 (the "Purchase Price") paid in cash at closing, subject to certain adjustments as provided for in the Merger Agreement. On the closing date, Kforce placed into escrow \$6,000,000 of the total Purchase Price to secure PCCI's indemnification obligations, and to satisfy certain adjustments to the Purchase Price.

PCCI was a privately held company based in Trevoise, Pennsylvania that, through its wholly-owned subsidiaries (primarily Pinkerton Computer Consultants, Inc.), has produced revenue of approximately \$95 million in technology staffing and the Federal government IT services sector over the last 12 months. Approximately 35% of that revenue was generated in the government sector. As a result of the above acquisition, Kforce expanded its presence in technology staffing in both the Federal government and commercial sectors. Because the closing occurred in 2006, none of PCCI's results of operations have been included in Kforce's consolidated financial statements as of December 31, 2005.

Kforce anticipates continued growth which may be organic and/or through acquisition of other entities that enhance or expand our existing businesses. We believe that we are positioned to acquire and integrate other businesses that are strategically beneficial.

Business Strategy

Kforce is a national provider of professional and technical specialty staffing services. Key elements of our business strategy include the following:

Focus on Value-Added Services. We focus on providing specialty staffing services to our clients, specifically in the areas of Technology, Finance and Accounting and Health and Life Sciences. We believe, based upon data published by the U.S. Bureau of Labor Statistics and other sources, that future employment growth may be significant in these sectors. The placement of highly skilled personnel requires operational and technical knowledge to effectively recruit and screen personnel, match them to client needs, and develop and manage the resulting relationships. We believe our historical focus in these markets, combined with our staff's operating expertise, provides us with a competitive advantage.

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Build Long-Term, Consultative Relationships. We believe we have developed long-term relationships with our clients by providing solutions to their specialty staffing requirements. We strive to differentiate ourselves by working closely with our clients to maximize their return on human assets. In addition, Kforce's ability to offer flexible staffing services, coupled with its permanent placement capability, offers the client a multi-faceted provider of specialty staffing services. We believe this ability enables Kforce to emphasize consultative rather than just transactional client relationships.

Achieve Extensive Client Penetration. Our client development process focuses on contacts with client employees responsible for staffing decisions. Contacts are made within numerous functional departments and at many different organizational levels within the client. Our associates are trained to develop a thorough understanding of each client's total staffing requirements.

Recruit High-Quality Consultants. We place great emphasis on recruiting qualified consultants. We believe we have a recruiting advantage over those of our competitors that lack the ability to offer candidates flexible and permanent opportunities. We frequently place candidates seeking permanent employment in flexible assignments until a permanent position becomes available as well as convert temporary candidates into permanent employees of our client companies.

Encourage Employee Achievement. We promote a quality-focused, results-oriented culture. Our field associates and corporate personnel are given incentives to encourage the achievement of Kforce's corporate goals.

Business Segments/Reporting Units

Kforce provides staffing services in three business segments:

Technology. The Bureau of Labor Statistics' lists computer and data processing services among the fastest growing industries over the last decade. The shortage of technical expertise to operate the advanced systems that businesses have acquired over the last decade is a major catalyst contributing to the growth of this segment. Our Technology services focus primarily on more sophisticated areas of information technologies (i.e., systems/applications programmers, systems analysts, and e-business and networking technicians). The economic slowdown of 2000-2003 significantly affected the willingness and ability of companies to commit capital resources to their technology systems/infrastructure. While our Technology staffing revenue increased substantially throughout 2004 and 2005, and we believe that the long-term business catalysts of technology remain in place, there can be no assurance that spending in the sector will return to the historic levels seen over the last decade.

Finance and Accounting. Our Finance and Accounting personnel provide both temporary staffing and search placement services to our clients in areas such as taxation, budget preparation and analysis, financial reporting, cost analysis, accounts payable, accounts receivable, professional administrative, credit and collections, general accounting, audit services and systems and controls analysis and documentation to support compliance work under Section 404 of the Sarbanes-Oxley Act of 2002. We believe we have built a reputation for providing qualified finance and accounting professionals to businesses. Historically, this business segment typically experiences its strongest demand in the months preceding and subsequent to the end of the calendar year as the result of increased demand for finance professionals to work on year-end closing and tax related assignments. During the 2000-2003 economic slowdown, Finance and Accounting revenues decreased significantly. While these areas improved substantially in 2004 and 2005, there can be no assurance that revenue in the Finance and Accounting sector will return to prior peak levels.

Health and Life Sciences. This segment consists of skilled professionals and technical services in the clinical research, health care and scientific fields. Examples of positions in these categories are: clinical research associates (CRAs) for the pharmaceutical industry, and health care information management professionals and nurses for hospitals. The Scientific specialty group supplies laboratory, research and development, quality assurance and quality control professionals to a variety of industries. This segment, and in particular the clinical research and scientific businesses, exhibits decreases in demand the final two weeks of the year as the result of holiday shutdowns at many large clients.

In January 2004, Kforce realigned the organizational structure in its Finance and Accounting and Technology business units by aligning them along regional market lines: eastern, central and western markets. Kforce believes this operational alignment will develop a more customer centric organization, leverage our best leaders, leverage client relationships across functional offerings and streamline the organization by placing senior management closer to the customer as well as achieve greater cost-efficiency. The Health and Life Sciences segment is organized and managed by specialty because of the unique operating characteristics of each business.

Financial information regarding our business segments is included in Item 8 of Part II.

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Staffing Services

Staffing services are provided to our clients based on an analysis of each client's individual functional needs, including a determination of time duration of services required. Kforce offers staffing services in two categories: Flexible Staffing Services and Search Services. In 2005, Flexible Staffing and Search Services accounted for 93.2% and 6.8% of revenue, respectively.

Flexible Staffing Services

Kforce offers Flexible Staffing Services, providing personnel in the fields of information technology, finance and accounting, and health and life sciences. Flexible Staffing Services entail placing skilled workers in the client environment on a contractual basis. Assignments typically run from three months to one year in duration. We currently offer Flexible Staffing Services in most large metropolitan market areas.

Search Services

Kforce provides Search Services (permanent placement) for professional and technical personnel in the areas of information technology, finance and accounting, financial services, clinical research, health care and scientific.

Kforce primarily performs contingency searches. A contingency search results in revenue to Kforce only when personnel are hired by a client. Our strategy is to perform contingency searches primarily in our core businesses. Fees are typically structured as a percentage of the placed individual's first-year annual compensation. Sometimes consultants initially work with clients on a Flex basis and then later are converted into permanent employees, for which we may also receive Search fees.

Client searches that are outside a core business area are typically restricted to management or executive level positions and require a targeted research and recruiting effort. Kforce typically performs these searches as retained searches where the client pays a part of the search fee in advance and the remainder upon completion of the search. Retained searches represent only a nominal portion of our search services.

An active database of candidates is maintained as the result of our continuous recruiting efforts and reputation in the industry. In addition, many candidates are located as a result of referrals from Flexible Staffing Services activities.

The clients targeted for Search Services are typically the same as those targeted for Flexible Staffing Services. This common focus is intended to contribute to Kforce's objective of providing an integrated solution for our clients' personnel needs. Search Services were severely impacted by the economic downturn during 2000-2003. Although we have seen recovery in 2004 and 2005, there can be no assurance or expectation that Search Services revenues will return to prior levels.

Technology

Our focus for Kforce's technology activities is to improve efficiency and maintain a leveragable platform. During 2005 we completed a data center refresh whereby virtually all of the hardware in our data center was replaced or upgraded with new hardware, which management believes will provide improved service to our corporate and field operations. In 2004, we continued to consolidate key technology activities to improve access to data and improve operating leverage. We completed a field server consolidation project which consolidated over 50 Microsoft Exchange (E-mail & Calendaring) servers in the field into one centralized Exchange system in our data center located in Tampa. We also completed the acquisitions of Hall Kinion in June 2004, Vista in February 2005, and PCCI in January 2006. We believe that we have successfully integrated Hall Kinion's and Vista's technical processes into Kforce processes and established a methodology for technical integration of future acquisitions. Kforce anticipates that the integration of PCCI's technical processes into Kforce processes will be substantially complete by March 31, 2006.

Kforce's nationwide computer, telephone and data communications infrastructure was upgraded in 2003 to take advantage of faster and lower cost devices and services. We believe that these projects improved internal communications and have reduced associated costs.

While we believe our technology systems are adequate to meet our current needs, there can be no assurance that they will not be subject to system outages or data loss caused by natural or man-made disaster. In addition, Kforce depends on certain third-party vendors whose reliability we can not guarantee going forward. One or more of such events could negatively impact our ability to conduct our normal course of business.

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Trade names

The Kforce and OnStaff trade names, which are registered with the United States Patent and Trademark Office, are important to our business.

Competition

The specialty staffing services industry is very competitive and fragmented. There are relatively few barriers to entry and new competitors frequently enter the market. A number of our competitors have substantially greater resources than we possess. We face substantial competition from large national firms and local specialty staffing firms. The local firms are typically operator-owned, and each market generally has one or more significant competitors. We also face competition from national clerical and light industrial staffing firms and national and regional accounting firms that also offer certain specialty staffing services.

In addition, many companies utilize Vendor Management Systems (“VMS”) for the purchase of staffing services. Generally, VMS are software systems that allow companies to manage service providers. According to a recent survey conducted by Staffing Industry Analysts, 24% of the Fortune 1000 have VMS installed, up from 20% a year ago, with another 17% planning to do so within the next two years. Data shows that larger, more sophisticated companies are more likely to add VMS. Approximately 35% of companies with at least 10,000 employees currently use VMS. Typically, VMS providers charge staffing firms 1% to 3% of total service revenues, which are usually recorded by staffing firms as a cost of services, thereby compressing margins. Kforce’s strategy has been to work with all VMS providers to enable us to provide Flexible Staffing Services to the broadest customer base possible in the sectors we serve.

In the United States, approximately 100 national competitors operate; and more than 20,000 smaller organizations compete in varying degrees at local levels. Several similar companies – global, national, and local – compete in foreign markets. In 2005, Kforce’s largest competitors included Adecco, S.A., Manpower, Inc., MPS Group, Inc., Robert Half International Inc., Spherion Corporation, Ciber Resources Connection, Jefferson Wells and CDI Corporation.

Kforce believes that availability and quality of personnel, level of service, effective monitoring of job performance, scope of geographic service and price of service are the principal elements of competition in our industry. We believe that availability of quality personnel is especially important. In order to attract candidates, we place emphasis upon our ability to provide permanent placement opportunities, competitive compensation and benefits, quality and varied assignments and scheduling flexibility. Because personnel pursue other employment opportunities on a regular basis, it is important that we respond to market conditions affecting these individuals. Additionally, in certain markets and in response to economic softening, we have experienced significant pricing pressure from some of our competitors. Although we believe we compete favorably with respect to these factors, we expect competition and pricing pressure to continue, and there can be no assurance that we will remain competitive.

Insurance

Kforce maintains a number of insurance policies including general liability, automobile liability and employers’ liability (each with excess liability coverage). We also maintain workers compensation, fidelity, fiduciary, directors and officers, professional liability, and employment practices liability policies. These policies provide coverage subject to their terms, conditions, limits of liability, and deductibles, for certain liabilities that may arise from Kforce’s operations. There can be no assurance that any of the above coverage will be adequate for our needs, or that we will maintain all such policies in the future.

Financial Information About Foreign and Domestic Operations

Materially all of Kforce’s revenues are derived from domestic operations with customers located in the United States, for the years ended December 31, 2005, 2004 and 2003.

Operating Employees and Personnel

As of December 31, 2005, Kforce employed 1,693 operating employees and had approximately 9,500 consultants on assignment (“Flexible Consultants”) providing flexible staffing services to our clients. Flexible Consultants are primarily individuals who are employed directly by Kforce (“Flexible Employees”) representing approximately 80% of Flexible Consultants; the balance are individuals who are employed by other entities (“Independent Contractors”) that provide their employees to Kforce for assignment to its clients. As the employer, Kforce is responsible for the operating employees’ and Flexible Employees’ payrolls and the employer’s share of applicable social security taxes (FICA), federal and state unemployment taxes, workers compensation insurance, and other direct labor costs relating to our employees. We offer

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access to various health, life and disability insurance programs and other benefits for operating employees and Flexible Employees. We have no collective bargaining agreements covering any of our operating employees or Flexible Employees, have never experienced any material labor disruption, and are unaware of any current efforts or plans to organize any of our employees.

Available Information

We make available, free of charge, through the Investor Relations page on our website, and by responding to requests addressed to our Vice President—Investor Relations, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports. These reports are available as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Our website address is <http://www.kforce.com>. The information contained on our website, or on other websites linked to our website, is not part of this document.

ITEM 1A. RISK FACTORS

Kforce may not be able to recruit and retain qualified personnel.

Kforce depends upon the abilities of its staff to attract and retain personnel, particularly technical and professional personnel, who possess the skills and experience necessary to meet the staffing requirements of our clients. We must continually evaluate and upgrade our base of available qualified personnel to keep pace with changing client needs and emerging technologies. We expect competition for individuals with proven technical or professional skills for the foreseeable future. If qualified personnel are not available to us in sufficient numbers and upon economic terms acceptable to us, it could have a material detrimental effect on our business.

Kforce's current market share may decrease as a result of limited barriers to entry for new competitors and discontinuation of clients outsourcing of their staffing needs.

Kforce faces significant competition in the markets we serve, and there are limited barriers to entry for new competitors. The competition among staffing services firms is intense. Kforce competes for potential clients with providers of outsourcing services, systems integrators, computer systems consultants, temporary personnel agencies, search firms and other providers of staffing services. A number of our competitors possess substantially greater resources than we do. From time to time we experience significant pressure from our clients to reduce price levels. During these periods, we may face increased competitive pricing pressures and may not be able to recruit the personnel necessary to fill our clients' needs. We also face the risk that certain of our current and prospective clients will decide to provide similar services internally. There can be no assurance that we will continue to successfully compete.

We rely on short-term contracts with most of our clients.

Because long-term contracts are not a significant part of our business, future results cannot be reliably predicted by considering past trends or extrapolating past results. Further, our reliance on short-term contracts exerts continued pressure on us when we try to renew contracts with existing clients who may seek better terms at each renewal.

Our "offshore" outsourcing solutions are limited.

Many staffing customers are now seeking an "offshore" solution to support their technology and business process function and, as a result, a significant amount of technology and financial staffing may be replaced by "offshore" resources. Prior to January 31, 2006, we did not provide an "offshore" program. Subsequent to the acquisition of PCCI on January 31, 2006, we do provide a limited technology staffing solution through a location in the Philippines to certain clients of PCCI whose contracts were acquired in conjunction with the acquisition. There can be no assurance that we will be able to compete successfully against other "offshore" solution providers or that we will not lose significant market share and revenue. While our Technology staffing revenue increased throughout 2004 and 2005, and we believe that the long-term business catalyst of technology remain in place, there can be no assurance that spending in the sector will return to the levels seen over the last decade.

We do not provide a Vendor Management System ("VMS") solution.

Many staffing customers are seeking to consolidate their use of staffing services through the use of VMS solutions. Kforce provides consultants to these clients through other staffing companies who utilize a VMS solution, but does not currently provide this service directly to its clients. There can be no assurance that we can continue to effectively compete with those companies that provide a VMS solution.

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Currently, Kforce is unable to recruit enough nurses to meet our clients' demands for nurse staffing services, limiting the potential growth of our healthcare staffing business.

Kforce relies on its ability to attract, develop, and retain nurses and other healthcare personnel who possess the skills, experience and licensure necessary to meet the specified requirements of our healthcare staffing clients. We compete for healthcare staffing personnel with other temporary healthcare staffing companies, as well as actual and potential clients. Currently, there is a shortage of qualified nurses in most areas of the United States and competition for nursing personnel is increasing. At this time, we do not have enough nurses to meet our clients' demands for our nurse staffing services. This shortage of nurses limits Kforce's ability to grow our healthcare staffing business. Furthermore, we believe that the aging of the existing nurse population and declining enrollments in nursing schools will result in further competition for qualified nursing personnel.

Decreases in patient occupancy at healthcare clients' facilities may adversely affect the profitability of Kforce's business.

Demand for temporary healthcare staffing services is significantly affected by the general level of patient occupancy at healthcare clients' facilities. When a hospital's occupancy increases, temporary employees are often added before full-time employees are hired. As occupancy decreases, clients may reduce their use of temporary employees before undertaking layoffs of their regular employees. Kforce may also experience more competitive pricing pressure during periods of occupancy downturn. This reduction in occupancy could adversely affect the demand for services and Kforce's profitability. There has been a significantly lessened demand for our healthcare staffing services in recent years. Although demand has improved for our healthcare staffing services during 2004 and 2005 there can be no assurance that such demand will remain at current levels.

Significant legal actions, particularly relating to our healthcare staffing services, could subject Kforce to substantial uninsured liabilities.

In recent years, healthcare providers have become subject to an increasing number of legal actions alleging malpractice, product liability or related legal theories. Many of these actions involve large claims and significant defense costs. In addition, we may be subject to claims related to torts or crimes committed by our employees or temporary staffing personnel. In some instances, we are required to indemnify clients against some or all of these risks. A failure of any of our employees or personnel to observe our policies and guidelines intended to reduce these risks, relevant client policies and guidelines or applicable federal, state or local laws, rules and regulations could result in negative publicity, payment of fines or other damages. To protect ourselves from the cost of these claims, we maintain professional malpractice liability insurance, fidelity insurance and general liability insurance coverage in amounts and with deductibles that we believe are appropriate for our operations. Our insurance coverage, however, may not cover all claims against us or continue to be available to us at a reasonable cost. If we are unable to maintain adequate insurance coverage, we may be exposed to substantial liabilities.

The addition of offices and entry into new geographic markets may not occur on a timely basis or achieve anticipated financial results.

Kforce's growth depends in part on our ability to enter new vertical or geographic markets successfully. This expansion is dependent on a number of factors, including our ability to:

- develop, recruit and maintain a base of qualified professionals within a new geographic market;
- initiate, develop and sustain corporate client relationships in each new vertical or geographic market;
- attract, hire, integrate and retain qualified sales and sales support employees; and
- accurately assess the demand of a new market.

The addition of new offices and entry into new vertical or geographic markets typically result in increases in operating expenses, primarily due to increased employee headcount. Expenses are incurred in advance of forecasted revenue, and there is typically a delay before our new employees reach full productivity. Additionally, demand for our services in new markets that we enter might also be less than we anticipate. If we are unable to enter new vertical or geographic markets in a cost-effective manner or if demand for our services in new markets does not meet or exceed our forecasts, our business, operating results and financial condition could be negatively impacted. In 2003, 2004 and 2005, we closed and consolidated offices to improve efficiency, and further closures or consolidation may occur depending on market and competitive conditions.

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Competition for acquisition opportunities may restrict Kforce's future growth by limiting our ability to make acquisitions at reasonable valuations.

Kforce's business strategy includes increasing market share and presence in the staffing industry through strategic acquisitions of companies that complement or enhance our business. We have historically faced competition for acquisitions. In the future, this could limit our ability to grow through acquisitions or could raise the prices of acquisitions and make them less accretive or possibly non-accretive to us. In addition, Kforce may be limited by its ability to obtain financing to consummate desirable acquisitions.

Kforce may face difficulties integrating acquisitions into existing operations and acquisitions may be unsuccessful, involve significant cash expenditures or expose Kforce to unforeseen liabilities.

Kforce continually evaluates opportunities to acquire staffing companies that complement or enhance our business and frequently has preliminary acquisition discussions with some of these companies.

These acquisitions involve numerous risks, including:

- potential loss of key employees or clients of acquired companies;
- difficulties integrating acquired personnel and distinct cultures into a single business;
- diversion of management attention from existing operations; and
- assumption of liabilities and exposure to unforeseen liabilities of acquired companies.

These acquisitions may also involve significant cash expenditures, debt incurrence, integration expenses and exposure to unforeseen liabilities that could have a material adverse effect on our financial condition and results of operations. Any acquisition may ultimately have a negative impact on our business and financial condition.

Kforce faces significant employment liability risk.

Kforce employs and places people in the workplaces of other businesses. An inherent risk of such activity includes possible claims of errors and omissions, misuse of client proprietary information, misappropriation of funds, discrimination and harassment, employment of illegal aliens, theft of client property, other criminal activity, torts or other claims. We have policies and guidelines in place to reduce our exposure to such risks. However, failure of any employee or personnel to follow these policies and guidelines may result in negative publicity, injunctive relief, payment by Kforce of monetary damages or fines or other material adverse effects upon our business. Moreover, we could be held responsible for the actions at a workplace of persons not under our immediate control. To reduce our exposure, we maintain insurance covering general liability, workers compensation claims, errors and omissions, and employee theft. Due to the nature of our assignments, in particular, access to client information systems and confidential information, and the potential liability with respect thereto, we may not be able to obtain insurance coverage in amounts adequate to cover any such liability on acceptable terms. In addition, we face various employment-related risks not covered by insurance, such as wage and hour laws and employment tax responsibility.

Kforce may be adversely affected by government regulation of the staffing business.

Our business is subject to regulation and licensing in many states. While we have had no material difficulty complying with regulations in the past, there can be no assurance that we will be able to continue to obtain all necessary licenses or approvals or that the cost of compliance will not prove to be material. If we fail to comply, such failure could materially adversely affect Kforce's financial results.

There are proposed changes in government visa rules that may materially impact our ability to bring foreign-born nurses to the United States. Our ability to bring nurses into the United States in the future may be severely impacted, which would affect our nurse staffing revenue. Kforce relies partially on foreign-born nurses in order to provide nurse staffing services to our healthcare customers.

Kforce may be adversely affected by government regulation of the workplace.

Part of our business entails employing individuals on a temporary basis and placing such individuals in clients' workplaces. Increased government regulation of the workplace or of the employer-employee relationship could have a material adverse affect on Kforce.

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If Kforce becomes subject to material liabilities under our self-insured programs, our financial results may be adversely affected.

Kforce provides workers compensation coverage through a program that is partially self-insured. In addition, we provide medical coverage to our employees through a partially self-insured preferred provider organization. If we become subject to substantial uninsured workers compensation or medical coverage liabilities, our financial results may be adversely affected.

Future changes in reimbursement trends could hamper our clients' ability to pay Kforce.

Many of Kforce's healthcare clients are reimbursed under the federal Medicare program and state Medicaid programs for the services they provide. In recent years, federal and state governments have made significant changes in these programs that have reduced government rates. In addition, insurance companies and managed care organizations seek to control costs by requiring that healthcare providers, such as hospitals, discount their services in exchange for exclusive or preferred participation in their benefit plans. Future federal and state legislation or evolving commercial reimbursement trends may further reduce, or change conditions for, our clients' reimbursement. Limitations on reimbursement could reduce our clients' cash flow, hampering their ability to pay us. This situation could have a significant impact on our cash flow.

Significant increases in payroll-related costs could adversely affect Kforce's business.

Kforce is required to pay a number of federal, state, and local payroll and related costs, including unemployment taxes, workers compensation and insurance, FICA, and Medicare, among others, for our employees. Significant increases in the effective rates of any payroll-related costs likely would have a material adverse effect upon Kforce. Costs could also increase as a result of health care reforms or the possible imposition of additional requirements and restrictions related to the placement of personnel. Recent federal and state legislative proposals have included provisions extending health insurance benefits to personnel who currently do not receive such benefits. We may not be able to increase the fees charged to our clients in a timely manner and in a sufficient amount to cover increased costs, if any such proposals are adopted.

Kforce depends on the proper functioning of our information systems.

Kforce is dependent on the proper functioning of information systems in operating its business. Critical information systems are used in every aspect of Kforce's daily operations, most significantly, in the identification and matching of staffing resources to client assignments and in the customer billing and consultant payment functions. Kforce's information systems are protected through physical and software safeguards including the use of a third party data processing center. However, Kforce and its systems are still vulnerable to natural disasters (we are headquartered in a hurricane prone area), fire, terrorist acts, power loss, telecommunications failures, physical or software break-ins, computer viruses and similar events. If our critical information systems fail or are otherwise unavailable, we would have to accomplish these functions manually, which could temporarily impact our ability to identify business opportunities quickly, to maintain billing and clinical records reliably, and to bill for services efficiently. In addition, we depend on third-party vendors for certain functions whose future performance and reliability we can not warranty.

Due to inherent limitations, there can be no assurance that our system of disclosure and internal controls and procedures will be successful in preventing all errors and fraud, or in making all material information known in a timely manner to management.

Our management, including our CEO and CFO, does not expect that our disclosure controls and internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Kforce have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, a control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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Kforce may not be able to maintain sufficient cash flow or borrowing capacity to support operations.

Kforce's liquidity may be adversely impacted by covenants in our Credit Facility. On October 28, 2005, Kforce entered into a Seventh Amendment to the Credit Facility (the "Extended Credit Facility") with a syndicate led by Bank of America. Under the Extended Credit Facility, Kforce's maximum borrowings are limited to \$100 million. In addition, Kforce has the right under the Extended Credit Facility to increase the maximum borrowings available to \$140 million under an accordion feature. Borrowings under the Extended Credit Facility are limited to 85% of eligible accounts receivable. Under the Extended Credit Facility, Kforce is required to meet certain minimum availability and fixed charge coverage ratio requirements. The Extended Credit Facility expires on November 3, 2010.

At no time during the existence of the Extended Credit Facility have we ever failed to meet the minimum availability and fixed charge coverage ratio requirements. If we did not comply with these financial covenants, such a breach of the Extended Credit Facility could materially adversely affect our liquidity and financial condition. Such lack of compliance could result, among other things, in the acceleration of all amounts borrowed under the Extended Credit Facility. See the Liquidity and Capital Resources section of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Adverse results in tax audits could result in significant cash expenditures or exposure to unforeseen liabilities.

Kforce is subject to periodic federal, state and local tax audits for various tax years. Although Kforce attempts to comply with all taxing authority regulations, adverse findings or assessments made by the taxing authorities as the result of an audit could have a material adverse affect on Kforce.

Kforce's success depends upon retaining the services of its management team.

Kforce is highly dependent on its management team and expects that continued success will depend largely upon their efforts and abilities. The loss of the services of any key executive for any reason could have a material adverse effect upon Kforce. Success also depends upon our ability to identify, develop, and retain qualified operating employees; particularly management, client servicing, and candidate recruiting employees. Kforce expends significant resources in the recruiting and training of its employees, as the pool of available applicants for these positions is limited. The loss of some of our key operating employees could have an adverse effect on our operations, including our ability to establish and maintain client and candidate, professional and technical relationships.

Kforce's stock price may be volatile.

Kforce's common stock is traded on The NASDAQ Stock Market under the symbol "KFRC". The market price of our stock has fluctuated substantially in the past and could fluctuate substantially in the future, based on a variety of factors, including our operating results, changes in general conditions in the economy, the financial markets, the employment services industry, or other developments affecting us, our clients, or our competitors, some of which may be unrelated to our performance.

In addition, the stock market in general, especially the NASDAQ National Market tier, along with market prices for staffing companies, has experienced volatility that has often been unrelated to the operating performance of these companies. These broad market and industry fluctuations may adversely affect the market price of our common stock, regardless of our operating results.

Among other things, volatility in our stock price could mean that investors will not be able to sell their shares at or above the prices that they pay. The volatility also could impair our ability in the future to offer common stock as a source of additional capital or as consideration in the acquisition of other businesses.

Provisions in Kforce's articles and bylaws and under Florida law may have certain anti-takeover effects.

Kforce's articles of incorporation and bylaws and Florida law contain provisions that may have the effect of inhibiting a non-negotiated merger or other business combination. In particular, our articles of incorporation provide for a staggered board of directors and permit the removal of directors only for cause. Additionally, management may issue up to 15 million shares of preferred stock, and fix the rights and preferences thereof, without a further vote of the shareholders. In addition, certain of our officers and managers have employment agreements containing certain provisions that call for substantial payments to be made to such employees in certain circumstances upon a change in control. Certain of these provisions may discourage a future acquisition of Kforce, including an acquisition in which shareholders might otherwise receive a premium for their shares. As a result, shareholders who might desire to participate in such a transaction may not have the opportunity to do so. Moreover, the existence of these provisions may have a depressive effect on the market price of our common stock.

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ITEM 2. PROPERTIES

We lease our corporate headquarters in Tampa, Florida, as well as space for our other locations. The aggregate area of office space under leases for locations is approximately 549,000 square feet. Field office leases generally run from month-to-month to five years. In September 2001, we relocated our corporate offices and local branches into a new headquarters in Tampa, Florida, which we have leased for 15 years. The aggregate annual rent expense in 2005 on all properties was approximately \$8.0 million. We believe that our facilities will be adequate for our current needs.

ITEM 3. LEGAL PROCEEDINGS

In the ordinary course of business, we are, from time to time, threatened with litigation or named as a defendant in various lawsuits and administrative proceedings, including workers compensation claims, discrimination claims, restrictive covenant disputes, service related disputes and other claims. We maintain liability insurance in such amounts and with such coverages and deductibles as management believes are reasonable. The principal risks that we insure against are workers compensation, personal injury, property damage, professional malpractice, errors and omissions, employment practices liability and fidelity losses. We are not aware of any pending legal proceedings that are likely to have a material adverse impact on Kforce.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR KFORCE COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

Our common stock trades on the NASDAQ National Market tier of The NASDAQ Stock Market(SM), under the symbol “KFRC”. The following table sets forth, for the periods indicated, the range of high and low closing sale prices for our common stock, as reported on the NASDAQ National Market. These prices represent inter-dealer quotations without retail markups, markdowns or commissions and may not represent actual transactions.

	<u>HIGH</u>	<u>LOW</u>
Calendar Year 2004:		
First Quarter	\$11.00	\$ 8.61
Second Quarter	\$11.35	\$ 8.19
Third Quarter	\$ 9.55	\$ 6.35
Fourth Quarter	\$12.31	\$ 8.15
Calendar Year 2005:		
First Quarter	\$11.71	\$10.06
Second Quarter	\$11.03	\$ 6.98
Third Quarter	\$11.36	\$ 8.09
Fourth Quarter	\$12.71	\$ 9.76

On February 28, 2006 there were approximately 270 holders of record of our common stock. On March 2, 2006, the last reported sale price of our common stock on the NASDAQ Exchange was \$12.03 per share.

Dividends

Since our initial public offering, we have not paid any cash dividends on our common stock. Under the terms of our Seventh Amendment to the Credit Facility, we are now allowed to make dividend distributions. Management has no plans on making any dividend distributions in the foreseeable future.

Equity Compensation Plan Information

The following table provides information about our common stock that may be issued upon the exercise of options, warrants, rights and restricted stock under all of our existing equity compensation plans as of December 31, 2005, including the Kforce Inc. Non-Employee Director Stock Option Plan, the Kforce Inc. Stock Incentive Plan, the Kforce Inc. Executive Investment Plan and the Kforce Inc. 1999 Employee Stock Purchase Plan:

<u>Plan Category</u>	<u>Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants, Rights and Restricted Stock Awards</u>	<u>Weighted Average Exercise Price of Outstanding Options, Warrants, Rights and Restricted Stock Awards</u>	<u>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans</u>
Equity Compensation Plans Approved by Shareholders	6,493,455	\$ 8.849	—

Issuer Purchases of Equity Securities

On June 23, 2005, our Board of Directors increased its authorization for open market repurchases of common stock by \$20 million to \$135 million. Prior to the execution of the Extended Credit Facility on October 28, 2005, the Credit Facility contained a provision that allowed Kforce to repurchase \$25 million of common stock per year. This limitation on the repurchase of common stock was removed under the Extended Credit Facility. Since inception to December 31, 2005, we have repurchased approximately 20.4 million shares for \$114.9 million under this plan. Approximately \$20.1 million is available under the current board authorization. Additional stock repurchases could have a material impact on the cash flow requirements for the next twelve months.

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<u>Period</u>	<u>Total number of shares purchased</u>	<u>Average price paid per share</u>	<u>Total number of shares purchased as part of publicly announced plans</u>	<u>Amount available under bank plan</u>	<u>Amount available under board plan</u>
January 2005	—	—	—	\$25,000,000	\$ 6,055,253
February 2005	—	—	—	25,000,000	6,055,253
March 2005	—	—	—	25,000,000	6,055,253
April 2005	—	—	—	25,000,000	6,055,253
May 2005	111,480	7.70	—	24,141,448	5,196,701
June 2005	639,800	7.90	—	19,087,511	20,142,765(a)
July 2005	—	—	—	19,087,511	20,142,765
August 2005	—	—	—	19,087,511	20,142,765
September 2005	—	—	—	19,087,511	20,142,765
October 2005	—	—	—	— (b)	20,142,765
November 2005	—	—	—	— (b)	20,142,765
December 2005	—	—	—	— (b)	20,142,765
Total	<u>751,280</u>	<u>7.87</u>	<u>—</u>	\$ — (b)	\$20,142,765
January 2004	34,510	\$ 10.40	—	\$24,640,944	\$10,006,478
February 2004	—	—	—	24,640,944	10,006,478
March 2004	—	—	—	24,640,944	10,006,478
April 2004	—	—	—	24,640,944	10,006,478
May 2004	—	—	—	24,640,944	10,006,478
June 2004	—	—	—	24,640,944	10,006,478
July 2004	—	—	—	24,640,944	10,006,478
August 2004	—	—	—	24,640,944	10,006,478
September 2004	—	—	—	24,640,944	10,006,478
October 2004	—	—	—	24,640,944	10,006,478
November 2004	—	—	—	24,640,944	10,006,478
December 2004	<u>351,011</u>	<u>11.26</u>	—	24,689,719	6,055,253
Total	<u>385,521</u>	<u>\$ 11.18</u>	<u>—</u>	\$24,689,719	\$ 6,055,253

- (a) Included in the calculation of amount available under board plan is an addition of \$20 million which was authorized in June 2005 by the Board of Directors.
- (b) Bank limitation on repurchases of common stock ended upon the execution of the Extended Credit Facility dated October 28, 2005.

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The information set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with Kforce's Consolidated Financial Statements and the related notes thereto incorporated into Item 8 of this report.

	YEARS ENDED DECEMBER 31,				
	2005	2004	2003	2002	2001
(IN THOUSANDS, EXCEPT PER SHARE DATA)					
STATEMENT OF OPERATIONS DATA:					
Net service revenues	\$802,265	\$661,451	\$495,585	\$513,547	\$658,417
Direct costs of services	542,276	457,567	341,617	345,585	406,017
Gross profit	259,989	203,884	153,968	167,962	252,400
Selling, general and administrative expenses	212,724	185,488	142,915	168,233	244,792
Depreciation and amortization.	8,283	5,221	4,371	9,629	17,325
Other expense, net	1,816	1,701	1,214	3,206	4,460
Income (loss) before income taxes and cumulative effect of change in accounting principle	37,166	11,474	5,468	(13,106)	(14,177)
Provision (benefit) for income taxes	14,845	(13,537)	350	102	(2,089)
Net income (loss) before cumulative effect of change in accounting principle	22,321	25,011	5,118	(13,208)	(12,088)
Cumulative effect of change in accounting principle	—	—	—	(33,823)	—
Net income (loss)	<u>\$ 22,321</u>	<u>\$ 25,011</u>	<u>\$ 5,118</u>	<u>\$ (47,031)</u>	<u>\$ (12,088)</u>
Earnings (loss) per share before cumulative effect of change in accounting principle-basic	<u>\$ 0.58</u>	<u>\$ 0.73</u>	<u>\$ 0.17</u>	<u>\$ (0.42)</u>	<u>\$ (0.38)</u>
Earnings (loss) per share-basic	<u>\$ 0.58</u>	<u>\$ 0.73</u>	<u>\$ 0.17</u>	<u>\$ (1.49)</u>	<u>\$ (0.38)</u>
Weighted average shares outstanding-basic	38,527	34,125	30,514	31,577	31,711
Earnings (loss) per share before cumulative effect of change in accounting principle-diluted	<u>\$ 0.55</u>	<u>\$ 0.69</u>	<u>\$ 0.16</u>	<u>\$ (0.42)</u>	<u>\$ (0.38)</u>
Earnings (loss) per share-diluted	<u>\$ 0.55</u>	<u>\$ 0.69</u>	<u>\$ 0.16</u>	<u>\$ (1.49)</u>	<u>\$ (0.38)</u>
Weighted average shares outstanding-diluted	40,616	36,091	31,231	31,577	31,711
DECEMBER 31,					
	2005	2004	2003	2002	2001
BALANCE SHEET DATA:					
Working capital	\$ 92,539	\$ 24,829	\$ 40,784	\$ 32,126	\$ 43,083
Total assets	\$324,746	\$273,195	\$160,317	\$151,435	\$222,772
Total long-term debt	\$ 38,167	\$ 1,727	\$ 22,000	\$ 22,000	\$ 28,185
Stockholders' equity	\$210,702	\$170,769	\$ 91,405	\$ 84,846	\$138,809

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ("MDA")

This MDA should be read in connection with Item 6. Selected Financial Data and Item 8. Financial Statements and Supplemental Data, included in this Form 10-K and, including the Notes to the Consolidated Financial Statements, referred to herein as "Financial Statements." Also, certain references to particular information in the Financial Statements are made to assist readers.

OVERVIEW

This overview is intended to assist readers in better understanding this MDA. Part 1, Item 1 of this Form 10-K includes additional information on Kforce's business.

Who We Are

We are a national provider of professional and technical specialty staffing services. At December 31, 2005, we operated 71 field offices covering 43 markets in 50 states and the District of Columbia. We provide our clients staffing services through three business segments: Technology ("Tech"), Finance and Accounting ("FA"), and Health and Life Sciences ("HLS"). Substantially all Tech and FA services are sold and delivered through our field offices. The HLS segment includes our Clinical Research, Scientific, Healthcare-Nursing ("Nursing") and Health Information Management ("HIM") specialties. The sales and delivery functions of substantial portions of HLS, particularly Clinical Research and HIM, are concentrated in our headquarters, with services being provided for certain clients through our field offices. Our headquarters provides support services to our field offices in areas such as human resources, nationwide recruiting, training, marketing, and national sales initiatives, in addition to the traditional "back office" support services like payroll, billing, accounting, legal and tax, which are highly centralized.

Kforce is focused on providing "staffing solutions" services to our clients. Our staffing services include Flexible Staffing Services ("Flex") and Search Services ("Search").

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Flex

Through Flex, we provide clients' with qualified individuals ("consultants") on a temporary basis with the appropriate skills and experience, when it is determined it is "the right match". To be successful, our employees ("associates") endeavor to (1) understand the clients' needs, (2) determine and understand the capabilities of the consultants being recruited, and (3) deliver and manage the client-consultant relationship to the satisfaction of both the clients and the consultants. Typically, the better job Kforce and our consultants do, the longer the assignments last and the more often those clients turn to Kforce for additional needs.

The Flex business comprised 93.2% of our revenues for the year ended December 31, 2005. Flex revenues are driven by hours billed and billing rates. Flex gross profit is determined by deducting consultant pay, benefits and other related costs from Flex revenues. Flex associate commissions, related taxes and other compensation and benefits as well as field management compensation are included in Selling, General and Administrative expenses ("SG&A") along with administrative and corporate compensation. The Flex business model involves attempting to maximize consultant hours and billing rates, while optimizing consultant pay rates and benefit costs and commissions and other compensation and benefits for associates, as well as minimizing the other operating costs necessary to effectively support such activities.

Search

The Search business is a smaller, yet important part of our business that involves locating permanent employees for our clients. We primarily perform searches on a contingency basis, with fees being earned only if personnel are hired by our clients. Fees are typically structured as a percentage of the placed individual's first-year annual compensation. We recruit permanent employees from our Flex consultant population, from the job boards, and from candidates we identify who are currently employed and not actively seeking another position. Sometimes consultants initially work with clients on a Flex basis and then later are converted into permanent employees, for which we also receive Search fees. There can be no assurance or expectation that Search revenues will increase if economic conditions improve, as has been the case in previous economic cycles. Clients and recruits are often targets for both Flex and Search services, and this common focus contributes to our objective of providing integrated solutions for all of our clients' human capital needs.

Search revenues are driven by placements made and the fees billed. There are no consultant payroll costs associated with the placement and thus all search revenue generally increases gross profit by a like amount. Search associate commissions, compensation and benefits are also included in SG&A. Search revenues comprised 6.8% of revenue in 2005.

Our Industry

We serve Fortune 1000 companies, as well as small and mid-size local and regional companies, with our largest ten clients representing approximately 22% of revenues for the year ended December 31, 2005. The specialty staffing industry is made up of thousands of companies, most of which are small local firms providing a limited service offering to a small local client base. We believe Kforce is one of the ten largest specialty staffing firms in the United States, that the ten firms combined have a market share of less than 21% of the applicable market and that no single firm has a larger than 5% market share. Competition in a particular market can come from many different companies, either large or small. We believe, however, that our geographic presence, diversified service offerings within our core businesses, and focus on consistent sales and delivery that is highly disciplined, provide a competitive advantage particularly with larger clients that have operations in multiple markets.

We believe 2003 was a bottoming-out year for the economy and for the staffing industry after having declined for approximately three years and that indicators favorable for staffing services improved through 2006. Selected industry reports indicate the United States temporary staffing industry has shown revenue levels of \$76 billion in 2003, \$81 billion in 2004 and \$107 billion in 2005. Of course, no predictions can or should be made about the general economy, the staffing industry as a whole, or specialty staffing in particular. We do believe, however, that a sustained economic recovery will stimulate demand for substantial additional U.S. workers or conversely, an economic slowdown will cause demand for additional U.S. workers to contract, that Flex demand generally increases before demand for permanent placements increases, that our three areas of focus, Tech, FA and HLS, will be among the higher growth categories in both the short and long-term and that over the long-term, temporary staffing will become a higher percentage of total jobs, particularly in the professional and technical areas. Further, we believe that the recent positive trends in our operating results, which we believe have been enhanced by the streamlining of our operations and centralizing certain support functions during the economic downturn of 2001-2003, demonstrate a strong positioning for success. There can be no assurance that customer demand for Kforce's specialty staffing sectors will return to previous levels or that pricing will return to historical levels. In addition, according to a recent survey of board members of mostly global companies by the American Staffing Association, 90% now utilize temporary staffing services. There can be no assurance that the Kforce Health and Life Sciences business segment will be able to assemble a

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sufficient candidate pool to service client needs. Partially driven by requirements at many public companies pertaining to the adoption of Section 404 of the Sarbanes-Oxley Act of 2002, competition for finance and accounting candidates significantly increased in 2004 and 2005. There can be no assurance that Kforce will be able to assemble a sufficient candidate pool to service client needs in finance and accounting. In addition, a number of national staffing companies are increasingly utilizing a lower-priced staffing preferred-vendor model. These factors may impact the future growth and profitability of Kforce.

Future Growth

Kforce's growth may be organic and/or through acquisition of other entities that enhance or expand our existing businesses. We believe that we are positioned to acquire and integrate other businesses that are strategically beneficial as evidenced by our successful acquisition and integration of Hall, Kinion and Associates, Inc. in June 2004 and VistaRMS, Inc. in February 2005.

On January 31, 2006, Kforce completed the acquisition of PCCI Holdings, Inc. ("PCCI") a privately held company based in Trevese, Pennsylvania. PCCI is engaged in the business of providing technology staffing and Federal government IT services. We believe the transaction will be accretive in 2006.

Highlights

The sections that follow this overview discuss and refer to critical accounting estimates and recent pronouncements, Kforce's results of operations and important aspects of its liquidity and capital resources. Set forth below are what we believe to be important highlights of our operating results and our positioning for the future. Such highlights should be considered in the context of all of the discussions herein and in conjunction with the Financial Statements. We believe such highlights are as follows:

- Revenue improved 21.3% during 2005, with growth in each of Kforce's operating segments for the year.
- Search revenue grew 32.6% during 2005.
- Kforce completed the acquisition and successful integration of VistaRMS during the first quarter. The integration of sales associates and the transition of the corporate headquarters all occurred on schedule.
- Operating expenses were reduced to 27.5% of revenues for 2005 versus 28.8% for 2004, and 29.7% for 2003.
- Total year net income before taxes of \$37.2 million in 2005 is an improvement of 224% over \$11.5 million in 2004.
- Cash flow was strong in 2005. At the end of the fourth quarter, cash on hand totaled \$37.1 million and bank debt outstanding under the credit facility totaled \$35 million.
- We believe that the quality of accounts receivable, our primary operating asset, continues to be good, with days sales outstanding ("DSO") at 37 days and 2005 bad debt expense of \$38,000.
- Kforce's stock price on the Nasdaq National Market increased 0.5% from \$11.10 on December 31, 2004, to \$11.16 at December 31, 2005.

CRITICAL ACCOUNTING ESTIMATES AND RECENT PRONOUNCEMENTS

The SEC has indicated that "critical accounting estimates" may be material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change, and due to their material impact on financial condition or operating performance. Readers should also refer to the Summary of Significant Accounting Policies in Note 1 to the Financial Statements for additional information. The following discussion is intended to assist the readers' understanding of the judgments, accounting estimates, and uncertainties inherent in the more significant of Kforce's policies.

This section is not intended to be a comprehensive list of all accounting estimates and all accounting policies are not set forth in the Financial Statements. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States of America, with no need for management's judgment in their application. There are also areas in which management's estimates and its judgment in selecting any available alternative would not produce a materially different result.

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Allowance for Doubtful Accounts and Fallouts

Kforce has established a reserve for estimated credit losses and fallouts on trade receivables based on our past experience and estimates of potential future write-offs, a specific analysis of material receivable balances that are past due and ongoing analysis of factors including short and long-term write-off trends, changes in economic conditions, and concentration of accounts receivable among clients. The allowance as a percentage of gross accounts receivable was 4.9% as of December 31, 2005 and 6.5% as of December 31, 2004. As of December 31, 2005, no single client has a receivable balance greater than 3.3% of total accounts receivable, and the largest ten clients represent approximately 20.2% of the total accounts receivable balance. Kforce incurred significant write-offs of accounts receivable in certain prior years. For the years ended December 31, 2005, 2004, and 2003, Kforce incurred bad debt expense (benefit), including the effects of net write-offs and write-ons plus changes in the allowance for doubtful accounts, totaling approximately \$38,000, \$1,846,000 and \$(394,000), respectively. In addition, for the years ended December 31, 2005, 2004 and 2003, Kforce incurred fallouts of search placements which have been deducted from net service revenues in the accompanying consolidated statements of income and comprehensive income totaling approximately \$1,967,000, \$1,431,000 and \$1,150,000, respectively. We cannot predict that such recent results can be sustained, particularly in a period of revenue growth. Also, it is possible that the write-off results could be materially impacted as the composition of accounts receivable changes over time. This is especially true if the economy deteriorates. We continually review and refine the estimation process to make it as responsive to these changes as possible.

Income Taxes

Kforce incurred net losses for each of the four years ending December 31, 2002, and, as a result, has significant net operating loss carryforwards (NOLs) for both federal and state income tax purposes. For accounting purposes, the estimated tax effects of such NOLs, plus or net of timing differences, result in current and non-current deferred tax assets. However, a determination must be made that it is "more likely than not" that the deferred tax assets will be realized, or valuation allowances must be established to offset such assets. At December 31, 2002, a "more likely than not" conclusion could not be reached, and the deferred tax assets were fully reserved. Kforce also acquired certain deferred tax assets in 2004 from Hall Kinion which were also fully reserved at the date of acquisition. Kforce had net income during each of the quarters in the year ended December 31, 2003, and portions of the deferred tax assets were recognized in that year by reducing such assets and the related valuation allowances instead of providing income tax expense, other than certain state tax expense or benefits. Kforce also had net income during each of the quarters in the year ended December 31, 2004. Kforce believes that profitability in each of the quarters for the years ended December 31, 2003 and December 31, 2004, and the corresponding forecast of future operating earnings, justifies changing the conclusion reached at December 31, 2002. Therefore, for the year ended December 31, 2004, Kforce recognized a \$13.5 million income tax benefit, which consists of the reversal of the valuation allowance in 2004, net of current and deferred income tax of \$5.7 million. In addition, during the year ended December 31, 2004, Kforce reversed \$21.8 million of valuation allowance related to deferred tax assets acquired in conjunction with the Hall Kinion acquisition. This reversal was recorded as an offset to goodwill. The tax provision recorded during the year ended December 31, 2005 totaled \$14.8 million, which resulted from Kforce earning income before income taxes totaling \$37.2 million and Kforce's effective tax rate of 39.9%. At December 31, 2005, Kforce has a remaining valuation allowance of \$1.4 million to offset certain deferred tax assets, including certain deferred tax assets acquired from Hall Kinion, for which a "more likely than not" conclusion could not be reached. Kforce will continue to evaluate this conclusion on a quarterly basis.

Goodwill

Kforce conducts an annual assessment of the carrying value of goodwill in accordance with generally accepted accounting standards. The annual assessments found that no impairment existed for the years ended December 31, 2005, 2004 or 2003. The annual assessment requires estimates and judgments by management to determine valuations for each "reporting unit", which for Kforce are Tech, FA, and HLS. Although not required, we may use independent outside experts to assist in performing such valuations. An independent expert valuation was performed in 2004, and management followed a similar methodology to reach its conclusion in 2003 and 2005. To the extent that economic conditions or the actual business activities and prospects of Kforce are materially worse in the future, the carrying value of goodwill assigned to any or all of its reporting units could require material write-downs. Kforce had goodwill of \$125.0 and \$108.4 million at December 31, 2005 and 2004, respectively. \$16.4 million of the increase in Goodwill is attributable to the acquisition of Vista and \$0.2 million is attributable to income tax related adjustments to the Hall Kinion acquisition goodwill.

Impairment of Long-Lived Assets

Kforce periodically reviews the carrying value of long-lived assets to determine if impairment has occurred. In Kforce's case, this primarily relates to fixed assets, capitalized software, and identifiable intangible assets (not goodwill) from acquisitions, which are being depreciated or amortized as described in the Financial Statements and which had net book values at December 31, 2005 of \$10.1 million, \$7.6 million, and \$9.3 million, respectively. Impairment losses, if any, are recorded in the period identified. Significant judgment is required to determine whether or not impairment has occurred. The determination is made by evaluating expected future undiscounted cash flows or the anticipated recoverability of costs

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incurred and, if necessary, determining the amount of the loss, if any, by evaluating the fair value of the assets. As further described in Note 4 to the Financial Statements, impairment write-offs were \$0.5 million in 2004, related to certain internally developed and purchased software and were included in selling, general and administrative expenses ("SG&A"). No such write-offs were recorded in 2003. Evaluation of the impairment of long-lived assets requires the exercise of continuing judgment and estimates by management.

Self-Insurance

Kforce offers employee benefits programs, including workers compensation and health insurance, to eligible employees, for which Kforce is self-insured for a portion of the cost. Kforce retains liability up to \$250,000 for each workers compensation claim and up to \$200,000 annually for each health insurance claim for which it is not insured. These self-insurance costs are accrued using estimates to approximate the liability for reported claims and claims incurred but not reported. Kforce believes that its estimation processes are adequate and its estimates in these areas have consistently been similar to actual results. However, estimates in this area are highly subjective and future results could be materially different.

Revenue Recognition

Net service revenues constitute the largest single item in our financial statements, though estimates in regard to revenue recognition are not material in nature. Net service revenues consist of Search fees and Flex billings inclusive of billable expenses and net of credits, discounts, rebates and fallouts. Kforce recognizes Flex billings based on the hours worked and reported, together with reimbursable expenses, by placed consultants. Search fees are recognized upon placement, net of an allowance for "fallouts". Fallouts are Search placements that do not complete the applicable contingency period which vary on a contract by contract basis. Contingency periods are typically ninety days or less. The allowance for fallouts is estimated based upon historical activity of Search placements that do not complete the contingency period and expectations of future fallouts, and is included with the allowance for doubtful accounts as a reduction in receivables.

Accrued Commissions

Associates earn commissions as a percentage of actual revenue or gross profit pursuant to a calendar year basis commission plan. For each associate, the amount of commissions paid as a percentage of revenue or gross profit increases as revenue levels increase. For interim periods, Kforce accrues commissions for actual revenue at a percentage equal to the percentage of total expected commissions payable to total revenue for the entire year. In estimating the percentage of expected commissions payable, Kforce uses factors including anticipated write-offs and the revenue anticipated for each associate. To the extent that these estimates differ from the actual results, commissions accrued could be materially different than commissions paid. Because of the calendar year basis of the plans, this estimation process is more significant at interim quarter ends than it is at calendar year end.

Accrued Bonuses

Kforce pays bonuses to certain executive management, field management and corporate employees based on, or after giving consideration to, a variety of measures of quarterly and annual performance. Executive management, field management, and certain corporate employees bonuses are accrued for payment after year end, based in part upon anticipated annual results compared to annual budgets. Field management bonuses are a component of approved compensation plans which specify individual incentive target levels based on actual results. Variances in revenue, gross margin, selling, general and administrative expenses or net income at a consolidated, segment or individual manager level can have a significant impact on the calculations and therefore the estimates of the required accruals. Accordingly, the actual earned bonuses may be materially different from the estimates used to determine the quarterly accruals.

EFFECTS OF RECENT ACCOUNTING PRONOUNCEMENTS

The following recently issued accounting pronouncements were effective for Kforce beginning January 1, 2004, and management has determined that the adoption of these standards had no material impact on Kforce's consolidated financial statements.

- SFAS 143, "Accounting for Asset Retirement Obligations", requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it occurred.
- SFAS 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of SFAS No. 13, and Technical Corrections", rescinds SFAS 4, "Reporting Gains and Losses from Extinguishment of Debt", and an amendment of that Statement, SFAS 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements". SFAS 145 also rescinds SFAS 44, "Accounting for Intangible Assets of Motor Carriers", and SFAS 13, "Accounting for Leases", eliminating an inconsistency between certain sale-leaseback transactions.

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- SFAS 146, “Accounting for Costs Associated with Exit or Disposal Activities”, addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue 94-3, “Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)”. SFAS 146 requires costs associated with exit or disposal activities to be recognized when the costs are incurred, rather than at a date of commitment to an exit or disposal plan.
- SFAS 149, “Amendment of Statement 133 on Derivative Instruments and Hedging Activities”, amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS 133. The changes in SFAS 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. In particular, SFAS 149 (1) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative discussed in paragraph 6(b) of SFAS 133, (2) clarifies when a derivative contains a financing component, (3) amends the definition of an underlying asset or liability to conform it to language used in FIN 45, and (4) amends certain other existing pronouncements.
- SFAS 150, “Accounting for Certain Financial Instruments with Certain Characteristics of Both Liabilities and Equity”, establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances).

SFAS 153, “Exchange of non-monetary assets”, amends APB Opinion No. 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. This statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of this standard did not have a material impact on Kforce’s consolidated financial statements.

In December of 2004 the Financial Accounting Standards Board (“FASB”) issued a revised version of SFAS 123, “Share-Based Payment” (SFAS 123R). This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods and services, but focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. This statement supersedes APB Opinion No. 25, “Accounting for Stock Issued to Employees,” and its related implementation guidance. This statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost is recognized over the period in which the employee is required to provide service in exchange for the award, which is usually the vesting period. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. This statement is effective for Kforce as of the beginning of the first annual reporting period that begins after June 15, 2005. Kforce intends to adopt SFAS 123R using the modified prospective method, and management does not believe the adoption of this standard will have a material impact on Kforce’s consolidated financial statements as all of Kforce’s outstanding stock options were fully vested as of December 31, 2005.

In May of 2005, FASB issued SFAS 154, “Accounting Changes and Error Corrections.” This statement replaces APB Opinion 20, “Accounting Changes,” and SFAS 3, “Reporting Accounting Changes in Interim Financial Statements.” This statement changes the requirements for the accounting for and reporting of a change in accounting principle, and applies to all voluntary changes in accounting principle. This statement also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. Previously, APB Opinion 20 required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires retrospective application to prior periods’ financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management does not believe the adoption of this standard will have a material impact on Kforce’s consolidated financial statements.

RESULTS OF OPERATIONS

Kforce saw a return to profitability in 2003 despite continuous challenges in the macro-economic environment. Profitability continued in 2004 and 2005 driven by revenue growth in all segments. We believe the expected stabilization of the economic outlook will allow for continued improving trends in the staffing industry and growth opportunities across our business lines in terms of both revenue and profitability. We believe this is particularly true in the Flex component of our revenues, which historically has shown growth during the early stages of an economic recovery. Our Search business has shown growth throughout 2004 and 2005; however, it remains difficult to predict whether there will be future growth in our Search business.

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We believe key components to our recent success were the initiatives undertaken during the last several years to restructure both our back office and field operations. The results of these efforts have increased operating efficiencies, thereby lowering our break-even level and enabling us to be more responsive to our clients. We believe our field operations model, which allows us to deliver our service offerings in a disciplined and consistent manner across all geographies and business lines, as well as our highly centralized back office operations, are competitive advantages and keys to our future growth and profitability.

The acquisitions of Hall Kinion, effective on June 7, 2004, and Vista, effective February 1, 2005, impacted our financial results and business drivers in the periods subsequent to the acquisitions. As a result of our successful integration efforts, revenues and costs contributed by the acquired entities are merged into the Kforce business segments, making it not feasible to accurately estimate the impact of the acquired businesses on Kforce's consolidated revenues and margins. Exclusive of any impacts of the acquisitions, we believe that demand is increasing and revenues are growing in all business segments. In addition, we believe that the acquisitions have provided a positive impact on Flex revenues for the Technology and Finance and Accounting segments. Search business and the HLS segment were not materially affected by the acquisitions. Kforce believes a portion of the increase in 2004 SG&A, primarily during the second quarter of 2004, is attributable to non-recurring integration expenses, transaction-related charges and temporary duplicate expenses related to the acquisition of Hall Kinion.

Net Service Revenues. The following table sets forth, as a percentage of net service revenues, certain items in our consolidated statements of operations for the indicated years:

	YEAR ENDED DECEMBER 31,		
	2005	2004	2003
Revenue by Segment:			
Tech	46.2%	46.3%	45.1%
FA	30.4	29.5	24.8
HLS	23.4	24.2	30.1
Net service revenues	100.0%	100.0%	100.0%
Revenue by Time:			
Flex	93.2%	93.7%	93.9%
Search	6.8	6.3	6.1
Net service revenues	100.0%	100.0%	100.0%
Gross profit	32.4%	30.8%	31.1%
Selling, general and administrative expenses	26.5%	28.0%	28.8%
Income before income taxes	4.6%	1.7%	1.1%
Net income	2.8%	3.8%	1.0%

The following table details net service revenues by service offering for each business segment and percentage changes from the prior year.

(in \$000's)	2005	Increase (Decrease)	2004	Increase (Decrease)	2003
Tech					
Flex	\$352,743	19.7%	\$294,598	36.0%	\$216,609
Search	18,037	58.3%	11,397	59.1%	7,162
Total Tech	<u>\$370,780</u>	21.2%	<u>\$305,995</u>	36.7%	<u>\$223,771</u>
FA					
Flex	\$211,873	25.1%	\$169,411	63.5%	\$103,630
Search	31,834	22.2%	26,058	36.0%	19,157
Total FA	<u>\$243,707</u>	24.7%	<u>\$195,469</u>	59.2%	<u>\$122,787</u>
HLS					
Flex	\$182,775	17.1%	\$156,071	7.7%	\$144,972
Search	5,003	27.8%	3,916	(3.4)%	4,055
Total HLS	<u>\$187,778</u>	17.4%	<u>\$159,987</u>	7.4%	<u>\$149,027</u>
Total Flex	\$747,391	20.5%	\$620,080	33.3%	\$465,211
Total Search	54,874	32.6%	41,371	36.2%	30,374
Total revenue	<u>\$802,265</u>	21.3%	<u>\$661,451</u>	33.5%	<u>\$495,585</u>

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Kforce experienced revenue growth in all segments in 2005 as well as 2004. Tech revenue increased 21.2% in 2005 versus a 36.7% increase in 2004 from 2003. FA revenue increased 24.7% in 2005 building on a 59.2% increase in 2004. Our HLS business segment grew by 17.4% in 2005 compared to revenue growth of 7.4% in 2004. Tech revenues were supplemented by the acquisition of Vista which occurred in February of 2005. FA and HLS revenues were unaffected by the Vista acquisition.

While quarterly comparisons are not fully discussed herein, certain quarterly revenue trends are referred to in discussing the annual comparisons. This 2005 quarterly information is presented only for this purpose.

(in \$000's, except Billing Days)	QUARTER ENDED			
	MARCH 31	JUNE 30	SEPT 30	DEC 31
Billing Days	63	64	64	61
Flex Revenue				
Tech	\$ 84,961	\$ 87,956	\$ 90,281	\$ 89,545
FA	51,279	51,627	54,998	53,969
HLS	43,174	44,993	47,907	46,701
Total Flex	<u>\$179,414</u>	<u>\$184,576</u>	<u>\$193,186</u>	<u>\$190,215</u>
Search Revenue				
Tech	\$ 4,592	\$ 4,307	\$ 4,793	\$ 4,345
FA	7,750	8,302	8,060	7,722
HLS	1,144	1,285	1,254	1,320
Total Search	<u>\$ 13,486</u>	<u>\$ 13,894</u>	<u>\$ 14,107</u>	<u>\$ 13,387</u>
Total Revenue				
Tech	\$ 89,553	\$ 92,263	\$ 95,074	\$ 93,890
FA	59,029	59,929	63,058	61,691
HLS	44,318	46,278	49,161	48,021
Total revenue	<u>\$192,900</u>	<u>\$198,470</u>	<u>\$207,293</u>	<u>\$203,602</u>

Flexible Billings. The primary drivers of Flex are the number of hours billed, bill rate per hour and, to a limited degree, the amount of expenses incurred by Kforce that are billable to the client.

Changing market share and the acquisition of Vista, coupled with overall changes in opportunities as the result of continued economic recovery are the main factors in changes in the number of hours billed. Total hours billed increased 12.8% to 16.7 million hours in 2005 from 14.8 million hours in 2004, due to increases in all segments. The increase of 39.8% in 2004 from 2003 was primarily a result of the economic recovery and the acquisition of Hall Kinion. Flex hours billed for the year, by segment, were as follows:

(in 000's)	2005	Increase (Decrease)	2004	Increase (Decrease)	2003
Tech	5,865	13.1%	5,185	39.3%	3,722
FA	7,116	14.5%	6,214	70.4%	3,647
HLS	3,746	9.0%	3,435	6.0%	3,241
Total hours billed	<u>16,727</u>	12.8%	<u>14,834</u>	39.8%	<u>10,610</u>

Billable expenses increased 18.8% in 2005 to \$15.4 million from \$12.9 million in 2004 and increased 9.4% in 2004 from \$11.8 million in 2003. The increase in 2005 was due to increases in HLS segment project work and the increase in 2004 is attributable to increases in all segments' project work. As the economic environment improves, clients' requests for consultants for longer assignments, which usually involve travel, typically increase. Changes in HLS billed expenses have corresponded with the overall changes in Flex billings for the segment. Flex billable expenses included in revenue for the year by segment were:

(in \$000's)	2005	Increase (Decrease)	2004	Increase (Decrease)	2003
Tech	\$ 2,897	(6.9)%	\$ 3,112	14.6%	\$ 2,714
FA	714	(34.7)%	1,093	16.4%	939
HLS	11,745	34.6%	8,724	6.9%	8,162
Total billable expenses	<u>\$15,356</u>	18.8%	<u>\$12,929</u>	9.4%	<u>\$11,815</u>

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Search Fees. The increase or decrease in Search fees is primarily attributable to the increase or decrease in the number of placements. Total placements increased 28.7% to 4,589 in 2005 and increased 34.8% to 3,567 placements in 2004 from 2,646 in 2003. An increase in the average placement fee of 3.1% in 2005 and 1.0% in 2004 also contributed to the results. We believe these results are primarily attributable to the improving economic conditions. Search activity historically increases after economic conditions have shown sustained improvement and is strongest during the peak of an economic cycle, although there can be no assurance that this historical trend will be followed in the current cycle. We believe that the acquisition of Vista has only had a minimal impact on Search revenue for 2005.

Gross Profit. Gross profit on Flex billings is determined by deducting the direct cost of services (primarily flexible personnel payroll wages, payroll taxes, payroll-related insurance, and subcontract costs) from net service revenues. Consistent with industry practices, gross profit dollars from search fees are equal to revenues, because there are generally no direct costs associated with such revenues. Gross profit increased 27.5% to \$260.0 million in 2005 and increased 32.4% to \$203.9 million in 2004 from \$154.0 million in 2003. Gross profit as a percentage of net service revenues increased to 32.4% in 2005 compared to 30.8% in 2004 and 31.1% in 2003.

The change in gross profit is attributable to changes in volume evidenced by changes in hours billed for Flex and for the number of placements for Search combined with changes in the spread between bill rate and pay rate ("Flex Rate") for Flex or the bill rate ("Rate") for Search. The increase in gross profit for Flex from 2004 to 2005 was \$42.6 million, of which \$23.2 million resulted from an increase in volume and \$19.4 million resulted from an increase in the Flex Rate. The increase in Search gross profit from 2004 to 2005 was \$13.5 million, comprised of a \$12.0 million increase in volume and a \$1.5 million increase in Rate. The increase in gross profit for Flex from 2003 to 2004 was \$38.9 million, of which \$46.2 million resulted from an increase in volume and \$7.3 million resulted from a decrease in the Flex Rate. The increase in Search gross profit from 2003 to 2004 was \$11.0 million, comprised of a \$10.5 million increase in volume and a \$0.5 million increase in Rate.

Changes in total gross profit percentage for the year by segment are as follows:

	<u>2005</u>	<u>Increase (Decrease)</u>	<u>2004</u>	<u>Increase (Decrease)</u>	<u>2003</u>
Tech	29.6%	7.3%	27.6%	0.3%	27.5%
FA	38.3%	2.2%	37.5%	(5.3)%	39.6%
HLS	30.3%	5.0%	28.8%	(1.8)%	29.3%
Total gross profit percentage	<u>32.4%</u>	<u>5.1%</u>	<u>30.8%</u>	<u>(0.8)%</u>	<u>31.1%</u>

Because Search revenue is accounted for as 100% gross profit, changes in the amount of search fees as a percent of total revenue can significantly impact the total gross profit percentage.

Flex gross profit percentage has been positively impacted by improvements in the Flex Rate between 2004 and 2005. We attribute this improvement to our continued focus on pricing, client mix, and business mix. Although we continue to see improvement, market pressures on pay rates as supply tightens impact the flex gross profit percentage negatively.

Flex gross profit percentage was negatively impacted from 2003 to 2004 by a shift in our client base to larger client contracts which provide a higher volume of business but often have lower margins. Additionally, payroll taxes, particularly unemployment taxes, which are highest in the first quarter of the year because employees have not yet earned sufficient wages to exceed the basis on which taxes are payable, have risen in recent years and may continue to rise and negatively impact Flex gross profit. In some cases, gross profit percentages for Flex were negatively impacted during 2004 by customer pressure to reduce bill rates and our inability to lower consultant pay rates in response to customer pressures. The reduction in gross profit percentage for the FA segment during 2004 was primarily the result of the inclusion of a larger mix of professional administrative positions contributed by the OnStaff group.

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Below is a table detailing Flex gross profit percentage for the year by segment.

	2005	Increase (Decrease)	2004	Increase (Decrease)	2003
Tech	26.0%	4.9%	24.8%	(1.3)%	25.2%
FA	29.0%	4.1%	27.9%	(1.9)%	28.4%
HLS	28.4%	4.9%	27.0%	(1.2)%	27.4%
Total Flex gross profit percentage	<u>27.4%</u>	<u>4.7%</u>	<u>26.2%</u>	<u>(1.4)%</u>	<u>26.6%</u>

Selling, General and Administrative (“SG&A”) Expenses. SG&A expenses were \$212.7 million, \$185.5 million, and \$142.9 million in 2005, 2004 and 2003, respectively, increasing by 14.7% during 2005 and increasing 29.7% during 2004. SG&A expenses as a percentage of net service revenues decreased to 26.5% in 2005 and 28.0% in 2004 compared to 28.8% for 2003.

The increase in SG&A expense in 2005, as compared to 2004 and 2003, is primarily attributable to increases in compensation expense as discussed below. Even with increasing compensation expense in 2005 and 2004, SG&A expenses as a percentage of net service revenues decreased in both 2005 and 2004 from prior year levels.

Total commissions, compensation, payroll taxes, and benefits costs were \$164.7 million, \$137.9 million and \$101.0 million representing 77.4%, 74.4% and 70.6% of total SG&A for the years ended December 31, 2005, 2004 and 2003, respectively. Increases in commissions and other incentive compensation are due to increases in gross profit and improved sales. Additional increases in compensation expense are due primarily to increases in headcount to support the increased volume of business, the increasing costs of payroll taxes, particularly unemployment taxes which have risen in recent years and compensation expense related to restricted stock and stock options in 2005 and 2004 as discussed below. The guiding principles related to employee compensation include competitive compensation plans that clearly pay for performance and align with Kforce’s objectives. Commissions and related payroll taxes and benefit costs are variable costs driven primarily by revenue and gross profit levels achieved by associates.

In January 2002, Kforce issued 223,800 shares of restricted stock to certain members of senior management and other employees in exchange for voluntarily reducing their 2002 salary and cash bonus potential. These shares vested over a five-year period with an acceleration clause if certain Kforce common stock price thresholds were met. During 2003 and 2002, \$221,000 and \$212,000, respectively, were charged to compensation expense for the straight-line amortization of vesting over the five-year period. On January 5, 2004, Kforce common stock closed at a price level that fully satisfied the acceleration clause for the 2002 shares and all of such restricted stock thereby vested. Because Kforce had been amortizing the value of such restricted stock on a straight line basis over the five-year period, and the stock price threshold had not been met on or prior to December 31, 2003, Kforce was required to record the unamortized balance of \$673,000 as compensation expense in the period when the stock price threshold was achieved, which was the first quarter of 2004.

On September 9, 2004, the Compensation Committee of the Board of Directors of Kforce accelerated the vesting period of stock options for all current employees that would otherwise have been unvested on January 1, 2005. The vesting period of options to purchase a total of 855,662 shares of Kforce’s common stock was accelerated. These options are held by fifteen employees, including options to purchase an aggregate of 748,162 shares of Kforce’s common stock held by six Executive Officers. Because of this accelerated vesting, Kforce does not currently have any outstanding options that would otherwise remain unvested on July 1, 2005. Accordingly, fair value accounting required by SFAS 123R, which will be adopted by Kforce on January 1, 2006, will not be applicable to any of Kforce’s currently outstanding options.

Kforce recorded \$1,106,000 of compensation expense in 2005 related to severance of \$882,000, option acceleration of \$130,000, and restricted stock acceleration of \$94,000 due to the departure of an executive officer. Kforce expects the remaining affected employees to continue to provide services through their applicable original vesting dates; therefore, there is no additional current expense as a result of the acceleration. If all affected employees were to terminate their employment prior to the applicable original vesting dates, the maximum future expense as of December 31, 2005 would be approximately \$751,000, and was reduced to approximately \$59,000 after the scheduled vesting dates in January 2006 passed.

On November 30, 2004, Kforce accelerated the vesting of 191,930 shares of performance restricted common stock that were granted to seven members of senior management in the first quarter of 2003. These shares were originally scheduled to vest in February 2005. Of this grant, 161,646 shares were granted to the CEO and the next four highest compensated employees. Kforce recorded \$27,000 of compensation expense related to this acceleration.

In addition to those activities undertaken to improve efficiencies, Kforce has attempted to manage its accounts receivable to minimize write-offs. Though there can be no assurance that Kforce will be able to maintain low levels of write-offs in the future, Kforce’s ability to sustain minimum write-offs and maintain days sales outstanding of accounts receivable at low levels has contributed to its continued low levels of SG&A as a percentage of revenue. Bad debt expense was \$38,000 and \$1.8 million or 0.0% and 0.3% of revenue for the years ended December 31, 2005 and 2004, respectively. The year ended December 31, 2003 had a net credit to expense of \$0.4 million.

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Kforce has substantially restructured both its field and back office operations over the past several years. We believe that these changes not only have had a significant impact on reductions in SG&A expenses in 2003, but also have allowed us to maintain a relatively low level of SG&A as a percentage of revenue, as revenues increased in 2004 and 2005. Some of the activities completed over the past three years as a result of restructuring include: (1) the roll-out of new front end software and related methodology in our field operations to ensure a consistent, disciplined process in our sales, recruiting and delivery activities; (2) the restructuring of compensation plans to more closely align with actual performance; and (3) the restructuring and consolidation of our technology infrastructure. As a result of increased efficiencies achieved by these actions, we believe the back office and other support service costs will increase at a lower rate than our revenues and profit in a growing environment. Additional systems initiatives are being undertaken in 2006 to further automate and integrate processing and support activities, which are expected to make them more efficient to scale, while also enhancing exceptional customer service capabilities. For example, we have acquired new time-entry and billing systems that are expected to be implemented in late 2006 or early 2007.

Depreciation and amortization. Depreciation and amortization were \$8.3 million, \$5.2 million and \$4.4 million in 2005, 2004 and 2003, respectively, representing an increase of 58.6% and an increase of 19.4% during 2005 and 2004, respectively. Depreciation and amortization expense as a percentage of net service revenue increased to 1.0% in 2005 from 0.8% for 2004 and 0.9% for 2003. Decreases or increases by category of expense, for the year, are as follows:

(in \$000's)	2005 Expense	Percent Increase (Decrease)	2004 Expense	Percent Increase (Decrease)	2003 Expense
Fixed asset depreciation	\$1,749	(15.6)%	\$2,073	(21.5)%	\$2,641
Capital lease asset depreciation	1,286	466.5	227	—	—
Capital software amortization	1,459	94.8	749	(23.2)	976
Intangible assets amortization	3,502	90.7	1,836	338.2	419
Other amortization	287	(14.6)	336	0.0	335
Total depreciation and amortization	<u>\$8,283</u>	58.6%	<u>\$5,221</u>	19.4%	<u>\$4,371</u>

The increase in expense in 2005 as compared to 2004 is primarily due to increases in amounts of intangible assets amortized as intangible assets increased from the Hall Kinion and Vista acquisitions in June of 2004 and February 2005 respectively, new capital leases for technology equipment, and increased capital software amortization related to new front end software. The increase in expense in 2004 as compared to 2003 is primarily due the increase in the amount of intangible assets amortized as intangible assets increased from the Hall Kinion acquisition in June of 2004 as well as to new capital leases for technology equipment. Capitalized software amortization expense also decreased in 2004 due to write-offs of obsolete software purchased in 2002. The purchases and implementation of the new time-entry and billing software mentioned above, will lead to increases in software amortization in future years. We believe the implementation of this software will enhance efficiency and productivity.

Other Expense. Other expense was \$1.8 million in 2005, \$1.7 million in 2004 and \$1.2 million in 2003. Other expense consists primarily of interest on Kforce's credit facility. The interest expense changes are primarily driven by changes in Kforce's outstanding balance and changes in the one month LIBOR rate which is used as the base rate in the credit facility. The average LIBOR rates in 2005, 2004 and 2003 were 3.46%, 1.54% and 1.20%, respectively. Other expense is partially offset by miscellaneous income of \$0.6 million in 2003 consisting primarily of legal and financial settlements.

Income Before Income Taxes. The income before income taxes of \$37.2 million in 2005, \$11.5 million in 2004 and \$5.5 million in 2003, is primarily the result of changes in net service revenues and gross margin and reduced SG&A and other expenses discussed above.

Income Taxes. The income tax provision for 2005 was \$14.8 million, the income tax benefit for 2004 was \$13.5 million and the income tax provision for 2003 was \$0.4 million. The 2005 income tax provision resulted from Kforce earning income before income taxes of \$37.2 million and Kforce's effective tax rate of 39.9%. The 2004 income tax benefit is primarily attributable to the reversal of valuation allowances of \$19.2 million, initially recorded in 2002 against all deferred tax assets, offset by current and deferred tax expense of \$5.7 million. The 2003 income tax provision is due to the recording of state income tax expense for which no corresponding state tax carryforwards were available.

Net Income. Net income was \$22.3 million in 2005 compared to \$25.0 million in 2004 and \$5.1 million in 2003, resulting from the net effects of those items discussed above.

LIQUIDITY AND CAPITAL RESOURCES

Historically, we have financed our operations through cash generated by operating activities and funds available from our revolving credit facilities. As highlighted in the Statements of Cash Flows, Kforce's liquidity and available capital resources are impacted by four key components: existing cash and equivalents, operating activities, investing activities and financing activities.

Cash and Equivalents

Cash and equivalents totaled \$37.1 million at the end of 2005, an increase of \$36.7 million from the \$0.4 million at year-end 2004 and \$23.4 million more than the \$13.7 million at year-end 2003. As further described below, during 2005, Kforce generated \$49.1 million of cash from operating activities, used \$7.2 million of cash in investing activities and used \$5.2 million in financing activities.

Operating Activities

During 2005, cash flow provided by operations was approximately \$49.1 million, resulting primarily from net income and non-cash adjustments for depreciation and amortization and for deferred income taxes, and an increase in accrued payroll costs.

At December 31, 2005, Kforce had \$55.4 million in positive working capital in addition to its \$37.1 million of cash and equivalents. Its current ratio (current assets divided by current liabilities) was 2.5 at the end of 2005 as compared to 1.3 at the end of 2004.

Investing Activities

During 2005, cash flow used in investing activities was approximately \$7.2 million, resulting primarily from \$2.9 million for the acquisition of Vista and \$5.3 million in capital expenditures, consisting primarily of computer software, offset by \$1.0 million from the release of restricted cash. Kforce expects cash and non-cash capital expenditures to remain relatively constant in 2006, primarily as the result of plans to purchase and implement new customer contracts management, time-entry, billing and possibly other software. Anticipated cash and non-cash capital expenditures in 2006 are currently expected to be in the \$10 million to \$12 million range and Kforce believes it has sufficient cash and borrowing capacity to fund these and such other capital expenditures necessary to operate the business.

Financing Activities

For the year 2005, cash flow used by financing activities was approximately \$5.2 million, resulting primarily from the purchase of treasury shares of \$5.9 million and the repayment of \$2.0 million of capital expenditure financing offset by proceeds of \$2.1 million from the exercise of stock options and \$0.9 million in net borrowings on our bank line of credit.

Kforce periodically issues restricted stock as part of compensation plans for certain members of corporate and field management. Details regarding these issuances can be found in Note 10 to the Financial Statements.

Credit Facility

Long-term debt outstanding under the \$100 million Amended and Restated Credit Facility with a syndicate of three banks ("the Credit Facility") was \$35.0 million and \$34.1 million at the end of 2005 and 2004, respectively.

On October 28, 2005, Kforce entered into a Seventh Amendment to the Credit Facility (the "Extended Credit Facility") with a syndicate led by Bank of America. Under the Extended Credit Facility, Kforce's maximum borrowings are limited to \$100 million. In addition, Kforce has the right under the Extended Credit Facility to increase the maximum borrowings available to \$140 million under an accordion feature. Borrowings under the Extended Credit Facility are limited to 85% of eligible accounts receivable. Under the Extended Credit Facility, Kforce may have loans outstanding with a rate of LIBOR plus 1.25% or Prime minus 0.25%. To the extent that Kforce has unused availability under the Extended Credit Facility, an unused line fee is required to be paid equal to 0.25% of the average unused balance on a monthly basis. Kforce was required to pay a closing fee of \$250,000 upon entering into the Extended Credit Facility, and is also required to pay an annual administrative fee of \$50,000. Borrowings under the Extended Credit Facility are secured by all of the assets of Kforce. Under the Extended Credit Facility, Kforce is required to meet certain minimum availability and fixed charge coverage ratio requirements, and is permitted to make dividend distributions if borrowing availability under the Extended Credit Facility is not less than \$15,000,000 after giving effect to the distributions. Kforce has been in compliance with the minimum availability and fixed charge coverage ratio requirements at all times during the history of the Extended Credit Facility. The Extended Credit Facility expires on November 3, 2010.

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In addition to the \$35.0 million and \$67.9 million outstanding, the amounts available under the Credit Facility as of December 31, 2005, and March 2, 2006 were \$36.7 million and \$16.8 million, respectively.

On June 23, 2005, our Board of Directors increased its authorization for open market repurchases of common stock by \$20 million to \$135 million. As of December 31, 2005 and March 2, 2006, we had repurchased approximately 20.4 million shares for \$114.9 million under this plan. Therefore, approximately \$20.1 million was available under the current board authorization as of December 31, 2005 and March 2, 2006. Additional stock repurchases could have a material impact on the cash flow requirements for the next twelve months. For a detailed presentation of open market purchases, see "Issuer Purchases of Equity Securities" on pages 15-16.

In March, April and May of 2003, we entered into four fixed interest rate swap contracts for a total notional amount of \$22 million expiring in March and May of 2005. The contracts, which have been classified as cash flow hedges pursuant to SFAS 133, as amended, effectively converted \$22 million of our outstanding debt under the Credit Facility to a fixed rate basis at an annual rate of approximately 4%, thus reducing the impact of interest rate changes on future income. One of these contracts expired on March 29, 2005. Subsequent to March 29, 2005, the remaining contracts effectively converted \$12 million of our outstanding debt under the credit facility to a fixed rate basis of approximately 4% until their expiration on May 31, 2005. After the expiration of the remaining interest rate swap contracts and prior to Kforce entering into the Extended Credit Facility, Kforce's interest rate on the entire Credit Facility returned to rates ranging from Prime to Prime plus .75% or LIBOR plus 1.75% to LIBOR plus 3.25% pursuant to certain financial performance targets as set forth in the original Amended Credit Facility.

Contractual Obligations and Commercial Commitments

Summarized below are Kforce's obligations and commitments to make future payments under lease agreements and debt obligations as of December 31, 2005:

(in \$000's)	Total	Less than	1-3 Years	3-5 Years	More than
		1 year			5 years
Operating leases	\$41,936	\$ 9,724	\$11,286	\$ 5,178	\$15,748
Capital leases	4,779	2,120	2,659	—	—
Credit facility	35,000	—	—	35,000	—
Deferred compensation plan liability	8,902	1,246	589	405	6,662
Other debt	1,775	995	780	—	—
Total	<u>\$92,392</u>	<u>\$14,085</u>	<u>\$15,314</u>	<u>\$40,583</u>	<u>\$22,410</u>

Kforce has a non-qualified deferred compensation plan pursuant to which eligible highly compensated key employees may elect to defer part of their compensation to later years. These amounts, which are classified as other accrued liabilities and other long-term liabilities, are payable upon retirement or termination of employment. Amounts payable upon the retirement or termination of employment may become payable during the next five years if covered employees retire or terminate during that time.

The amount outstanding on our Credit Facility currently bears interest at a rate of approximately 6.0% on \$35.0 million of the debt. At this level of \$35.0 million of debt and this effective rate of 6.0% on the entire balance, for a period of one year, interest expense would be approximately \$2.1 million.

Kforce provides letters of credit to certain vendors in lieu of cash deposits. Kforce currently has letters of credit totaling \$5,728 outstanding for facility lease deposits, workers compensation and property insurance obligations.

Kforce has no material, unrecorded commitments, losses, contingencies or guarantees associated with any related parties or unconsolidated entities.

We believe that existing cash and cash equivalents, cash flow from operations, and borrowings under the Credit Facility will be adequate to meet the capital expenditure and the working capital requirements of current operations for at least the next twelve months. However, deterioration in the business environment and market conditions could negatively impact operating results and liquidity. There is no assurance that, if operations were to deteriorate and additional financing were to become necessary, we will be able to obtain financing in amounts sufficient to meet operating requirements or at terms which are satisfactory and which allow us to remain competitive. Our expectation that existing resources will fund capital expenditure and working capital requirements is a forward-looking statement that is subject to risks and uncertainties.

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Actual results could differ from those indicated as a result of a number of factors, including the use of currently available resources for possible acquisitions and possible additional stock repurchases.

Acquisitions and Divestitures

Kforce made acquisitions and divestitures in 2005 and 2004 which are discussed in Note 6 to the Financial Statements. In addition, on January 31, 2006 we completed the acquisition of PCCI Holdings, Inc., as discussed below.

PCCI Holdings, Inc.

On January 31, 2006, Kforce acquired PCCI Holdings, Inc., pursuant to an Agreement and Plan of Merger (the "Merger Agreement") by and among Kforce, Trevoze Acquisition Corporation, a Delaware corporation and a wholly-owned subsidiary of Kforce ("Merger Sub"), PCCI Holdings, Inc., a Delaware corporation ("PCCI"), H.I.G. Pinkerton, Inc., a Cayman company, in its capacity as Representative, William D. Pinkerton and Richard J. Quigley. Under the terms of the Merger Agreement, Kforce acquired all of the outstanding stock of PCCI for approximately \$60,000,000 (the "Purchase Price") payable in cash at closing, subject to certain adjustments as provided for in the Merger Agreement. On the closing date, Kforce placed into escrow \$6,000,000 of the total Purchase Price to secure PCCI's indemnification obligations, and to satisfy certain adjustments to the Purchase Price. To the extent that escrowed funds remain after satisfaction of PCCI's indemnification obligations and Purchase Price adjustments, those amounts will be released to PCCI and accounted for as Purchase Price as of the date the proceeds are issuable from the escrow.

PCCI was a privately held company based in Trevoze, Pennsylvania that, through its wholly-owned subsidiaries (primarily Pinkerton Computer Consultants, Inc.), produced revenue of approximately \$95 million in technology staffing and the Federal government IT services sector over the last 12 months. Approximately 35% of that revenue was generated in the government sector. As a result of the above acquisition, Kforce expanded its presence in technology staffing in both the Federal government and commercial sectors. Because the closing occurred in 2006, none of PCCI's results of operations have been included in Kforce's consolidated financial statements as of December 31, 2005. Kforce is currently in the process of allocating the purchase price to the fair values of the assets and liabilities acquired in conjunction with the acquisition.

VistaRMS, Inc.

On February 1, 2005, Kforce completed the acquisition of substantially all of the assets of VistaRMS, Inc. ("Vista"), a privately held company based in Herndon, Virginia. Vista is engaged in the business of providing integrated business and information technology staffing and solutions to the commercial and government sectors. The integration of the operations of Vista into Kforce was substantially complete as of the end of the first quarter of 2005.

Pursuant to an Asset Purchase Agreement, dated as of December 3, 2004, between Kforce, Vista, and the shareholders of Vista, Kforce purchased substantially all of the assets of Vista and assumed and became responsible for certain of Vista's liabilities at the closing of the transaction on February 1, 2005. As consideration for the assets being acquired, Kforce issued upon the closing of the transactions 2,348,337 shares of Kforce common stock (the "Common Stock"). The number of shares of Common Stock issued in connection with the Agreement was based on a price per share of Common Stock of \$10.22, which represented the average per share closing price of the Common Stock during the period of October 20, 2004 through November 2, 2004.

On the date of closing, Kforce placed into escrow 450,000 shares of the Common Stock for the purpose of securing Vista's indemnification obligations under the Agreement and placed an additional 782,779 shares of the Common Stock into escrow to satisfy potential adjustments to the purchase price that were determined following the consummation of the transactions contemplated by the Agreement. Following the closing, the purchase price was reduced by approximately \$3.2 million pursuant to the terms of the Agreement to reflect (i) the extent to which the net assets of Vista as of June 30, 2004 exceeded the net assets of Vista as of the date of the closing of the transaction contemplated by the Agreement, (ii) certain of Vista's accounts receivable that were being transferred to Kforce under the Agreement and that remained uncollected 90 days following the closing of the transaction contemplated by the Agreement, and (iii) the amount of tax liability incurred by Kforce resulting from Vista's use of the cash receipts and disbursements method of accounting for computing taxable income.

At February 1, 2006, 1,809,336 shares were issued under the terms of the Agreement, with a total addition to equity of approximately \$20.9 million and 225,000 shares remain in escrow. Kforce also incurred approximately \$455,000 in transaction costs, which includes approximately \$179,000 of transaction costs paid in 2004, and assumed net liabilities of approximately \$663,000. To the extent additional shares are issued out of escrow to Vista after purchase price contingencies have been resolved, those shares will be recorded as an addition to the purchase price.

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Hall, Kinion and Associates Inc.

On June 7, 2004, Kforce acquired 100% of the outstanding common stock of Hall, Kinion and Associates Inc. ("Hall Kinion") and its subsidiaries in exchange for approximately 5.7 million shares of Kforce stock. This acquisition was accounted for using the purchase method. Hall Kinion's first quarter 2004 and full year 2003 revenues were \$30.4 million and \$156.9 million, respectively. The results of Hall Kinion's operations since the date of acquisition have been included in Kforce's consolidated financial statements. Hall Kinion specialized in providing technology and finance and accounting related talent on a temporary and permanent basis to its customers primarily in the United States. The results of the technology and finance and accounting businesses (previously provided by Hall Kinion's "OnStaff" group) are included in Kforce's Technology and Finance and Accounting business segments, respectively.

As a result of this acquisition, Kforce expanded its market presence by adding 18 offices, not including 25 offices that have been consolidated with existing Kforce offices. The acquisition also expanded Kforce's service offerings in technology and finance and accounting in certain market segments. We believe the integration of the operations of Hall Kinion into Kforce is substantially complete and has had a positive effect on revenues, net income and earnings per share beginning in the third quarter of 2004. We have not compiled separate results for the former Hall Kinion operations because these operations have been integrated into Kforce and it is not feasible to track their results.

Details of the terms of the acquisition are included in a Registration Statement on Form S-4 that we filed on December 24, 2003, and amended on February 9, 2004, April 13, 2004, May 3, 2004 and May 5, 2004.

Income Tax Audits

We are also periodically subject to state and other local income tax audits for various tax years. During 2005, an income tax audit for the state of North Carolina was concluded with no material adverse assessments. At December 31, 2005, an ongoing audit for which no final determination has been made was being conducted by the state of New Jersey. As of March 2, 2006, we do not believe the resolution of any of these audits will have a material adverse impact on our operations or financial condition.

Registration Statement on Form S-3

On May 24, 2002, Kforce filed a Registration Statement on Form S-3 that allows the issuance of up to \$250 million of common stock and other equity and financial instruments for the financing of various corporate activities to potentially include funding for acquisitions and other business expansion opportunities, as well as compensation arrangements. Such filings are referred to as "Shelf Registrations". No issuance of securities has been made under this registration statement as of December 31, 2004. The Shelf Registration was not used for the shares issued in connection with the Hall Kinion or Vista acquisitions because Shelf Registrations on Form S-3 are not available for the registration of securities issued in business combination transactions. There is no assurance that the existence of the Shelf Registration will assist Kforce in registering its securities in connection with future efforts to raise capital or for other purposes.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Kforce is exposed to a variety of risks, including changes in interest rates on borrowings. As of December 31, 2005, Kforce is exposed to changes in interest rates on the \$35.0 million of debt. Kforce does not engage in trading market risk sensitive instruments for speculative purposes. Kforce believes that effects on it of changes in interest rates are limited and a 1% change in rates would have an annual effect of approximately \$350,000 on our interest expense.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and notes thereto and the report of Deloitte & Touche LLP, our independent auditors, are set forth on the pages indicated in Item 15 and are incorporated into this item by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

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ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation required by Rules 13a-15 and 15d-15 under the Exchange Act (the "Evaluation"), as of the end of the period covered by this report, under the supervision and with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15 and 15d-15 under the Exchange Act ("Disclosure Controls"). Based on the Evaluation, our CEO and CFO concluded that, our Disclosure Controls are effective in timely alerting them to material information required to be included in our periodic SEC reports.

Changes in Internal Controls

There has not been any change in our internal control over financial reporting identified in connection with the Evaluation that occurred during the quarter ended December 31, 2005 that has materially affected, or is reasonably likely to materially affect, those controls.

Inherent Limitations of Internal Control Over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

CEO and CFO Certifications

Exhibits 31.1 and 31.2 are the Certifications of the CEO and the CFO, respectively. The Certifications are required in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 (the "Section 302 Certifications"). This Item of this report, which you are currently reading, is the information concerning the Evaluation referred to in the Section 302 Certifications and this information should be read in conjunction with the Section 302 Certifications for a more complete understanding of the topics presented.

Management Report on Internal Control Over Financial Reporting

The management of Kforce is responsible for establishing and maintaining adequate internal control over financial reporting. Kforce's internal control system was designed to provide reasonable assurance to Kforce's management and Board of Directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

On February 20, 2006, Kforce management assessed the effectiveness of Kforce's internal control over financial reporting as of December 31, 2005. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control — Integrated Framework*. Based on our assessment we believe that, as of December 31, 2005, Kforce's internal control over financial reporting is effective based on those criteria.

Kforce's independent registered public accounting firm, Deloitte & Touche LLP, has issued an audit report on our assessment of Kforce's internal control over financial reporting. This report appears below.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Kforce Inc.
Tampa, Florida

We have audited management's assessment, included in the accompanying Management Report on Internal Control Over Financial Reporting that Kforce Inc. and subsidiaries ("Kforce") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Kforce's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting.

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Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of Kforce's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Kforce maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, Kforce maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2005 of Kforce and our report dated March 2, 2006 expressed an unqualified opinion on those financial statements and financial statement schedule.

Deloitte & Touche LLP
Certified Public Accountants

Tampa, Florida
March 2, 2006

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF KFORCE

The information required by Item 10 relating to our executive officers and directors is incorporated herein by reference to our definitive proxy statement for the 2006 Annual Meeting of Shareholders, to be filed with the Securities and Exchange Commission within 120 days of December 31, 2005.

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ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 relating to executive compensation is incorporated herein by reference to our definitive proxy statement for the 2006 Annual Meeting of Shareholders, to be filed with the Securities and Exchange Commission within 120 days of December 31, 2005.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 relating to security ownership of certain beneficial owners and management and related stockholders matters is incorporated herein by reference to our definitive proxy statement for the 2006 Annual Meeting of Shareholders, to be filed with the Securities and Exchange Commission within 120 days of December 31, 2005.

Information regarding equity compensation plans required by this item is included in Item 5 of Part II of this report and is incorporated into this item by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by Item 13 relating to certain relationships and related transactions is incorporated herein by reference to our definitive proxy statement for the 2006 Annual Meeting of Shareholders, to be filed with the Securities and Exchange Commission within 120 days of December 31, 2005.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 relating to executive compensation is incorporated herein by reference to our definitive proxy statement for the 2006 Annual Meeting of Shareholders, to be filed with the Securities and Exchange Commission within 120 days of December 31, 2005.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 10-K

- (a) The following documents are filed as part of this Report:

1. Financial Statements. The consolidated financial statements, and related notes thereto, of Kforce with the Report of Independent Registered Public Accounting Firm thereon are included in Part IV of this report on the pages indicated by the Index to Consolidated Financial Statements and Schedule as presented on page 35 of this report.

2. Consolidated Financial Statement Schedule. The consolidated financial statement schedule of Kforce is included in Part IV of this report on the page indicated by the Index to Consolidated Financial Statements and Schedule as presented on page 35 of this report. The independent auditors' report as presented on page 36 of this report applies to the consolidated financial statement schedule. This financial statement schedule should be read in conjunction with the consolidated financial statements, and related notes thereto of Kforce.

Schedules not listed in the Index to Consolidated Financial Statements and Schedule have been omitted because they are not applicable, not required, or the information required to be set forth therein is included in the consolidated financial statements or notes thereto.

3. Exhibits. See Item 15(c) below.

- (c) **Exhibits.** The exhibits listed on the Exhibits Index are filed as part of, or incorporated by reference into, this report.
- (d) **Consolidated Financial Statement Schedules.** See Item 15(a) above.

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KFORCE INC. AND SUBSIDIARIES
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Kforce Inc.
Tampa, Florida

We have audited the accompanying consolidated balance sheets of Kforce Inc. and subsidiaries (“Kforce”) as of December 31, 2005 and 2004, and the related consolidated statements of income and comprehensive income, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of Kforce’s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Kforce Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Kforce’s internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 2, 2006 expressed an unqualified opinion on management’s assessment of the effectiveness of Kforce’s internal control over financial reporting and an unqualified opinion on the effectiveness of Kforce’s internal control over financial reporting.

Deloitte & Touche LLP
Certified Public Accountants

Tampa, Florida
March 2, 2006

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KFORCE INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	DECEMBER 31,	
	2005	2004
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 37,104	\$ 363
Trade receivables, net of allowance for doubtful accounts and fallouts of \$5,099 and \$6,268, respectively	99,354	90,682
Income tax refund receivable	72	606
Current deferred tax asset, net	15,793	17,180
Prepaid expenses and other current assets	3,236	5,162
Total current assets	155,559	113,993
Fixed assets, net	10,148	8,579
Non-current deferred tax asset, net	4,451	19,016
Other assets, net	20,248	13,416
Intangible assets, net	9,336	9,838
Goodwill	125,004	108,353
Total assets	<u>\$ 324,746</u>	<u>\$ 273,195</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and other accrued liabilities	\$ 19,808	\$ 22,097
Accrued payroll costs	39,332	30,321
Bank overdrafts	146	1,349
Current debt - credit facility	—	34,100
Other current debt	2,885	993
Income taxes payable	849	303
Total current liabilities	63,020	89,163
Long-term debt - credit facility	35,000	—
Long-term debt - other	3,167	1,727
Other long-term liabilities	12,857	11,536
Total liabilities	<u>114,044</u>	<u>102,426</u>
Commitments and contingencies (Note 12)		
Stockholders' Equity:		
Preferred stock, \$0.01 par; 15,000 shares authorized, none issued and outstanding	—	—
Common stock, \$0.01 par; 250,000 shares authorized, 57,895 and 55,891 issued, respectively	579	559
Additional paid-in capital	278,486	257,315
Unamortized stock based compensation	(1,094)	(2,759)
Accumulated other comprehensive income	—	37
Retained earnings	39,694	17,373
Less reacquired shares at cost; 19,238 and 18,614 shares, respectively	(106,963)	(101,756)
Total stockholders' equity	<u>210,702</u>	<u>170,769</u>
Total liabilities and stockholders' equity	<u>\$ 324,746</u>	<u>\$ 273,195</u>

The accompanying notes are an integral part of these consolidated financial statements.

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KFORCE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	YEARS ENDED DECEMBER 31,		
	2005	2004	2003
Net service revenues	\$802,265	\$661,451	\$495,585
Direct costs of services	<u>542,276</u>	<u>457,567</u>	<u>341,617</u>
Gross profit	259,989	203,884	153,968
Selling, general and administrative expenses	212,724	185,488	142,915
Depreciation and amortization	<u>8,283</u>	<u>5,221</u>	<u>4,371</u>
Income from operations	38,982	13,175	6,682
Other expense (income):			
Interest income	(199)	(98)	(84)
Interest expense	2,055	1,827	1,703
Other (income) expense, net	<u>(40)</u>	<u>(28)</u>	<u>(405)</u>
Income before income taxes	37,166	11,474	5,468
Provision (benefit) for income taxes	<u>14,845</u>	<u>(13,537)</u>	<u>350</u>
Net income	22,321	25,011	5,118
Other comprehensive (loss) income:			
Cash flow hedges, net of taxes	<u>(37)</u>	<u>188</u>	<u>154</u>
Comprehensive income	<u>\$ 22,284</u>	<u>\$ 25,199</u>	<u>\$ 5,272</u>
Earnings per share - Basic	<u>\$ 0.58</u>	<u>\$ 0.73</u>	<u>\$ 0.17</u>
Weighted average shares outstanding - Basic	<u>38,527</u>	<u>34,125</u>	<u>30,514</u>
Earnings per share - Diluted	<u>\$ 0.55</u>	<u>\$ 0.69</u>	<u>\$ 0.16</u>
Weighted average shares outstanding - Diluted	<u>40,616</u>	<u>36,091</u>	<u>31,231</u>

The accompanying notes are an integral part of these consolidated financial statements.

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KFORCE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(IN THOUSANDS)

	Years Ended December 31,		
	2005	2004	2003
Common stock – shares:			
Shares at beginning of period	55,891	48,903	48,544
Exercise of stock options	420	849	193
Stock issued for business acquired	1,584	5,742	—
Issuance of restricted stock	—	397	166
Shares at end of period	<u>57,895</u>	<u>55,891</u>	<u>48,903</u>
Common stock – par value:			
Balance at beginning of period	\$ 559	\$ 489	\$ 485
Exercise of stock options	4	9	2
Stock issued for business acquired	16	57	—
Issuance of restricted stock	—	4	2
Balance at end of period	<u>\$ 579</u>	<u>\$ 559</u>	<u>\$ 489</u>
Additional paid-in capital:			
Balance at beginning of period	\$ 257,315	\$ 197,660	\$196,510
Exercise of stock options	2,266	4,506	872
Tax benefit from disqualifying dispositions of stock options	341	611	—
Deferred compensation plan transactions	—	—	228
Employee stock purchase plan	256	68	(297)
Stock issued for business acquired	18,308	51,331	—
Issuance of restricted stock	—	3,139	347
Balance at end of period	<u>\$ 278,486</u>	<u>\$ 257,315</u>	<u>\$197,660</u>
Deferred compensation stock obligation:			
Balance at beginning of period	\$ —	\$ —	\$ (742)
Change in obligation	—	—	742
Balance at end of period	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Unamortized stock based compensation:			
Balance at beginning of period	\$ (2,759)	\$ (863)	\$ (894)
Issuance of restricted stock, net	—	(3,143)	(349)
Amortization of stock based compensation	1,665	1,247	380
Balance at end of period	<u>\$ (1,094)</u>	<u>\$ (2,759)</u>	<u>\$ (863)</u>
Accumulated other comprehensive income (loss):			
Balance at beginning of period	\$ 37	\$ (151)	\$ (305)
Change in fair value of cash flow hedges, net of taxes	(37)	188	(151)
Amortization of hedged interest	—	—	305
Balance at end of period	<u>\$ —</u>	<u>\$ 37</u>	<u>\$ (151)</u>
Retained earnings (accumulated deficit):			
Balance at beginning of period	\$ 17,373	\$ (7,638)	\$ (12,756)
Net income	22,321	25,011	5,118
Balance at end of period	<u>\$ 39,694</u>	<u>\$ 17,373</u>	<u>\$ (7,638)</u>
Treasury stock - shares:			
Shares at beginning of period	18,614	18,350	18,286
Deferred compensation plan transactions	—	—	177
Employee stock purchase plan	(127)	(121)	(162)
Repurchase of common stock	751	385	49
Shares at end of period	<u>19,238</u>	<u>18,614</u>	<u>18,350</u>
Treasury stock - cost:			
Balance at beginning of period	\$(101,756)	\$ (98,092)	\$ (97,452)
Deferred compensation plan transactions	—	—	(1,357)
Employee stock purchase plan	705	646	863
Repurchase of common stock	(5,912)	(4,310)	(146)
Balance at end of period	<u>\$(106,963)</u>	<u>\$(101,756)</u>	<u>\$ (98,092)</u>

The accompanying notes are an integral part of these consolidated financial statements.

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KFORCE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	YEARS ENDED DECEMBER 31,		
	2005	2004	2003
Cash flows from operating activities:			
Net income	\$ 22,321	\$ 25,011	\$ 5,118
Adjustments to reconcile net income to cash provided by operating activities:			
Deferred income tax provision (benefit), net	14,945	(12,789)	—
Depreciation and amortization	8,283	5,221	4,371
Amortization of stock based compensation	1,795	1,247	380
Gain on cash surrender value of company-owned life insurance policies	(546)	(469)	(1,469)
Deferred compensation expenses	533	404	1,226
Provision for (recovery of) bad debts on accounts receivable	38	1,846	(394)
(Gain) loss on asset sales/disposals	(38)	224	74
Amortization of hedged interest	—	—	305
Loss on asset impairment	—	498	—
(Increase) decrease in operating assets:			
Trade and notes receivables, net	1,422	(13,090)	1,212
Prepaid expenses and other current assets	1,037	(458)	783
Income tax refund receivable	533	(338)	551
Other assets, net	(1,956)	(1,058)	(560)
Increase (decrease) in operating liabilities:			
Accounts payable and other accrued liabilities	(3,865)	(807)	(2,056)
Accrued payroll costs	6,861	4,745	2,209
Bank overdrafts	(1,204)	(2,040)	867
Income taxes payable	(41)	203	—
Other liabilities	(970)	(1,970)	364
Cash provided by operating activities	<u>49,148</u>	<u>6,380</u>	<u>12,981</u>
Cash flows from investing activities:			
Capital expenditures	(5,304)	(3,646)	(1,255)
Acquisition, net of cash received	(2,903)	(28,012)	—
Release of restricted cash	964	—	—
Cash proceeds from sale of assets	<u>13</u>	<u>42</u>	<u>208</u>
Cash used in investing activities	<u>(7,230)</u>	<u>(31,616)</u>	<u>(1,047)</u>
Cash flows from financing activities:			
Proceeds from bank line of credit	157,835	241,688	34,351
Payments on bank line of credit	(156,935)	(229,588)	(34,351)
Payment of loan financing costs	(250)	—	—
Payment of capital expenditure financing	(2,055)	(421)	—
Proceeds from exercise of stock options	2,140	4,515	874
Repurchases of common stock	(5,912)	(4,310)	(146)
Cash (used in) provided by financing activities	<u>(5,177)</u>	<u>11,884</u>	<u>728</u>
Change in cash and cash equivalents	36,741	(13,352)	12,662
Cash and cash equivalents at beginning of year	363	13,715	1,053
Cash and cash equivalents at end of year	<u>\$ 37,104</u>	<u>\$ 363</u>	<u>\$ 13,715</u>

The accompanying notes are an integral part of these consolidated financial statements.

KFORCE INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

Kforce Inc. and subsidiaries (“Kforce”) is a provider of professional staffing services in 71 locations in 43 markets in the United States. Kforce provides its customers staffing services in the following specialties: Technology, Finance and Accounting, and Health and Life Sciences. Kforce provides flexible staffing services on both a temporary and contract basis and provides search services on both a contingency and retained basis. Kforce serves clients from the Fortune 1000, as well as local and regional, small to mid-size companies.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Kforce Inc. and its subsidiaries. References in this document to “Kforce,” “the Company,” “we,” “our” or “us” refer to Kforce or its subsidiaries, except where the context otherwise requires. All material intercompany transactions and balances have been eliminated in consolidation.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

Kforce classifies all highly liquid investments with an initial maturity of three months or less as cash equivalents.

ALLOWANCE FOR DOUBTFUL ACCOUNTS AND FALLOUTS

Kforce has established a reserve for expected credit losses and fallouts on trade receivables based on past experience and estimates of potential future write offs. Kforce performs ongoing analyses of factors including recent write off and delinquency trends, changes in economic conditions, a specific analysis of material receivable balances that are past due, and concentration of accounts receivables among clients in establishing this reserve. The allowance as a percentage of gross accounts receivable was 4.9% as of December 31, 2005 and 6.5% as of December 31, 2004. No single client has a receivable balance greater than 3.3% of the total accounts receivable and the top ten clients represent approximately 20.2% of the total accounts receivable balance.

FIXED ASSETS

Fixed assets are carried at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The cost of leasehold improvements is amortized using the straight-line method over the shorter of the estimated useful lives of the assets or the terms of the related leases, which range from three to fifteen years.

INCOME TAXES

Kforce accounts for income taxes under the principles of Statement of Financial Accounting Standards (“SFAS”) 109, “Accounting for Income Taxes”. SFAS 109 requires the asset and liability approach to the recognition of deferred tax assets and liabilities for the expected future tax consequences of the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. SFAS 109 requires that unless it is “more likely than not” that a deferred tax asset can be utilized to offset future taxes, a valuation allowance must be recorded against that asset. The tax benefits of deductions attributable to the employees’ disqualifying dispositions of shares obtained from incentive stock options are reflected as increases in additional paid-in capital.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Kforce, using available market information and appropriate valuation methodologies, has determined the estimated fair value of financial instruments. However, considerable judgment is required in interpreting data to develop the estimates of fair value. The fair values of Kforce’s financial instruments are estimated based on current market rates and instruments with the same risk and maturities. The fair value of long-term debt approximates its carrying value due to the variable interest rate applicable to the debt.

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GOODWILL AND INTANGIBLE ASSETS

In accordance with SFAS 142, "Goodwill and Other Intangible Assets", Kforce does not amortize goodwill but performs an annual review to ensure that no impairment of goodwill exists. In some of Kforce's acquisitions, a portion of the purchase price has been allocated to non-compete agreements and customer lists. These assets have been capitalized and are being amortized on a straight-line basis over the estimated useful lives of the assets. Kforce also has allocated a portion of the purchase price of Hall Kinion to the OnStaff trade name. This asset has been determined to have an indefinite life and is not being amortized.

IMPAIRMENT OF LONG-LIVED ASSETS

In accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", Kforce periodically reviews the carrying value of long-lived assets to determine if impairment has occurred. Impairment losses, if any, are recorded in the period identified. Significant judgment is required to determine whether or not impairment has occurred. The determination is made by evaluating expected future undiscounted cash flows or the anticipated recoverability of costs incurred and, if necessary, determining the amount of the loss, if any, by evaluating the fair value of the assets.

CAPITALIZED SOFTWARE

Kforce purchases, and in certain cases develops, and implements new computer software to enhance the performance of its accounting and operating systems. Kforce accounts for direct internal and external costs subsequent to the preliminary stage of the projects under the principles of AICPA Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use". Software development costs are being capitalized and classified as other assets and amortized over the estimated useful life of the software using the straight-line method. Direct internal costs, such as payroll and payroll-related costs, and external costs incurred during the development stage of each project are capitalized and classified as capitalized software. Kforce capitalized development stage implementation costs of \$3,134 and \$976 during the years ended 2005 and 2004, respectively. Kforce did not incur or capitalize any internally developed software costs during 2003.

DEFERRED LOAN COSTS

Costs incurred to secure Kforce's Credit Facility were capitalized and are being amortized over the terms of the related agreements using the straight-line method.

COMMISSIONS

Associates make placements and earn commissions as a percentage of actual revenue or gross profit pursuant to a calendar year basis commission plan. The amount of commissions paid as a percentage of revenue or gross profit increases as volume increases. Kforce accrues commissions for actual revenue or gross profit at a percentage equal to the percent of total expected commissions payable to total revenue and gross profit for the year.

STOCK BASED COMPENSATION

SFAS 148, "Accounting for Stock-Based Compensation – Transition and Disclosure", was issued in December 2002. SFAS 148 amends SFAS 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change from the intrinsic-value-based method of recognizing stock compensation under Accounting Principles Board ("APB") Opinion 25, "Accounting for Stock Issued to Employees", to the SFAS 123 fair-value-based method of accounting for stock-based employee compensation. Under the fair value method, the fair value of stock options granted to employees is recognized as compensation over the service period (usually the vesting period). Under the intrinsic value method, compensation expense is recognized for options that are in-the-money, thereby having intrinsic value, at the date of grant. SFAS 148 also amends SFAS 123 to require more prominent disclosure in interim and annual financial statements of the effect of all stock-based compensation. Kforce continues to apply the intrinsic-value method under APB Opinion 25 in accounting for its plans and discloses the effect on net income and earnings per share as if Kforce had applied the fair value recognition provisions of SFAS 148 to stock-based employee and non-employee compensation. As of December 31, 2005, Kforce had two stock-based compensation plans currently under which options are outstanding, an employee incentive stock option plan (the "Employee Incentive Stock Option Plan") and a non-employee director stock option plan (the "Non-Employee Director Stock Option Plan"). The Employee Incentive Stock Option Plan and the Non-Employee Director Stock Option Plan expired in March and October of 2005, respectively. Kforce applies the recognition and measurement principles of APB Opinion 25 and related interpretations in accounting for those plans. All options granted under those plans have had an exercise price equal to the market value of the underlying common stock on the date of the grants.

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The table below illustrates the effects on Kforce's net income and earnings per share had compensation cost for Kforce's option plans been determined based on the fair value at the grant dates, as prescribed by SFAS 148.

Included in the pro forma amounts below for 2004 is an expense related to options to purchase 856 shares of common stock for which vesting was accelerated in September 2004. As a result of recognizing this expense during the period in which they were accelerated, no future expense related to these options will be incurred. These options were originally scheduled to vest during 2005 and 2006.

In addition, in accordance with FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation", the modification to accelerate the vesting of a fixed award effectively results in the renewal for that award if, after the modification, an employee is able to exercise the award that, under the original terms, would have expired unexercisable. Accordingly, in the event that an employee terminates prior to the time that the stock options would have vested under the original terms, Kforce would incur additional compensation expense based upon the intrinsic value at the time of the acceleration of vesting, reduced by any amounts previously expensed as a result of the acceleration.

If all affected employees were to terminate their employment prior to the applicable original vesting dates, the maximum future expense would be approximately \$3,253, with such amount reduced to approximately \$940 after scheduled vesting dates in January 2005 have passed and to approximately \$59 after scheduled vesting dates in January 2006 have passed.

	Pro Forma		
	YEARS ENDED DECEMBER 31,		
	2005	2004	2003
Net income (loss):			
As reported (b)	\$22,321	\$25,011	\$ 5,118
Compensation expense (benefit) per SFAS 123, net of related tax benefits (a)(c)	(4,359)	(2,709)	(3,467)
Pro forma net income (loss)	<u>\$17,962</u>	<u>\$22,302</u>	<u>\$ 1,651</u>
Earnings (loss) per share:			
Basic:			
As reported	\$ 0.58	\$ 0.73	\$ 0.17
Pro forma	\$ 0.47	\$ 0.65	\$ 0.05
Diluted:			
As reported	\$ 0.55	\$ 0.69	\$ 0.16
Pro forma	\$ 0.45	\$ 0.62	\$ 0.05

- (a) The pro forma stock-based employee compensation expense for the options to purchase 856 shares of common stock that were accelerated in September 2004 was \$685. Excluding this amount from the pro forma results above would have resulted in expense, net of tax, of \$2,294 for the year ended December 31, 2004. Pro forma net income per share – basic would have been \$.67 and pro forma net income per share – diluted would have been \$.63 for the year ended December 31, 2004.
- (b) Included in the calculation of net income is expense related to the amortization of Kforce's restricted stock plan. Restricted stock amortization is treated the same under FAS 123 and APB 25 and therefore has no impact on the pro forma net income.
- (c) No tax benefit has been included in the Pro Forma net income calculation for the year ended December 31, 2003 as Kforce recorded a valuation allowance that fully offset its net deferred tax assets as of that date.

For purposes of determining the compensation expense per SFAS 123, the fair value of each option is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions used for grants during the applicable periods: dividend yield of 0.0%, risk-free interest rates of 3.9% for options granted, a weighted average expected option term of 4.7 years, and a volatility factor of 50%.

SELF-INSURANCE

Kforce offers employee benefit programs, including workers compensation and health insurance, to eligible employees, for which Kforce is self-insured for a portion of the cost. Kforce retains liability up to \$250 for each workers compensation accident and up to \$200 annually for each health insurance participant. Self-insurance costs are accrued using estimates to approximate the liability for reported claims and claims incurred but not reported.

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REVENUE RECOGNITION

Net service revenues consist of search fees and flexible billings inclusive of billable expenses, net of credits, discounts and fallouts. Kforce recognizes flexible billings based on hours worked by assigned personnel. Search fees are recognized upon placement, net of an allowance for “fallouts”. Fallouts are search placements that do not complete the contingency period. Contingency periods are typically ninety days or less.

Revenues received as reimbursements of billable expenses are reported gross within revenue in accordance with Emerging Issues Task Force, Issue 01-14, “Income Statement Characterization of Reimbursements Received for ‘Out-of-Pocket’ Expenses Incurred”.

OTHER COMPREHENSIVE INCOME (LOSS)

Other comprehensive income (loss) is comprised of unrealized gains and losses from changes in the fair value of certain derivative instruments that qualify for hedge accounting under SFAS 133, “Accounting for Derivative Instruments and Hedging Activities”, as amended.

ACCOUNTING FOR DERIVATIVES

SFAS 133, “Accounting for Derivative Instruments and Hedging Activities”, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. It also requires that all derivatives and hedging activities be recognized as either assets or liabilities in the balance sheet and be measured at fair value. Gains or losses resulting from the changes in fair value of derivatives are recognized in net income (loss) or recorded in other comprehensive income (loss), and recognized in the statement of operations when the hedged item affects earnings, depending upon the purpose of the derivatives and whether they qualify for hedge accounting treatment. Kforce’s policy is to designate at a derivative’s inception the specific assets, liabilities, or future commitments being hedged and monitor the derivative to determine if it remains an effective hedge. Kforce does not enter into or hold derivatives for trading or speculative purposes. The fair value of Kforce’s interest rate swap agreements is based on dealer quotes. In the unlikely event that the counterparty fails to perform under the contract, Kforce bears the credit risk that payments due to Kforce, if applicable, may not be collected.

EARNINGS PER SHARE

Under SFAS 128, “Earnings Per Share”, basic earnings (loss) per share is computed as earnings divided by weighted average shares outstanding. Diluted earnings (loss) per share include the dilutive effects of stock options and other potentially dilutive securities such as non-vested stock grants and shares held in escrow related to the purchase of VistaRMS, Inc. (Note 6).

Options to purchase 2,549, 2,381 and 3,421 shares of common stock were not included in the computations of diluted earnings per share for the years ended December 31, 2005, 2004 and 2003, respectively, because these options were anti-dilutive. The dilutive effect of options to purchase 3,639, 4,081 and 2,662 shares of common stock and 305, 318 and 404 shares of restricted stock are included in the computation of diluted earnings per share for the years ended December 31, 2005, 2004 and 2003, respectively.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

The following recently issued accounting pronouncements were effective for Kforce beginning January 1, 2004, and management has determined that the adoption of these standards had no material impact on Kforce’s consolidated financial statements.

- SFAS 143, “Accounting for Asset Retirement Obligations”, requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it occurred.
- SFAS 145, “Rescission of FASB Statements No. 4, 44, and 64, Amendment of SFAS No. 13, and Technical Corrections”, rescinds SFAS 4, “Reporting Gains and Losses from Extinguishment of Debt”, and an amendment of that Statement, SFAS 64, “Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements”. SFAS 145 also rescinds SFAS 44, “Accounting for Intangible Assets of Motor Carriers”, and SFAS 13, “Accounting for Leases”, eliminating an inconsistency between certain sale-leaseback transactions.
- SFAS 146, “Accounting for Costs Associated with Exit or Disposal Activities”, addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue 94-3, “Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)”. SFAS 146 requires costs associated with exit or disposal activities to be recognized when the costs are incurred, rather than at a date of commitment to an exit or disposal plan.

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- SFAS 149, “Amendment of Statement 133 on Derivative Instruments and Hedging Activities”, amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS 133. The changes in SFAS 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. In particular, SFAS 149 (1) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative discussed in paragraph 6(b) of SFAS 133, (2) clarifies when a derivative contains a financing component, (3) amends the definition of an underlying asset or liability to conform it to language used in FIN 45, and (4) amends certain other existing pronouncements.
- SFAS 150, “Accounting for Certain Financial Instruments with Certain Characteristics of Both Liabilities and Equity”, establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances).

SFAS 153, “Exchange of non-monetary assets”, amends APB Opinion No. 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. This statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of this standard did not have a material impact on Kforce’s consolidated financial statements.

In December of 2004 the Financial Accounting Standards Board (“FASB”) issued a revised version of SFAS 123, “Share-Based Payment” (SFAS 123R). This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods and services, but focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. This statement supersedes APB Opinion No. 25, “Accounting for Stock Issued to Employees,” and its related implementation guidance. This statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost is recognized over the period in which the employee is required to provide service in exchange for the award, which is usually the vesting period. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. This statement is effective for Kforce as of the beginning of the first annual reporting period that begins after June 15, 2005. Kforce intends to adopt SFAS 123R using the modified prospective method, and management does not believe the adoption of this standard will have a material impact on Kforce’s consolidated financial statements as all of Kforce’s outstanding stock options were fully vested as of December 31, 2005.

In May of 2005, FASB issued SFAS 154, “Accounting Changes and Error Corrections.” This statement replaces APB Opinion 20, “Accounting Changes,” and SFAS 3, “Reporting Accounting Changes in Interim Financial Statements.” This statement changes the requirements for the accounting for and reporting of a change in accounting principle, and applies to all voluntary changes in accounting principle. This statement also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. Previously, APB Opinion 20 required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires retrospective application to prior periods’ financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management does not believe the adoption of this standard will have a material impact on Kforce’s consolidated financial statements.

2. FIXED ASSETS

Major classifications of fixed assets and related asset lives are summarized as follows:

		DECEMBER 31,	
	USEFUL LIFE	2005	2004
Land		\$ 1,310	\$ 1,310
Furniture and equipment	5-7 years	5,434	5,424
Computer equipment	3-5 years	1,433	1,188
Leasehold improvements	3-15 years	4,267	3,936
Capital leases	3 years	5,837	2,248
		18,281	14,106
Less accumulated depreciation and amortization		8,133	5,527
		<u>\$10,148</u>	<u>\$ 8,579</u>

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Kforce purchased fixed assets totaling \$1,058 and \$1,272, and invested in assets under capital leases of \$3,589 and \$2,248, during 2005 and 2004. Depreciation and amortization expense during 2005, 2004 and 2003 was \$3,035, \$2,300 and \$2,640, respectively. Kforce recognized losses on the sale or disposal of assets of \$38, \$224 and \$74 for the years ended 2005, 2004 and 2003, respectively.

Land consists of a parcel of property adjacent to the site of the corporate headquarters building.

3. INCOME TAXES

The provision (benefit) for income taxes consists of the following:

	YEARS ENDED DECEMBER 31,		
	2005	2004	2003
Current:			
Federal	\$ (223)	\$ 265	\$ —
State	123	(1,013)	350
Deferred	14,945	6,461	2,200
Increase (decrease) in valuation allowance	—	(19,250)	(2,200)
	<u>\$14,845</u>	<u>\$(13,537)</u>	<u>\$ 350</u>

The provision (benefit) for income taxes shown above varied from the statutory federal income tax rates for those periods as follows:

	YEARS ENDED DECEMBER 31,		
	2005	2004	2003
Federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal tax effect	4.6	(2.4)	6.4
Non-deductible compensation	—	10.6	6.2
Non-deductible meals and entertainment	0.1	2.6	4.1
Alternative Minimum Tax	(0.6)	2.3	—
Other	0.8	1.7	(4.3)
Deferred tax asset valuation allowance	—	(167.8)	(41.0)
Effective tax rate	<u>39.9%</u>	<u>(118.0)%</u>	<u>6.4%</u>

Deferred income tax assets and liabilities are comprised of the following:

	DECEMBER 31,	
	2005	2004
Deferred taxes, current:		
Assets		
Allowance for doubtful accounts	\$ 2,144	\$ 3,145
Accrued liabilities	2,539	3,812
Federal net operating loss carryforward	10,628	9,001
State net operating loss carryforward	1,656	1,222
Other assets	305	—
	17,272	17,180
Liabilities	(595)	—
Current deferred tax asset, net of current deferred tax liabilities	16,677	17,180
Valuation allowance	(884)	—
Net current deferred tax asset	<u>\$15,793</u>	<u>\$17,180</u>
Deferred taxes, non-current:		
Assets		
Deferred compensation	\$ 3,742	\$ 3,686
Federal net operating loss carryforward	5,449	9,587
State net operating loss carryforward	671	5,063
Amortization of goodwill and intangible assets	—	4,486
Other	873	304
	10,735	23,126
Liabilities		
Depreciation of fixed assets	(2,802)	(446)
Amortization of goodwill and intangible assets	(3,000)	—
	(5,802)	(446)
Non-current deferred tax asset, net of non-current deferred tax liabilities	4,933	22,680
Valuation allowance	(482)	(3,664)
Net non-current deferred tax asset	<u>\$ 4,451</u>	<u>\$19,016</u>

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At December 31, 2005, Kforce had federal net operating loss carryforwards (“NOLs”) of approximately \$45,934 related to net operating losses in 2002 and 2004 and the recording of Hall Kinion federal NOLs, both of which expire in varying amounts through 2024. Further, Kforce has approximately \$55,101 of state tax NOLs at December 31, 2005, which will be carried forward to be offset against future state taxable income. The state tax NOLs expire in varying amounts through 2022.

Kforce incurred NOLs for both federal and state income tax purposes in 2004 and in years prior to 2003. For accounting purposes, the estimated tax effects of such NOLs, plus or net of timing differences, result in current and non-current deferred tax assets. However, a determination must be made that it is “more likely than not” that the NOLs will be utilized for tax purposes, or valuation allowances must be established to offset such assets. At December 31, 2002, a “more likely than not” conclusion could not be reached, and the deferred tax assets were fully reserved. Kforce had net income during 2003, and portions of the deferred tax assets were recognized by reducing such assets and the related valuation allowances by \$2,200, instead of providing any 2003 income tax expense other than certain state tax expense for which corresponding state tax carryforwards were not available. In 2004, Kforce recognized a tax benefit of \$13,537, which consisted of the reversal of the valuation allowance totaling \$19,250, net of current and deferred tax expense of \$5,713. Kforce continues to carry a \$1,366 valuation allowance at December 31, 2005, offsetting federal and state NOL carryforwards for which a “more likely than not” conclusion for tax purposes could not be reached. \$474 of this valuation allowance relates to net deferred tax assets recorded in conjunction with the acquisition of Hall Kinion. Therefore, if this portion of the valuation allowance is reversed at a future date, the related tax benefit will be recorded as an offset to goodwill previously recognized in conjunction with this acquisition. Also in 2004, Kforce reversed \$21,841 of valuation allowances related to deferred tax assets recorded in conjunction with the Hall Kinion acquisition. The reversal of these valuation allowances has been recorded as an offset to Goodwill recognized in this acquisition.

Kforce is periodically subject to U.S. Internal Revenue Service audits for various tax years. Kforce is also periodically subject to state and other local income tax audits for various tax years. At December 31, 2005, one state income tax audit for which no final determination has been made was in progress. During 2005, an income tax audit for a state was concluded with no material adverse assessments.

4. OTHER ASSETS

	DECEMBER 31,	
	2005	2004
Cash surrender value of life insurance policies (Note 9)	\$10,831	\$ 8,452
Capitalized software, net of amortization	7,592	3,009
Prepaid rent – headquarters, net of amortization	1,073	1,184
Deferred merger and acquisition costs	198	178
Deferred loan costs, net of amortization	242	279
Cash flow hedge asset (Note 7)	—	37
Other non-current assets	312	277
	<u>\$20,248</u>	<u>\$13,416</u>

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Cash surrender value of life insurance policies relates to policies maintained by Kforce that could be used to fund obligations under the Deferred Compensation Plan (Note 9).

Kforce purchased capitalized software for \$2,911 and \$2,289 during 2005 and 2004, respectively. Accumulated amortization on capitalized software was \$4,508 and \$3,081 as of December 31, 2005 and 2004, respectively. In addition, Kforce capitalized costs related to software developed for internal use totaling \$3,134 and \$976 in 2005 and 2004, respectively. Amortization expense on capitalized software during 2005, 2004 and 2003 was \$1,459, \$750 and \$976, respectively.

In accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", Kforce periodically reviews the carrying value of long-lived assets to determine if impairment has occurred. During the year ended December 31, 2004 it was determined that time entry software purchased but not implemented by Kforce could not be customized to meet Kforce's requirements. Based on this determination Kforce recognized an impairment loss of \$498 which included \$305 in capital software costs and \$193 of maintenance costs. For the years ended December 31, 2005 and 2003, it was determined that there were no impairments. The impairment losses are recorded as a component of selling, general and administrative expenses in the accompanying Consolidated Statements of Operations and Comprehensive Income (Loss).

As part of the agreement with the landlord of Kforce's corporate headquarters, Kforce was required to prepay lease costs relating to building upgrades above a base amount. This amount is being amortized over the 15 year term of the lease.

Deferred merger and acquisition costs of \$198 and \$178 were capitalized in connection with Kforce's agreement to acquire PCCI as of December 31, 2005 (Note 16) and asset purchase agreement with VistaRMS, Inc. as of December 31, 2004 (Note 6), respectively. The cost deferred and capitalized as of December 31, 2005 will be recorded as additional purchase price upon the close of the transaction with PCCI. The deferred merger and acquisition costs of \$178 as of December 31, 2004 were capitalized are recorded as part of the purchase price of VistaRMS, Inc.

Accumulated amortization on deferred loan costs was \$8 and \$2,221 as of December 31, 2005 and 2004, respectively. In November 2005, Kforce signed the Seventh Agreement to our Credit Facility. As a result, the fully amortized expense relating to previous agreements was written off. Amortization expense on deferred loan costs was \$288, \$335 and \$335 in 2005, 2004 and 2003, respectively.

5. GOODWILL AND INTANGIBLE ASSETS

In accordance with SFAS 142, "Goodwill and Other Intangible Assets", Kforce completed annual tests for goodwill impairment as required and found no impairment existed at December 31, 2005, 2004 or 2003.

In accordance with SFAS 141, "Business Combinations" Kforce assigned, based on a valuation analysis performed by an independent firm, \$2,800 to customer list intangible assets and \$200 related to non-compete agreements in the acquisition of Vista (Note 6). In 2004, Kforce assigned, based on a valuation analysis performed by an independent firm, \$10,000 to customer list intangible assets and \$870 related to the OnStaff trade name in the acquisition of Hall Kinion (Note 6). The remaining value of intangible assets relates to customer lists and non-compete agreements acquired during 2001 that are being amortized over four years. Accumulated amortization on intangible assets from acquisitions was \$6,211 and \$2,709 as of December 31, 2005 and 2004, respectively. Amortization expense on intangible assets from acquisitions for 2005, 2004 and 2003 was \$3,502, \$1,836 and \$419, respectively. For existing intangible assets from acquisitions, amortization expense for 2006, 2007, 2008, 2009 and 2010 will be \$3,258, \$3,258, \$1,841, \$105 and \$4, respectively.

6. ACQUISITIONS AND DIVESTITURES

FOR THE YEAR ENDED DECEMBER 31, 2005

VistaRMS, Inc.

On February 1, 2005, Kforce completed the acquisition of substantially all of the assets of VistaRMS, Inc. ("Vista"), a privately-held company based in Hemdon, Virginia, in exchange for 2,348 shares of Kforce common stock. This transaction was accounted for using the purchase method. The results of Vista's operations since the date of acquisition have been included in Kforce's consolidated financial statements. Vista had produced revenue of approximately \$50,000 in technology staffing over the 12 months prior to the acquisition with approximately 40% of that revenue in the Federal government sector. As a result of this acquisition, Kforce has been able to expand its presence in the Federal government sector.

As consideration for the purchase, Kforce issued 2,348 shares of Kforce stock of which 1,233 were held in escrow under the terms of the agreement. The Kforce stock was valued at a price of \$11.57 per share, the average market price of the shares from the period 5 days before and after the date the agreement was signed and announced. At December 31, 2005, 1,584

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shares were issued under the terms of the agreement, with a total addition to equity of \$18,324, and 450 shares remained in escrow. Kforce also incurred \$455 in transaction costs, which includes \$179 of transaction costs paid in 2004, and assumed net liabilities of \$663. To the extent additional shares are issued out of escrow to Vista after purchase price contingencies have been resolved, those shares will be recorded as an addition to the purchase price.

The following table summarizes the total purchase price, net assets acquired and intangible assets recorded in conjunction with the acquisition:

Equity issued	\$ 18,324
Transaction costs	455
Total purchase price	\$ 18,779
Goodwill	\$ 16,442
Customer lists	2,800
Non-compete agreements	200
Net liabilities acquired	(663)
Total purchase price	\$ 18,779

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

Accounts receivable	\$ 10,031
Other assets	75
Total assets acquired	10,106
Current liabilities	5,347
Debt	2,467
Long-term liabilities	2,955
Total liabilities assumed	10,769
Net liabilities assumed	\$ 663

Included in current and long term liabilities above are a net deferred tax liability of \$1.2 million and a federal tax liability of \$2.3 million that were acquired in conjunction with the acquisition.

Based on an analysis completed in accordance with SFAS 141, \$2,800 of the excess purchase price has been allocated to customer lists and contracts that are being amortized over a weighted average useful life of 4 years, and \$200 of the excess purchase price has been allocated to non-compete agreements that are being amortized over a weighted average useful life of 5 years.

The \$16,442 of remaining excess purchase price has been assigned to goodwill. This goodwill has been allocated to the Technology business segment. This goodwill is not deductible for tax purposes.

FOR THE YEAR ENDED DECEMBER 31, 2004

Hall, Kinion & Associates Inc.

On June 7, 2004, Kforce acquired 100% of the outstanding common stock of Hall, Kinion and Associates Inc. and its subsidiaries ("Hall Kinion"). This transaction was accounted for using the purchase method. The results of Hall Kinion's operations since the date of acquisition have been included in Kforce's consolidated financial statements. Hall Kinion specialized in providing technology and finance and accounting related talent on a temporary and permanent basis to its customers primarily in the United States. As a result of this acquisition, Kforce expanded its market presence by adding 18 offices, not including those offices already combined with existing Kforce offices. The acquisition also expanded Kforce's service offerings in technology and finance and accounting in certain market segments.

As consideration for the purchase of the common stock, Kforce issued 5,742 shares of Kforce stock at a price of \$8.95 a share, the market price of the shares on the date of issuance, with a total addition to equity of \$51,388. Kforce also incurred \$13,899 in transaction costs, which includes approximately \$1,459 of transaction costs paid in 2003. Additionally, Kforce assumed net assets of \$10,152 and bought out potential future earnouts related to OnStaff for \$2,500. Kforce recorded an adjustment to the assets acquired of \$209 in 2005 due to changes to the net deferred tax assets realized in 2005 increasing goodwill by \$209. The following table summarizes the total purchase price, net assets acquired and intangible assets recorded in conjunction with the acquisition:

Equity issued	\$ 51,388
Transaction costs	13,899
Future earnouts – OnStaff	2,500
Total purchase price	\$ 67,787
Goodwill	\$ 46,765
Customer lists	10,000
Trade name	870
Net assets acquired	10,152
Total purchase price	\$ 67,787

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The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

Cash	\$ 2,827
Other current assets	19,895
Furniture and equipment	586
Other assets	21,657
Total assets acquired	44,965
Current liabilities	14,233
Long-term debt	10,638
Other long-term liabilities	9,942
Total liabilities assumed	34,813
Net assets acquired	\$ 10,152

Included in other current assets and other assets above is a net deferred tax asset of \$23,266 that was acquired in conjunction with the acquisition.

Based on an analysis completed in accordance with SFAS 141, "Business Combinations" ("SFAS 141"), \$10,000 of the excess purchase price was allocated to acquired intangible assets and is included in intangible assets, net in the accompanying consolidated balance sheet. Such value is assigned to customer lists and contracts that are amortized over a weighted average useful life of 4 years. An additional \$870 was assigned to the OnStaff trade name, which is also included in intangible assets, net, in the accompanying consolidated balance sheet. This asset has been determined to have an indefinite life and is not being amortized.

The \$46,765 of remaining excess purchase price was assigned to goodwill. This goodwill has been allocated to the Technology and Finance and Accounting business segments. This goodwill is not deductible for tax purposes.

The following unaudited pro forma consolidated financial information for Kforce gives effect to the acquisition of Vista and Hall Kinion as if they had occurred on January 1, 2003. These unaudited pro forma results have been prepared for comparative purposes only and do not purport to be indicative of the results of operations that actually would have resulted had the acquisitions occurred on the date indicated, or that may result in the future.

	2005	2004	2003
Revenues	\$ 806,713	\$ 772,681	\$ 690,809
Net income (loss)	\$ 22,403	\$ 21,379	\$ (13,148)
Basic income (loss) per share	\$.58	\$.55	\$ (.34)
Diluted income (loss) per share	\$.55	\$.53	\$ (.34)
Basic shares outstanding	38,762	38,637	38,290
Diluted shares outstanding	40,850	40,512	38,290

7. CREDIT FACILITY

On October 28, 2005, Kforce entered into a Seventh Amendment to the Credit Facility (the "Extended Credit Facility") with a syndicate led by Bank of America. Under the Extended Credit Facility, Kforce's maximum borrowings are limited to

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\$100,000. In addition, Kforce has the right under the Extended Credit Facility to increase the maximum borrowings available to \$140,000 under an accordion feature. Borrowings under the Extended Credit Facility are limited to 85% of eligible accounts receivable. Under the Extended Credit Facility, Kforce may have loans outstanding with a rate of LIBOR plus 1.25% or Prime minus 0.25%. To the extent that Kforce has unused availability under the Extended Credit Facility, an unused line fee is required to be paid equal to 0.25% of the average unused balance on a monthly basis. Kforce was required to pay a closing fee of \$250 upon entering into the Extended Credit Facility, and is also required to pay an annual administrative fee of \$50. Borrowings under the Extended Credit Facility are secured by all of the assets of Kforce. Under the Extended Credit Facility, Kforce is required to meet certain minimum availability and fixed charge coverage ratio requirements, and is permitted to make dividend distributions if borrowing availability under the Extended Credit Facility is not less than \$15,000 after giving effect to the distributions. Kforce has been in compliance with the minimum availability and fixed charge coverage ratio requirements at all times during the history of the Extended Credit Facility. The Extended Credit Facility expires on November 3, 2010.

In March, April and May of 2003, we entered into four fixed interest rate swap contracts for a total notional amount of \$22,000 expiring in March and May of 2005. The contracts, which have been classified as cash flow hedges pursuant to SFAS 133, as amended, effectively converted \$22,000 of our outstanding debt under the Credit Facility to a fixed rate basis at an annual rate of approximately 4%, thus reducing the impact of interest rate changes on future income. One of these contracts expired on March 29, 2005. Subsequent to March 29, 2005, the remaining contracts effectively converted \$12,000 of our outstanding debt under the credit facility to a fixed rate basis of approximately 4% until their expiration on May 31, 2005. After the expiration of the remaining interest rate swap contracts and prior to Kforce entering into the Extended Credit Facility, Kforce's interest rate on the entire Credit Facility returned to rates ranging from Prime to Prime plus .75% or LIBOR plus 1.75% to LIBOR plus 3.25% pursuant to certain financial performance targets as set forth in the original Amended Credit Facility.

On June 23, 2005, our Board of Directors increased its authorization for open market repurchases of common stock by \$20,000 to \$135,000. At December 31, 2005, we had repurchased 20,368 shares for \$114,857 under this plan. 751 shares have been repurchased during 2005 for \$5,912. Therefore, \$20,143 was available under the current board authorization as of December 31, 2005. Additional stock repurchases could have a material impact on the cash flow requirements for the next twelve months.

Borrowings under the Credit Facility were \$35,000 and \$34,100 as of December 31, 2005 and 2004, respectively.

8. OTHER LONG-TERM LIABILITIES

	DECEMBER 31,	
	2005	2004
Deferred compensation plan liability (Note 9)	\$ 8,902	\$ 8,278
Straight-line rent accrual	1,864	1,559
Corporate Income Tax Payable - Federal Non Current	1,172	—
Accrued rent, long-term	919	1,699
	<u>\$ 12,857</u>	<u>\$ 11,536</u>

Kforce has a non-qualified deferred compensation plan pursuant to which eligible Kforce management and highly compensated key employees may elect to defer part of their compensation to later years. These amounts, which are classified as other long-term liabilities, are payable upon retirement or termination of employment.

Kforce has accrued the net present value of rent for the minimum required lease payments on vacant properties and the net rent payable after sublease payments on sublet properties, at interest rates of 4% to 9%. In addition to the non-current amounts of \$919 and \$1,699 for 2005 and 2004 included above, respectively, net lease payments scheduled within the next 12 months of \$1,016 and \$2,431 for 2005 and 2004, respectively, have been included in accounts payable and other current liabilities.

Future minimum lease payments and receipts for accelerated leases and subleases under non-cancelable operating leases are summarized as follows:

	2006	2007	2008	2009	Thereafter
Lease payments	\$1,944	\$1,631	\$ 721	\$—	\$ —
Sublease receivables	928	875	425	—	—
Net leases payable	<u>\$1,016</u>	<u>\$ 756</u>	<u>\$ 296</u>	<u>\$—</u>	<u>\$ —</u>

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Expenses of \$64, \$684 and \$272 were recognized during 2005, 2004 and 2003, respectively, to record accrued rent related to vacated or subleased properties. The straight-lining of escalating rent payments relates primarily to Kforce's corporate headquarters facility lease (Note 12). These expenses are included in SG&A.

9. EMPLOYEE BENEFIT PLANS

401(k) SAVINGS PLAN

Kforce has a qualified defined contribution 401(k) plan covering substantially all employees. Employer matching contributions are discretionary and are funded annually as approved by the Board of Directors. Kforce has accrued a match of \$813 for the plan year ended December 31, 2005. A match of \$643 was made in 2005 for the plan year ended December 31, 2004. A match of \$475 was made in 2004 for the plan year ended December 31, 2003. Assets of this plan are held in trust for the sole benefit of employees.

At December 31, 2005, 2004, and 2003, the Plan held 660, 862, and 981 shares, respectively, of Kforce's stock, representing approximately 1.71%, 2.31% and 3.21%, respectively, of Kforce's outstanding shares.

EMPLOYEE STOCK PURCHASE PLAN

Kforce has an Employee Stock Purchase Plan which allows all employees to purchase stock at a 15% discount from the lower of the market price of Kforce's common stock at the beginning or end of the six month purchase period and without commissions on the purchases. Employees are eligible to participate in the plan as of the next plan enrollment date following their date of hire. During 2005, 2004, and 2003, respectively, Kforce issued 128, 121, and 162 shares of common stock, at an average purchase price of \$7.57, \$6.18 and \$3.49 per share, pursuant to the plan. These shares were transferred to the plan from Kforce's treasury stock. Of the 128 shares issued in 2005, Kforce issued 55 of the shares at an average price of \$7.96 and 73 shares at an average price of \$7.19. Of the 121 shares issued in 2004, Kforce issued 69 of the shares at an average price of \$4.34 and 52 shares at an average price of \$8.02. Of the 162 shares issued in 2003, Kforce issued 74 of the shares at an average price of \$3.38 and 88 shares at an average price of \$3.59. In January 2006, Kforce issued 104 shares at an average price of \$7.21, related to employee contributions made during the second half of 2005. Effective January 1, 2006, Kforce's Employee Stock Purchase Plan was revised to reduce the discount on the purchase of shares from 15% to 5%, and to eliminate the look back period.

DEFERRED COMPENSATION PLAN

Kforce has a nonqualified deferred compensation plan pursuant to which eligible management and highly compensated key employees, as defined by IRS regulations, may elect to defer part of their compensation to later years. These amounts are classified as accounts payable and other accrued liabilities if due to be paid within the next year or as other long-term liabilities if due to be paid out after the next year or upon retirement or termination of employment. At December 31, 2005 and 2004, amounts included in accounts payable and other accrued liabilities related to the deferred compensation plan totaled \$1,246 and \$966, respectively. Amounts included in other long-term liabilities related to the deferred compensation plan totaled \$8,902 and \$8,278 as of December 31, 2005 and 2004, respectively. Kforce has insured the lives of the participants in the deferred compensation plan to assist in the funding of the deferred compensation liability. The cash surrender value of these Kforce-owned life insurance policies, \$10,831 and \$8,452 at December 31, 2005 and 2004, respectively, are classified as other assets (Note 4). Compensation expense of \$700, \$731, and \$1,375 was recognized for the plan for the years ended December 31, 2005, 2004, and 2003, respectively. Kforce has accrued a discretionary matching contribution of \$140, 10 percent of contributions, for the plan year ended December 31, 2005. A match of \$161 was made by Kforce in 2005 for the plan year ended December 31, 2004. A match of \$120 was made by Kforce in 2004 for the plan year ended December 31, 2003.

10. STOCK INCENTIVE PLANS

In 1994, Kforce established the Employee Incentive Stock Option Plan that allows the issuance of Incentive Stock Options. The Employee Incentive Stock Option Plan was subsequently amended in 1996 to allow for the issuance of Nonqualified Stock Options, Stock Appreciation Rights and Restricted Stock. The number of shares of common stock that may be issued under the plan was increased from 6,000 at inception to 12,000 in 2001. The Employee Incentive Stock Option Plan expired in March of 2005.

During 1995, Kforce established the Non-Employee Director Stock Option Plan, which authorized the issuance to non-employee directors of options to purchase common stock. The maximum number of shares of common stock that can be issued under this plan is 400. The Non-Employee Director Stock Option Plan expired in October of 2005.

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A summary of Kforce's stock option and restricted stock activity is as follows:

	EMPLOYEE INCENTIVE STOCK OPTION PLAN	NON- EMPLOYEE DIRECTOR STOCK OPTION PLAN	TOTAL	WEIGHTED AVERAGE EXERCISE PRICE PER SHARE	WEIGHTED AVERAGE FAIR VALUE OF OPTIONS GRANTED
Outstanding as of December 31, 2002	5,869	319	6,188	\$ 8.52	
Granted	907	—	907	\$ 4.14	\$ 1.96
Exercised	(359)	—	(359)	\$ 4.37	
Forfeited	(248)	—	(248)	\$ 10.69	
Outstanding as of December 31, 2003	6,169	319	6,488	\$ 8.05	
Granted	1,605	—	1,605	\$ 8.19	\$ 4.78
Exercised	(1,246)	—	(1,246)	\$ 4.94	
Forfeited	(67)	—	(67)	\$ 9.90	
Outstanding as of December 31, 2004	6,461	319	6,780	\$ 8.63	
Granted	390	—	390	\$ 11.00	\$ 4.93
Exercised	(420)	—	(420)	\$ 5.10	
Forfeited	(257)	—	(257)	\$ 10.97	
Outstanding as of December 31, 2005	6,174	319	6,493	\$ 8.85	
Exercisable at December 31:					
2003	3,972	319	4,291		
2004	5,457	319	5,776		
2005	6,174	319	6,493		

On September 9, 2004, the Compensation Committee of the Board of Directors of Kforce accelerated stock options for all current employees that would otherwise have been unvested on January 1, 2005. Options to purchase a total of 855,662 shares of Kforce's common stock were accelerated. These options were held by fifteen employees, including options to purchase an aggregate of 748,162 shares of Kforce's common stock held by six Executive Officers.

Effective December 22, 2005, the former Chief Marketing Officer ceased being employed by Kforce. Kforce expects the other affected employees to continue to provide services through their applicable original vesting dates; therefore, the only expense recorded as a result of the above acceleration and subsequent termination of employment was \$130 in December 2005. If the remaining affected employees were to terminate their employment prior to the applicable original vesting dates, the maximum future expense would be approximately \$751 with such amount being reduced to approximately \$59 after the scheduled vesting dates in January 2006 passed.

Options expire at the end of ten years from the date of grant.

The following table summarizes information about employee and director stock options:

RANGE OF EXERCISE PRICES	OPTIONS OUTSTANDING		
	NUMBER OUTSTANDING AT DECEMBER 31, 2005 (SHARES)	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE (\$)
\$ 0.000 - \$ 3.150	586	7.8	\$ 1.38
\$ 3.151 - \$ 6.300	1,661	5.6	\$ 4.59
\$ 6.301 - \$ 9.450	1,694	4.8	\$ 8.01
\$ 9.451 - \$12.600	1,209	7.5	\$ 11.03
\$12.601 - \$15.750	1,040	3.8	\$ 14.29
\$15.751 - \$18.900	2	1.9	\$ 18.06
\$18.901 - \$22.050	1	1.8	\$ 20.62
\$22.051 - \$25.200	213	2.1	\$ 22.37
\$25.201 - \$28.350	87	2.3	\$ 27.81
	6,493	5.5	\$ 8.85

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RANGE OF EXERCISE PRICES	OPTIONS EXERCISABLE	
	NUMBER EXERCISABLE AT DECEMBER 31, 2005 (SHARES)	WEIGHTED AVERAGE EXERCISE PRICE (\$)
\$ 0.000 - \$ 3.150	288	\$ 2.82
\$ 3.151 - \$ 6.300	1,654	\$ 4.58
\$ 6.301 - \$ 9.450	1,694	\$ 8.01
\$ 9.451 - \$12.600	1,209	\$ 11.03
\$12.601 - \$15.750	1,040	\$ 14.29
\$15.751 - \$18.900	2	\$ 18.06
\$18.901 - \$22.050	1	\$ 20.62
\$22.051 - \$25.200	213	\$ 22.37
\$25.201 - \$28.350	87	\$ 27.81
	<u>6,188</u>	\$ 9.28

The following restricted stock grants are included in the Employee Incentive Stock Option Plan in the above table detailing grants, exercises and forfeitures. In 2001, Kforce granted approximately 194 shares of stock that was restricted as to sale, to certain members of management, not including the Chief Executive Officer, in lieu of a cash bonus.

In January 2002, Kforce issued 223 shares of restricted stock to certain members of senior management and other employees in exchange for voluntarily reducing their 2002 salary and cash bonus potential. These shares vested over a five-year period with an acceleration clause if certain Kforce common stock price thresholds were met. During 2003 and 2002, \$221 and \$212, respectively, were charged to compensation expense for the straight-line amortization of vesting over the five-year period. On January 5, 2004, Kforce common stock closed at a price level that fully satisfied the acceleration clause for the 2002 shares and all of such restricted stock thereby vested. Because Kforce had been amortizing the value of such restricted stock on a straight-line basis over the five-year period, and the stock price threshold had not been met on or prior to December 31, 2003, Kforce was required to record the unamortized balance of \$673 as compensation expense in the period when the stock price threshold was achieved, which was the first quarter of 2004.

In February 2003, Kforce granted 192 shares of restricted stock to certain members of senior management as a component of compensation. The shares, which were originally scheduled to vest in February of 2005, were accelerated by Kforce on November 30, 2004. During 2003 and 2004 Kforce recognized \$136 and \$163, respectively, of compensation expense for the straight line amortization of the vesting over two years. Kforce recognized an additional \$27 of expense in 2004 due to the acceleration.

In January 2004, Kforce granted 75 shares, net of 13 shares which were forfeited, of restricted stock to certain members of senior management as a component of compensation. Also, in December 2004, Kforce granted 223 shares of restricted stock to certain members of senior management as a component of compensation. Kforce recognizes compensation expense using straight-line amortization over the vesting period of two years. Kforce recognized \$383 of compensation in relation to these grants for the year ended December 31, 2004.

Kforce recognized \$1,665 of compensation in relation to these grants for the year ended December 31, 2005.

Tax benefits resulting from disqualifying dispositions of shares acquired under Kforce's Employee Incentive Stock Option Plan were \$341, \$611 and \$0 in 2005, 2004 and 2003, respectively. These tax benefits have been credited to additional paid-in-capital in the accompanying Consolidated Balance Sheets.

11. SEVERANCE COSTS

In 2005, Kforce incurred compensation expense of \$1,106 for severance costs upon the termination of a named officer. These costs are a component of SG&A in the Consolidated Statement of Operations and Comprehensive Income (Loss).

12. COMMITMENTS AND CONTINGENCIES

LEASE COMMITMENTS

Kforce leases space and operating assets under operating and capital leases expiring at various dates, with some leases cancelable upon 30 to 90 days notice. The leases require payment of taxes, insurance and maintenance costs in addition to rental payments.

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Future minimum lease payments, inclusive of accelerated lease payments (Note 8), under non-cancelable capital and operating leases are summarized as follows:

	2006	2007	2008	2009	2010	Thereafter
Capital Leases						
Present values of payments	\$ 1,901	\$1,719	\$ 669	\$ —	\$ —	\$ —
Interest	219	177	94	—	—	—
Cap Lease Payments	2,120	1,896	763	—	—	—
Operating Leases						
Facilities	8,591	6,500	4,206	2,623	2,495	15,748
Equipment	774	309	139	1	—	—
Furniture	359	67	66	57	1	—
Total Operating Leases	9,724	6,876	4,411	2,681	2,496	15,748
Total Leases	<u>\$11,844</u>	<u>\$8,772</u>	<u>\$5,174</u>	<u>\$2,681</u>	<u>\$2,496</u>	<u>\$15,748</u>

Kforce acquired \$3,589 and \$2,247 of computer equipment under capital leases in 2005 and 2004, respectively. Capital lease payments made in 2005 totaled \$1,581, inclusive of imputed interest of \$260. Interest on capital leases is calculated using an interest rate of 9%.

Rental expense under operating leases was \$10,758, \$13,195, and \$14,784 for 2005, 2004 and 2003 respectively.

On September 14, 2001, Kforce executed an agreement for lease of its new headquarters and consolidation of its Tampa operations. Kforce has classified the lease as an operating lease. Significant terms included the prepayment of rent in the amount of \$2,200. The prepayment is being amortized over the 15 year term of the lease. Kforce is required to make minimum annual lease payments escalating from approximately \$1,929 to \$2,949, which are included in the above future minimum lease payments. \$1,901 and \$2,388, respectively, related to the present value of future minimum lease payments on capital leases, are included in other current debt and long-term debt-other in the accompanying Consolidated Balance Sheet as of December 31, 2005.

OTHER FINANCING COMMITMENTS

Kforce entered into financing agreements related to the purchase of capitalized software valued at \$1,799 and \$893 during the years ended December 31, 2005, and 2004, respectively. Future payments under the agreements are \$994 and \$780, inclusive of interest of \$10 and \$1 for the years ended December 31, 2006 and 2007, respectively. Payments under the agreements totaled \$754 inclusive of \$20 of interest in 2005. \$984 and \$779, respectively, related to the present value of future payments under these agreements, are included in other current debt and long term debt – other in the accompanying Consolidated Balance Sheet as of December 31, 2005.

LETTERS OF CREDIT

Kforce provides letters of credit to certain vendors in lieu of cash deposits. Kforce currently has letters of credit outstanding for workers compensation and property insurance totaling \$1,272 and for facility lease deposits totaling approximately \$4,456.

LITIGATION

In the ordinary course of its business, Kforce is, from time to time, threatened with or named as a defendant in various lawsuits, including discrimination, harassment and other similar allegations. Kforce maintains insurance in such amounts and with such coverage and deductibles as management believes is reasonable. The principal risks that Kforce insures against are workers' compensation, personal injury, bodily injury, property damage, professional malpractice, errors and omissions, employment practices liability and fidelity losses. Kforce is not aware of any litigation that would reasonably be expected to have a material adverse effect on its results of operations or financial condition.

EMPLOYMENT AGREEMENTS

Kforce has entered into employment agreements with certain executive officers and managers that provide for minimum compensation, salary and continuation of certain benefits for a six month to three-year period under certain circumstances. The agreements also provide for a payment of one to three times their annual salary and one half to three times their average annual bonus if a change in

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control (as defined by the agreements) of Kforce occurs and include a covenant against competition with Kforce that extends for one year after termination for any reason. Kforce's liability at December 31, 2005, would have been approximately \$25,618 in the event of a change in control or \$18,076 if all of the employees under contract were to be terminated by Kforce without good cause (as defined) under these contracts.

13. SEGMENT ANALYSIS

Kforce reports segment information in accordance with SFAS 131, "Disclosures about Segments of an Enterprise and Related Information". SFAS 131 requires a management approach in determining reportable segments of an organization. The management approach designates the internal organization that is used by management for making operation decisions and addressing performance as the source of determining Kforce's reportable segments. Kforce's internal reporting follows its three functional service offerings: Technology, Finance and Accounting, and Health and Life Sciences. Kforce also reports Flexible billings and Search fees separately by segment.

Historically, and through December 31, 2005, Kforce has generated only sales and gross profit information on a functional basis. As such, asset information by segment is not disclosed. Substantially all operations and long-lived assets are located in the U.S.

Information concerning operations in these segments of business is as follows:

	TECHNOLOGY	FINANCE AND ACCOUNTING	HEALTH AND LIFE SCIENCES	TOTAL
2005				
Net service revenues				
Flexible billings	\$ 352,743	\$ 211,873	\$ 182,775	\$747,391
Search fees	18,037	31,834	5,003	54,874
Total revenue	\$ 370,780	\$ 243,707	\$ 187,778	\$802,265
Gross profit	\$ 109,856	\$ 93,310	\$ 56,823	\$259,989
2004				
Net service revenues				
Flexible billings	\$ 294,598	\$ 169,411	\$ 156,071	\$620,080
Search fees	11,397	26,058	3,916	41,371
Total revenue	\$ 305,995	\$ 195,469	\$ 159,987	\$661,451
Gross profit	\$ 84,513	\$ 73,263	\$ 46,108	\$203,884
2003				
Net service revenues				
Flexible billings.	\$ 216,609	\$ 103,630	\$ 144,972	\$465,211
Search fees	7,162	19,157	4,055	30,374
Total revenue	\$ 223,771	\$ 122,787	\$ 149,027	\$495,585
Gross profit	\$ 61,646	\$ 48,586	\$ 43,736	\$153,968

14. QUARTERLY FINANCIAL DATA (UNAUDITED)

	QUARTER ENDED			
	MAR 31	JUN 30	SEPT 30	DEC 31
2005				
Net service revenues	\$ 192,900	\$ 198,470	\$ 207,293	\$ 203,602
Gross profit	60,028	64,064	68,389	67,508
Net income	3,079	5,669	6,713	6,860
Net earnings per share-basic	\$.08	\$.15	\$.17	\$.18
Net earnings per share-diluted	\$.08	\$.14	\$.17	\$.17
2004				
Net service revenues	\$ 130,208	\$ 152,162	\$ 188,862	\$ 190,219
Gross profit	38,708	47,261	57,875	60,040
Net income	1,067	251	6,047	17,646
Net earnings per share-basic	\$.03	\$.01	\$.16	\$.48
Net earnings per share-diluted	\$.03	\$.01	\$.16	\$.45

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\$12,636 of net income in the fourth quarter of 2004 relates to net tax benefit recorded in that quarter. See Note 3 for further discussion.

15. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information is as follows:

	2005	2004	2003
Cash paid (received) during the period for:			
Income taxes	\$ (29)	\$ (399)	\$ (441)
Interest, net	1,888	1,841	1,314
Non-Cash Transaction Information:			
Cash flow hedges, net of taxes	(37)	188	151
Tax benefit from disqualifying dispositions of stock options	341	611	—
Common Stock Transactions:			
Deferred compensation plan transactions	—	—	80
Employee stock purchase plan	(961)	714	566
Issuance of stock in an acquisition	18,324	51,388	—
Restricted stock issued or assigned in lieu of compensation, net of forfeitures	—	3,143	349
Software acquired under financing agreement	1,799	893	—
Equipment acquired under capital lease	3,589	2,247	—
Non cash gain on sale of Board Network	74	—	—
Cash used in connection with acquisition, net:			
Transaction costs	\$ 277	\$12,441	\$ —
Payment of acquired business bank line of credit	2,467	10,638	—
Payment of 2003 OnStaff earnout	—	4,210	—
Buyout of future OnStaff earnout	—	2,500	—
Payment of acquired business long-term liability	—	1,050	—
Cash received in acquisition	—	(2,827)	—
Transaction costs – Hall Kinion tax adjustments	58	—	—
Cash over draft received in acquisition	101	—	—
	<u>\$ 2,903</u>	<u>\$28,012</u>	<u>\$ —</u>

16. SUBSEQUENT EVENT

On January 31, 2006, Kforce acquired PCCI Holdings, Inc., pursuant to an Agreement and Plan of Merger (the “Merger Agreement”) by and among Kforce, Trevoze Acquisition Corporation, a Delaware corporation and a wholly-owned subsidiary of Kforce (“Merger Sub”), PCCI Holdings, Inc., a Delaware corporation (“PCCI”), H.I.G. Pinkerton, Inc., a Cayman company, in its capacity as Representative, William D. Pinkerton and Richard J. Quigley. Under the terms of the Merger Agreement, Kforce acquired all of the outstanding stock of PCCI for approximately \$60,000 (the “Purchase Price”) paid in cash at closing, subject to certain adjustments as provided for in the Merger Agreement. On the closing date, Kforce placed into escrow \$6,000 of the total Purchase Price to secure PCCI’s indemnification obligations, and to satisfy certain adjustments to the Purchase Price. To the extent that escrowed funds remain after satisfaction of PCCI’s indemnification obligations and Purchase Price adjustments, those amounts will be released to PCCI and accounted for as Purchase Price as of the date the proceeds are issuable from the escrow.

PCCI was a privately held company based in Trevoze, Pennsylvania that, through its wholly-owned subsidiaries (primarily Pinkerton Computer Consultants, Inc.), produced revenue of approximately \$95,000 in technology staffing and the Federal government IT services sector over the last 12 months. Approximately 35% of that revenue was generated in the government sector. As a result of the above acquisition, Kforce expanded its presence in technology staffing in both the Federal government and commercial sectors. Because the closing occurred in 2006, none of PCCI’s results of operations have been included in Kforce’s consolidated financial statements as of December 31, 2005. Kforce is currently in the process of allocating the purchase price to the fair values of the assets and liabilities acquired in conjunction with the acquisition.

SCHEDULE II

KFORCE INC. AND SUBSIDIARIES
VALUATION AND QUALIFYING
ACCOUNTS AND RESERVES
SUPPLEMENTAL SCHEDULE

<u>COLUMN A</u>	<u>COLUMN B</u>		<u>COLUMN C</u>		<u>COLUMN D</u>	<u>COLUMN E</u>
<u>DESCRIPTION</u>	<u>BALANCE AT BEGINNING OF</u>		<u>CHARGED TO COSTS AND EXPENSES (RECOVERY)</u>	<u>CHARGED TO OTHER ACCOUNTS (a)</u>	<u>DEDUCTIONS (b)</u>	<u>BALANCE AT END OF PERIOD</u>
Allowance for doubtful accounts and fallouts	2003	\$ 5,827	\$ (394)	\$ 1,150	\$ (959)	\$ 5,624
	2004	5,624	1,846	1,431	(2,633)	6,268
	2005	6,268	38	1,967	(3,174)	5,099

- (a) Charged to other accounts includes the provision for fallouts of search placements that has been deducted from net service revenues in the accompanying consolidated statements of income and comprehensive income.
- (b) Deductions include writeoffs of uncollectible accounts receivable and fallouts of search placements that have been charged against the allowance for doubtful accounts and fallouts.

EXHIBIT INDEX

- 2.1 Agreement and Plan of Merger, dated as of December 2, 2003, by and among the Registrant, Novato Acquisition Corporation and Hall, Kinion & Associates, Inc. (12)
- 2.2 Letter Amendment to Agreement and Plan of Merger, dated December 9, 2003, by and among the Registrant, Novato Acquisition Corporation and Hall, Kinion & Associates, Inc. (12)
- 2.3 Letter Amendment to Agreement and Plan of Merger, dated December 31, 2003, by and among the Registrant, Novato Acquisition Corporation and Hall, Kinion & Associates, Inc. (12)
- 3.1 Amended and Restated Articles of Incorporation. (1)
 - 3.1a Articles of Amendment to Articles of Incorporation. (5)
 - 3.1b Articles of Amendment to Articles of Incorporation. (5)
 - 3.1c Articles of Amendment to Articles of Incorporation. (5)
 - 3.1d Articles of Amendment to Articles of Incorporation. (6)
 - 3.1e Articles of Amendment to Articles of Incorporation. (4)
- 3.2 Amended and Restated Bylaws. (1)
 - 3.2a Amendment to the Amended & Restated Bylaws. (5)
- 4.1 Rights Agreement, dated October 28, 1998, between Romac International, Inc. and State Street Bank and Trust Company as Rights Agent. (2)
- 4.2 Amendment to Rights Agreement dated as of October 24, 2000. (3)
- 4.9 Form of Stock Certificate. (1)
- 10.3 Amended and Restated Credit Agreement dated as of November 3, 2000. (7)
 - 10.3a First Amendment to the Amended and Restated Credit Agreement dated as of December 10, 2000. (8)
 - 10.3b Second Amendment to the Amended and Restated Credit Agreement dated as of February 12, 2001. (7)
 - 10.3c Third Amendment to the Amended and Restated Credit Agreement dated as of January 1, 2002. (8)
 - 10.3d Fourth Amendment to the Amended and Restated Credit Agreement dated as of August 5, 2002. (9)
 - 10.3e Fifth Amendment to the Amended and Restated Credit Agreement dated as of December 5, 2002. (10)
 - 10.3f Sixth Amendment to the Amended and Restated Credit Agreement dated as of August 26, 2004. (11)
 - 10.3g Waiver related to the Amended and Restated Credit Agreement dated as of April 21, 2005. (13)
 - 10.3h Waiver related to the Amended and Restated Credit Agreement dated as of August 3, 2005. (14)
 - 10.3i Seventh Amendment to the Amended and Restated Credit Agreement dated as of October 28, 2005. (15)
 - 10.3j Corrective Modification to the Seventh Amendment to the Amended and Restated Credit Agreement dated as of November 7, 2005. (16)
- 10.12 Form of Voting Agreement, dated as of December 2, 2003, by and between the Registrant and certain stockholders of Hall, Kinion & Associates, Inc. (5)
- 10.13 Form of Voting Agreement, dated as of December 2, 2003, by and between Hall Kinion & Associates, Inc. and certain stockholders of the Registrant. (5)
- 23 Consent of Deloitte & Touche LLP
- 31.1 Certification by the Chief Executive Officer of Kforce Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by the Chief Financial Officer of Kforce Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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- 32.1 Certification by the Chief Executive Officer of Kforce Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by the Chief Financial Officer of Kforce Inc. pursuant to 18 U.S.C. Section 2350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

-
- (1) Incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-03393) filed May 9, 1996.
- (2) Incorporated by reference to the Registrant's Current Report on Form 8-K (File No. 000-26058), filed October 29, 1998.
- (3) Incorporated by reference to the Registrant's Current Report on Form 8-K (File No. 000-26058), filed on November 3, 2000.
- (4) Incorporated by reference to the Registrant's Annual Report on Form 10-K (File No. 000-26058) filed March 29, 2002.
- (5) Incorporated by reference to the Registrant's Form S-4/A (File No. 333-111566) filed February 9, 2004 as amended.
- (6) Incorporated by reference to the Registrant's Form 8-K (File No. 000-26058) filed May 17, 2000.
- (7) Incorporated by reference to the Registrant's Form 10-K (File No. 000-26058) filed March 29, 2001.
- (8) Incorporated by reference to the Registrant's Form 10-K (File No. 000-26058) filed March 29, 2002.
- (9) Incorporated by reference to the Registrant's Form 10-Q (File No. 000-26058) filed November 14, 2002.
- (10) Incorporated by reference to the Registrant's Form 8-K (File No. 000-26058) filed December 6, 2002.
- (11) Incorporated by reference to the Registrant's Form 8-K (File No. 000-26058) filed August 31, 2004.
- (12) Incorporated by reference to the Registrant's Form S-4 (File No. 333-111566) filed December 24, 2003, as amended.
- (13) Incorporated by reference to the Registrant's Form 10-Q (File No. 000-26058) filed May 6, 2005.
- (14) Incorporated by reference to the Registrant's Form 10-Q (File No. 000-26058) filed August 8, 2005.
- (15) Incorporated by reference to the Registrant's Form 8-K (File No. 000-26058) filed November 3, 2005.
- (16) Incorporated by reference to the Registrant's Form 8-K (File No. 000-26058) filed November 7, 2005.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-50539, 33-50543, 333-94563, 333-60302, and 333-68212 on Forms S-8, and Registration Statement Nos. 333-89144 and 333-123428 on Forms S-3 of our report dated March 2, 2006 relating to the consolidated financial statements and financial statement schedule of Kforce Inc. and subsidiaries ("Kforce") (which report expresses an unqualified opinion) and our report dated March 2, 2006 relating to management's report of the effectiveness of internal control over financial reporting, appearing in this Annual Report on Form 10-K of Kforce for the year ended December 31, 2005.

Deloitte & Touche LLP
Tampa, Florida
March 2, 2006

CERTIFICATIONS

I, David L. Dunkel, certify that:

1. I have reviewed this annual report on Form 10-K of Kforce Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 2, 2006

/s/ David L. Dunkel

David L. Dunkel,
Chief Executive Officer

CERTIFICATIONS

I, Joseph J. Liberatore, certify that:

1. I have reviewed this annual report on Form 10-K of Kforce Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 2, 2006

/s/ Joseph J. Liberatore
Joseph J. Liberatore,
Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Kforce Inc. (the "Firm") on Form 10-K for the fiscal year ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Form 10-K"), I, David L. Dunkel, Chief Executive Officer of Kforce, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Form 10-K fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) The information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of Kforce.

Date: March 2, 2006

/s/ David L. Dunkel
David L. Dunkel,
Chief Executive Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Kforce Inc. (the "Firm") on Form 10-K for the fiscal year ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Form 10-K"), I, Joseph J. Liberatore, Chief Financial Officer of Kforce, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Form 10-K fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) The information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of Kforce.

Date: March 2, 2006

/s/ Joseph J. Liberatore

Joseph J. Liberatore,
Chief Financial Officer