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

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended December 31, 2001

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

Commission file number 1–12997

MAXIMUS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Virginia (State or Other Jurisdiction of Incorporation or Organization)	**54-1000588** (I.R.S. Employer Identification No.)
11419 Sunset Hills Road **Reston, Virginia** (Address of Principal Executive Offices)	**20190** (Zip Code)

Registrant's Telephone Number, Including Area Code:
(703) 251-8500

Indicate by check 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 ☐

Class	Outstanding at February 8, 2002
Common Shares, no par value	23,191,328

MAXIMUS, Inc.

Quarterly Report on Form 10–Q
For the Quarter Ended December 31, 2001

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements.

Consolidated Balance Sheets as of September 30, 2001 (audited) and December 31, 2001 (unaudited)

Consolidated Statements of Income for the three months ended December 31, 2000 and 2001 (unaudited)

Consolidated Statements of Cash Flows for the three months ended December 31, 2000 and 2001 (unaudited)

Notes to Unaudited Consolidated Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8–K.

Signature

Exhibit Index

Throughout this Quarterly Report on Form 10-Q, the terms "we," "us," "our" and "MAXIMUS" refer to MAXIMUS, Inc. and its subsidiaries.

MAXIMUS, Inc.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	September 30, 2001	December 31, 2001 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 114,108	$ 94,705
Marketable securities	1,232	25,224
Accounts receivable - billed	118,988	118,270
Accounts receivable - unbilled	20,436	25,231
Prepaid expenses and other current assets	5,483	8,118
Total current assets	260,247	271,548
Property and equipment at cost:		
Land	2,462	2,462
Building and improvements	11,096	11,257
Office furniture and equipment	17,079	17,839
Leasehold improvements	992	1,141
	31,629	32,699
Less: Accumulated depreciation and amortization	(11,090)	(11,761)
Total property and equipment, net	20,539	20,938
Software development costs	13,961	15,623
Less: Accumulated amortization	(2,245)	(2,683)
Total software development, net	11,716	12,940
Deferred income taxes	2,726	2,726
Intangible assets, net	859	596
Goodwill, net	48,959	48,959
Other assets	2,669	2,042
Total assets	$ 347,715	$ 359,749
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 12,709	$ 12,376
Accrued compensation and benefits	18,611	13,851
Deferred revenue	10,756	8,664
Income taxes payable	1,214	5,314
Deferred income taxes	1,849	1,849
Other current liabilities	642	716
Total current liabilities	45,781	42,770
Other liabilities	520	458
Total liabilities	46,301	43,228
Shareholders' equity:		
Common stock, no par value; 60,000,000 shares authorized; 22,985,806 and 23,166,240 shares issued and outstanding at September 30, 2001 and December 31, 2001, at stated amount, respectively	185,658	189,577
Accumulated other comprehensive loss	(18)	(65)
Retained earnings	115,774	127,009
Total shareholders' equity	301,414	316,521
Total liabilities and shareholders' equity	$ 347,715	$ 359,749

See notes to unaudited consolidated financial statements.

MAXIMUS, Inc.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended December 31,	
	2000	2001
Revenues	$ 109,246	$ 129,570
Cost of revenues	77,254	88,786
Gross profit	31,992	40,784
Selling, general and administrative expenses	19,751	22,528
Amortization of goodwill and other acquisition-related intangibles	1,392	263
Income from operations	10,849	17,993
Interest and other income	288	733
Income before income taxes and cumulative effect of accounting change	11,137	18,726
Provision for income taxes	4,622	7,490
Income before cumulative effect of accounting change	6,515	11,236
Cumulative effect of accounting change, net of tax benefit	(3,856)	—
Net income	$ 2,659	$ 11,236

Earnings per share:		
Income before cumulative effect of accounting change:		
Basic	$ 0.31	$ 0.49
Diluted	$ 0.30	$ 0.47
Net income:		
Basic	$ 0.13	$ 0.49
Diluted	$ 0.12	$ 0.47
Weighted average shares outstanding:		
Basic	21,145	23,101
Diluted	21,615	24,017

See notes to unaudited consolidated financial statements.

MAXIMUS, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Three Months Ended December 31,	
	2000	**2001**
Cash flows from operating activities:		
Net income	$ 2,659	$ 11,236
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,346	1,372
Deferred income taxes	(150)	—
Cumulative effect of accounting change	3,856	—
Change in assets and liabilities:		
Accounts receivable — billed	(10.948)	718
Accounts receivable — unbilled	(3,712)	(4,795)
Prepaid expenses and other current assets	284	(2,546)
Other assets	80	506
Accounts payable	(388)	(333)
Accrued compensation and benefits	(4,226)	(4,760)
Deferred revenue	1,157	(2,091)
Income taxes payable	3,679	4,100
Other liabilities	82	74
Net cash (used in) provided by operating activities	(5,281)	3,481
Cash flows from investing activities:		
Proceeds from notes receivable	15	30
Capitalization of software development costs	(2,140)	(1,663)
Purchase of property and equipment	(1,751)	(1,069)
Decrease (increase) in marketable securities	1,162	(24,039)
Net cash used in investing activities	(2,714)	(26,741)
Cash flows from financing activities:		
Issuance of common stock	619	3,919
Net payments on borrowings	(99)	(62)
Net cash provided by financing activities	520	3,857
Net decrease in cash and cash equivalents	(7,475)	(19,403)
Cash and cash equivalents, beginning of period	36,975	114,108
Cash and cash equivalents, end of period	$ 29,500	$ 94,705

See notes to unaudited consolidated financial statements.

MAXIMUS, Inc.
Notes to Unaudited Consolidated Financial Statements
For the Three Month Periods Ended December 31, 2001 and 2000
(Dollars in thousands, except per share amounts)

In these Notes to Unaudited Consolidated Financial Statements, the terms the "Company" and "MAXIMUS" refer to MAXIMUS, Inc. and its subsidiaries.

1. Organization and Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normally recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three-month period ended December 31, 2001 are not necessarily indicative of the results that may be expected for the full fiscal year. These financial statements should be read in conjunction with the audited financial statements as of September 30, 2001 and 2000 and for each of the three years in the period ended September 30, 2001, included in the Company's Annual Report on Form 10-K for the year ended September 30, 2001 (File No. 1–12997) filed with the Securities and Exchange Commission on December 21, 2001.

2. Revenue Recognition

During fiscal 2001, the Company changed its method of accounting for revenue recognition in accordance with SEC Staff Accounting Bulletin No. 101, *Revenue*

Recognition in Financial Statements. Effective October 1, 2000, the Company recorded the cumulative effect of the accounting change resulting in a charge to income of $3,856 (net of an income tax benefit of $2,735). As reported in the Company's fiscal 2001 Annual Report on Form 10-K, the quarterly information originally reported in fiscal 2001 Quarterly Reports on Form 10-Q was restated for the change in accounting.

3. Goodwill and Intangible Assets

The Company adopted Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, ("FAS 142"), effective October 1, 2001. Under FAS 142, goodwill is no longer amortized but reviewed for impairment annually, or more frequently if certain indicators arise. The Company is required to complete the initial step of a transitional impairment test within six months of adopting FAS 142 and to complete the final step of the transitional impairment test by the end of the fiscal year. Any impairment loss resulting from the transitional impairment test will be recorded as a cumulative effect of a change in accounting principle. Subsequent impairment losses will be reflected in operating income in the income statement. Had the Company been accounting for its goodwill under FAS 142 for the three months ended December 31, 2000, the Company's net income and earnings per share would have been as follows:

Reported net income	$	2,659
Add back goodwill amortization, net of tax		694
Adjusted net income	$	3,353
Basic earnings per share:		
As reported	$	0.13
Goodwill amortization, net of tax		0.03
Adjusted basic earnings per share	$	0.16
Diluted earnings per share:		
As reported	$	0.12
Goodwill amortization, net of tax		0.03
Adjusted diluted earnings per share	$	0.15

Intangible assets are comprised of employee contracts and customer lists and are amortized using the straight-line method over a period of two and five years, respectively. The accumulated amortization related to intangible assets at September 30, 2001 was $2,256 and at December 31, 2001 was $2,519. The aggregate intangible amortization expense for the quarter ended December 31, 2001 was $263. The estimated amortization expense for the years ending September 30, 2002, 2003, 2004 and 2005 is $642, $132, $70 and $15, respectively.

4. Business Combinations

On May 11, 2001, the Company acquired all of the outstanding membership interests of Opportunity America, LLC for $780. In conjunction with the purchase, the Company recorded goodwill of $593 and intangible assets of $115.

5. Commitments and Contingencies

The Company is involved in various legal proceedings in the ordinary course of its business. In the opinion of management, these proceedings involve amounts that would not have a material effect on the financial position or results of operations of the Company if such proceedings were disposed of unfavorably.

6. Earnings per share

The following table sets forth the components of basic and diluted earnings per share:

	Three Months Ended December 31,			
		2000		2001
Numerator:	$	2,659	$	11,236
Net income				
Denominator:				
Weighted average shares outstanding		21,145		23,101
Effect of dilutive securities:				
Employee stock options		470		916
Denominator for diluted earnings per share		21,615		24,017

7. Segment Information

The Company has reorganized its business into four reportable operating segments in order to better focus and manage its healthcare outsourcing work, which had been part of the Government Operations Group. Accordingly, prior period amounts have been reclassified to reflect current period presentation of segment information. In a Current Report on Form 8-K filed on February 4, 2002, the Consulting Group was identified as the "Consulting/Management & Information Services Group." Henceforth, it shall be referred to as the "Consulting Group" for ease of reference.

The following table provides certain financial information for each business segment:

	Three Months Ended December 31,			
		2000		2001
Revenues:				
Consulting Group	$	33,038	$	33,403
Health Management Services Group		28,874		40,155
Human Services Group		30,440		37,180
Systems Group		16,894		18,832
Total	$	109,246	$	129,570

Gross Profit:		
Consulting Group	$ 12,575	$ 15,530
Health Management Services Group	5,643	8,468
Human Services Group	5,974	7,549
Systems Group	7,800	9,237
Total	$ 31,992	$ 40,784
Income from operations:		
Consulting Group	$ 4,591	$ 7,951
Health Management Services Group	2,606	5,113
Human Services Group	1,772	3,300
Systems Group	1,880	1,629
Total	$ 10,849	$ 17,993

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Overview

We are a leading provider of program management, consulting services and systems solutions primarily to state and local government agencies throughout the United States. Since our inception, we have been at the forefront of innovation in meeting our mission of "Helping Government Serve the People®." We use our expertise, experience and advanced information technology to make government operations more efficient and cost-effective while improving the quality of services provided to program beneficiaries. We have had contracts with government agencies in all 50 states, 49 of the 50 largest cities and 27 of the 30 largest counties. We have been profitable every year since we were founded. For the fiscal year ended September 30, 2001, we had revenues of $487.3 million and income, before the cumulative effect of an accounting change, of $40.1 million. For the three months ended December 31, 2001, we had revenues of $129.6 million and net income of $11.2 million.

Prior to fiscal 2002, we conducted our operations through three groups: the Government Operations Group, the Systems Group and the Consulting Group. In fiscal 2002, we reorganized our business into four reportable operating segments in order to better focus and manage our healthcare outsourcing work, which had been part of the Government Operations Group. The Health Management Services division and the Federal Services division, both formerly part of the Government Operations Group, now comprise the newly formed Health Management Services Group. The Child Support division and the Workforce Services division, both formerly part of the Government Operations Group, now are located in the newly formed Human Services Group. Accordingly, we have reflected the segment information for the periods reported in this Quarterly Report on Form 10-Q to be consistent with our current reporting of four operating segments.

Our revenues are generated from contracts with various payment arrangements, including: (1) fixed-price; (2) costs incurred plus a negotiated fee ("cost-plus"); (3) performance-based criteria; and (4) time and materials reimbursement (used primarily by the Consulting Group). For the fiscal year ended September 30, 2001, the most recent period for which this information is available, revenues from fixed-price contracts were approximately 36% of total revenues; revenues from cost-plus contracts were approximately 22% of total revenues; revenues from performance-based contracts were approximately 28% of total revenues; and revenues from time and materials reimbursement contracts were approximately 14% of total revenues. Traditionally, a majority of our contracts with state and local government agencies have been fixed-price and performance-based and our contracts with the federal government have been cost-plus. Fixed-price and performance-based contracts generally offer higher margins but typically involve more risk than cost-plus or time and materials reimbursement contracts because we are subject to the risk of potential cost overruns or inaccurate revenue estimates.

The Company recognizes revenue on its performance-based contracts as such revenue becomes fixed or determinable which generally occurs when amounts are billable to customers, rather than as costs are incurred. For certain contracts, this may result in revenue being recognized in large, irregular increments. Additionally, costs related to certain contracts are incurred in periods prior to recognizing revenue. These factors may result in irregular revenues and profit margins in operating segments with performance-based contracts.

The Human Services Group and Health Management Services Group contracts generally contain base periods of one or more years as well as one or more option periods that may cover more than half of the potential contract duration. As of September 30, 2001, our average Human Services Group and Health Management Services Group contract duration was approximately 2.5 years. Our Consulting Group contracts had performance periods ranging from one month to approximately two years. Our average Systems Group contract duration was 1.2 years.

Our most significant expense is cost of revenues, which consists primarily of project-related employee salaries and benefits, subcontractors, computer equipment and travel expenses. Our ability to accurately predict personnel requirements, salaries and other costs as well as to effectively manage a project or achieve certain levels of performance can have a significant impact on the service costs related to our fixed-price, performance-based and time and materials contracts. Service cost variability has little impact on cost-plus arrangements because allowable costs are reimbursed by the client.

Selling, general and administrative expenses consist of management, marketing and administration costs (including salaries, benefits, travel, recruiting, continuing education and training), facilities costs, printing, reproduction, communications and equipment depreciation.

Business Combinations and Acquisitions

As part of our growth strategy, we intend to continue to selectively identify and pursue complementary businesses to expand our geographic reach and the breadth and depth of our services and to enhance our customer base. On May 11, 2001, we acquired all of the outstanding membership interests of Opportunity America, LLC for $780. In conjunction with the purchase, we recorded goodwill and other intangible assets of $708.

Results of Operations

The following table sets forth, for the periods indicated, selected statements of income data as a percentage of revenues:

	Three Months Ended December 31,	
	2000	2001

Revenues:		
Consulting Group	30.2%	25.8%
Health Management Services Group	26.4	31.0
Human Services Group	27.9	28.7
Systems Group	15.5	14.5
Total revenues	100.0	100.0
Gross Profit:		
Consulting Group	38.1	46.5
Health Management Services Group	19.5	21.1
Human Services Group	19.6	20.3
Systems Group	46.2	49.0
Total gross profit	29.3	31.5
Selling, general and administrative expenses	18.1	17.4
Amortization of goodwill and other acquisition—related intangibles	1.3	0.2
Income from operations:		
Consulting Group	13.9	23.8
Health Management Services Group	9.0	12.7
Human Services Group	5.8	8.9
Systems Group	11.1	8.7
Total income from operations	9.9	13.9
Interest and other income	0.3	0.6
Income before income taxes and cumulative effect of accounting change	10.2	14.5
Provision for income taxes	4.2	5.8
Income before cumulative effect of accounting change	6.0	8.7
Cumulative effect of accounting change	3.6	—
Net income	2.4%	8.7%

Three Months Ended December 31, 2001 Compared to Three Months Ended December 31, 2000

Revenues. Our total contract revenues increased 18.6% to $129.6 million for the three months ended December 31, 2001 from $109.2 million for the same period in 2000. Revenues of our Consulting Group increased 1.1% to $33.4 million for the three months ended December 31, 2001 from $33.0 million for the same period in 2000. Revenues of our Health Management Services Group increased 39.1% to $40.2 million for the three months ended December 31, 2001 from $28.9 million for the same period in 2000. This increase was due to an increase in the number of contracts in the Group and an increase in revenues on a few existing contracts in the Group. Revenues of our Human Services Group increased 22.1% to $37.2 million for the three months ended December 31, 2001 from $30.4 million for the same period in 2000. This increase was due to an increase in the number of contracts in the Group and revenues totaling $0.7 million related to an acquisition. Revenues of our Systems Group increased 11.5% to $18.8 million for the three months ended December 31, 2001 from $16.9 million for the same period in 2000 primarily due to an increase in the number of contracts in the Group. For the three months ended December 31, 2001 compared to the three months ended December 31, 2000, our overall growth in revenue was 17.9%, excluding revenue related to an acquisition.

Gross Profit. Our total gross profit increased 27.5% to $40.8 million for the three months ended December 31, 2001 from $32.0 million for the same period in 2000. Gross profit of our Consulting Group increased 23.5% to $15.5 million for the three months ended December 31, 2001 from $12.6 million for the same period in 2000. As a percentage of Consulting Group revenues, that Group's gross profit increased to 46.5% for the three months ended December 31, 2001 from 38.1% for the same period in 2000, primarily due to improved margins on performance-based contracts. Gross profit of our Health Management Services Group increased 50.1% to $8.5 million for the three months ended December 31, 2001 from $5.6 million for the three months ended December 31, 2000. As a percentage of Health Management Services Group revenues, that Group's gross profit increased to 21.1% for the three months ended December 30, 2001 from 19.5% for the same period in 2000. The increase was due to increased margins on a few contracts within the Group. Gross profit of our Human Services Group increased 26.4% to $7.5 million for the three months ended December 31, 2001 from $6.0 million for the three months ended December 31, 2000. As a percentage of Human Services Group revenues, Human Services Group gross profit increased to 20.3% for the three months ended December 30, 2001 from 19.6% for the same period in 2000. The increase was due to increased margins on a few projects within the Group. Gross profit of our Systems Group increased 18.4% to $9.2 million for the three months ended December 31, 2001 from $7.8 million for the same period in 2000. As a percentage of Systems Group revenues, Systems Group gross profit increased to 49.0% for the three months ended December 31, 2001 from 46.2% for the same period in 2000, primarily due to improved performance in the Asset Solutions division.

Selling, General and Administrative Expenses. Our total selling, general and administrative (SG&A) expenses increased 14.1% to $22.5 million for the three months ended December 31, 2001 from $19.8 million for the same period in 2000. The primary reasons for the increase in SG&A costs were the growth in the number of employees, the increase in expenses necessary to support higher revenues and the increase in marketing and proposal preparation expenditures incurred to pursue further growth. As a percentage of our revenues, our SG&A expenses decreased to 17.4% for the three months ended December 30, 2001 from 18.1% for the same period in 2000.

Amortization of Goodwill and Other Acquisition-Related Intangibles. In the quarter ended December 31, 2001, we incurred $0.3 million of amortization expense, as compared to $1.4 million for the same period in 2000. The decrease was due to the non-amortization of goodwill under FAS 142 effective October 1, 2001.

Interest and Other Income. The increase in interest and other income to $0.7 million for the three months ended December 31, 2001 as compared to $0.3 million for the same period in 2000 was due to an increase in the average balance of funds we invested.

Provision for Income Taxes. Our provision for income tax for the three months ended December 31, 2001 was 40.0% of income before income taxes as compared to 41.5% for the three months ended December 31, 2000. This decrease was due to differences in the amounts of certain expense items and some recently implemented tax reduction strategies.

Liquidity and Capital Resources

For the three months ended December 31, 2001, cash provided by our operations was $3.5 million as compared to $5.3 million of cash used in operations for the three months ended December 31, 2000. Cash provided by operating activities for the three months ended December 31, 2001 consisted primarily of net income of $11.2 million offset by an increase in unbilled accounts receivable of $4.8 million, a decrease in deferred revenues of $2.1 million, and a decrease in accrued compensation of $4.7 million, offset by other positive cash flow items. During the three months ended December 31, 2000, cash used in operating activities consisted primarily of net income of $2.7 million plus non-cash adjustments of $6.1 million, offset by increases in billed accounts receivable of $10.9 million and unbilled accounts receivable of $3.7 million and a decrease

in accrued compensation and benefits of $4.2 million. Cash flow was affected in the first quarter of both fiscal years, because we accrue for incentive compensation throughout the fiscal year and make payments to employees in the first quarter.

For the three months ended December 31, 2001, cash used in investing activities was $26.7 million as compared to $2.7 million for the three months ended December 31, 2000. Cash used in investing activities for the three months ended December 31, 2001 primarily consisted of purchases of marketable securities of $24.0 million, expenditures for capitalized software costs totaling $1.7 million and purchases of property and equipment of $1.1 million. During the three months ended December 31, 2000, we used cash in investing activities primarily for expenditures related to capitalized software costs totaling $2.1 million and purchases of property and equipment of $1.8 million offset by a decrease in marketable securities of $1.2 million.

Cash provided by financing activities for the three months ended December 31, 2001 and 2000 was $3.9 and $0.5 million, respectively, which consisted primarily of sales of stock to employees through our Employee Stock Purchase Plan and Equity Incentive Plan.

Our management believes that we do not have significant off-balance sheet risk or exposures to liabilities that are not recorded or disclosed in our financial statements. While we have significant operating lease commitments for office space, those commitments are generally tied to the period of performance under related contracts. Additionally, although on certain contracts we are bound by performance bond commitments, we have not had any defaults resulting in draws on performance bonds. Also, we do not speculate in derivative transactions.

Our management believes that we will have sufficient resources to meet our currently anticipated capital expenditure and working capital requirements for at least the next twelve months.

Forward Looking Statements

From time to time, we may make forward-looking statements that are not historical facts, including statements about our confidence and strategies and our expectations about revenues, results of operations, profitability, future contracts, market opportunities, market demand or acceptance of our products and services. These statements involve risks and uncertainties that could cause our actual results to differ materially from those indicated by such forward–looking statements. Examples of these risks include: risks associated with government contracting; risks involved in managing government projects; opposition from government unions; challenges resulting from our growth; legislative changes and political developments; adverse publicity; and legal, economic, and other risks detailed in Exhibit 99 to this Quarterly Report on Form 10-Q for the fiscal period ended December 31, 2001.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We believe that our exposure to market risk related to the effect of changes in interest rates, foreign currency exchange rates, commodity prices and equity prices with regard to instruments entered into for trading or for other purposes is immaterial.

Part II. Other Information.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits. The Exhibits filed as part of this Form 10-Q are listed on the Exhibit Index immediately preceding the Exhibits. The Exhibit Index is incorporated herein by reference.

(b) Reports on Form 8-K. The Company did not file any Current Reports on Form 8-K during the quarter ended December 31, 2001.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MAXIMUS, INC

Date: February 13, 2002

By: /s/ F. ARTHUR NERRET
F. Arthur Nerret
Vice President, Finance, Chief Financial Officer
(Principal Financial and Chief Accounting Officer)

EXHIBIT INDEX

Exhibit No.	Description
99	Important Factors Regarding Forward Looking Statements. Filed herewith.

Important Factors Regarding Forward Looking Statements

From time to time, we may make forward-looking public statements, such as statements concerning our then-expected future revenues or earnings or concerning projected plans, performance or contract procurement, as well as other estimates relating to future operations. Forward-looking statements may be in reports filed under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), in press releases or in informal statements made with the approval of an authorized executive officer. The words or phrases “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimate,” “project,” “believe,” “could,” “intend,” “may,” “opportunity,” “plan,” “potential” or similar terms and expressions are intended to identify “forward-looking statements” within the meaning of Section 21E of the Exchange Act and Section 27A of the Securities Act of 1933, as amended, as enacted by the Private Securities Litigation Reform Act of 1995.

We wish to caution you not to place undue reliance on these forward-looking statements that speak only as of the date on which they are made. In addition, we wish to advise you that the factors listed below, as well as other factors we have not currently identified, could affect our financial or other performance and could cause our actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods or events in any current statement.

We will not undertake and we specifically decline any obligation to publicly release revisions to these forward-looking statements to reflect either circumstances after the date of the statements or the occurrence of events that may cause us to re-evaluate our forward-looking statements.

In connection with the “safe harbor” provisions of the Private Securities Litigation Reform Act, we are hereby filing the following cautionary statements identifying important factors that could cause our actual results to differ materially from those projected in forward-looking statements made by us or on our behalf:

If we fail to satisfy our contractual obligations, our ability to compete for future contracts and our financial condition may be adversely affected.

Our failure to comply with contract requirements or to meet our client’s performance expectations when performing a contract could materially and adversely affect our financial performance and our reputation, which, in turn, would impact our ability to compete for new contracts. In addition, our contracts often require us to indemnify clients for our failure to meet performance standards. Some of our contracts contain liquidated damages provisions and financial penalties related to performance failures. Although we have liability insurance, the policy limits may not be adequate to provide protection against all potential liabilities. Further, in order to bid on certain contracts, we are required to post a cash performance bond or obtain a letter of credit to secure our indemnification obligations. If a claim is made against a performance bond or letter of credit, the issuer could demand higher premiums. Increased premiums would adversely affect our earnings and could limit our ability to bid for future contracts.

If we fail to estimate accurately the factors upon which we base our contract pricing, we may have to report a decrease in revenues or incur losses on those contracts.

We derived approximately 36% of our fiscal 2001 revenues from fixed-price contracts and approximately 28% of our fiscal 2001 revenues from performance-based contracts. For fixed-price contracts, we receive our fee if we meet specified objectives or achieve certain units of work. Those objectives might include placing a certain number of welfare recipients into jobs, collecting target amounts of child support payments, completing a particular number of managed care enrollments, or delivering a planning document under a consulting arrangement. For performance-based contracts, we receive our fee on a per-transaction basis. These contracts include, for example, child support enforcement contracts, in which we often receive a fee based on the amount of child support collected. To earn a profit on these contracts, we must accurately estimate costs involved and assess the probability of meeting the specified objectives, realizing the expected

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units of work or completing individual transactions, within the contracted time period. If our estimates prove to be inaccurate, we may not achieve the level of profit we expected or we may incur a net loss on a contract.

If we are unable to manage our growth, our profitability will be adversely affected.

Sustaining our growth places significant demands on our management as well as on our administrative, operational and financial resources. For us to continue to manage our growth, we must continue to improve our operational, financial and management information systems and expand, motivate and manage our workforce. If our growth comes at the expense of providing quality service and generating reasonable profits, our ability to successfully bid for contracts and our profitability will be adversely affected.

Government entities have in the past and may in the future terminate their contracts with us earlier than we expect, which may result in revenue shortfalls.

Many of our government contracts contain base periods of one or more years, as well as option periods covering more than half of the contract’s potential duration. Government agencies do not have to exercise these option periods. The profitability of some of our contracts could be adversely impacted if the option periods are not exercised. Our contracts also typically contain provisions permitting a government client to terminate the contract on short notice, with or without cause. The unexpected termination of significant contracts could result in significant revenue shortfalls. If revenue shortfalls occur and are not offset by corresponding reductions in expenses, our business could be adversely affected. We cannot anticipate if, when or to what extent a client might terminate its contracts with us.

Government unions may oppose outsourcing of government programs to outside vendors such as us, which could limit our market opportunities.

Our success depends in part on our ability to win profitable contracts to administer and manage health and human services programs traditionally administered by government employees. Many government employees, however, belong to labor unions with considerable financial resources and lobbying networks. Unions have in the past and are likely to continue to apply political pressure on legislators and other officials seeking to outsource government programs. For example, union lobbying was instrumental in influencing the Department of Health and Human Services to deny a petition to allow private corporations to make Food Stamp and Medicaid eligibility determinations in Texas. Union opposition may result in fewer opportunities for us to service government agencies.

We may lose executive officers and senior managers on whom we rely to generate business and execute projects successfully.

The abilities of our executive officers and our senior managers to generate business and execute projects successfully is important to our success. While we have an employment agreement with one of our executive officers, this agreement does not prevent him from terminating his employment with us. The loss of an executive officer or senior manager could impair our ability to secure and manage engagements.

Government agencies may investigate and audit our contracts and, if any improprieties are found, we may be required to refund revenues we have received, to forego anticipated revenues and may be subject to penalties and sanctions, including prohibitions on our bidding in response to RFPs.

The government agencies we contract with have the authority to audit and investigate our contracts with them. As part of that process, the government agency reviews our performance on the contract, our pricing practices, our cost structure and our compliance with applicable laws, regulations and standards. If the agency determines that we have improperly allocated costs to a specific contract, we will not be reimbursed for those costs and we will be required to refund the amount of any such costs that have been reimbursed. If a government audit uncovers improper or illegal activities by us or we otherwise determine that these activities have occurred, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeitures of profits, suspension of payments, fines and suspension or

disqualification from doing business with the government. Any adverse determination could adversely impact our ability to bid in response to RFPs in one or more jurisdictions.

We may incur significant costs before receiving related revenues which could result in cash shortfalls.

When we are awarded a contract to manage a government program, we may incur significant expenses before we receive contract payments, if any. These expenses include leasing office space, purchasing office equipment and hiring personnel. As a result, in certain large contracts where the government does not fund program start-up costs, we are required to invest significant sums of money before receiving related contract payments. In addition, payments due to us from government agencies may be delayed due to billing cycles or as a result of failures to approve governmental budgets in a timely manner. Moreover, any resulting cash shortfall could be exacerbated if we fail to either invoice the government agency or collect our fee in a timely manner.

Inaccurate, misleading or negative media coverage could adversely affect our reputation and our ability to bid for government contracts.

The media frequently focuses its attention on our contracts with government agencies. If the media coverage is negative, it could influence government officials to slow the pace of outsourcing government services, which could reduce the number of RFPs. The media also focuses its attention on the activities of political consultants engaged by us, even when their activities are unrelated to our business, and we may be tainted by adverse media coverage about their activities. Moreover, inaccurate, misleading or negative media coverage about us could harm our reputation and, accordingly, our ability to bid for and win government contracts.

We obtain most of our business through responses to government RFPs. We may not be awarded contracts through this process in the future and contracts we are awarded may not be profitable.

Substantially all of our clients are government authorities. To market our services to government clients, we are often required to respond to government RFPs. To do so effectively, we must estimate accurately our cost structure for servicing a proposed contract, the time required to establish operations and likely terms of the proposals submitted by competitors. We must also assemble and submit a large volume of information within an RFP's rigid timetable. Our ability to respond successfully to RFPs will greatly impact our business. We may not be awarded contracts through the RFP process and our proposals may not result in profitable contracts.

We may be unable to attract and retain sufficient qualified personnel necessary to sustain our business.

Our delivery of services is labor-intensive. When we are awarded a government contract, we must quickly hire project leaders and case management personnel. The additional staff also creates a concurrent demand for increased administrative personnel. Our success requires that we attract, develop, motivate and retain:

- experienced and innovative executive officers;
- senior managers who have successfully managed or designed government services programs in the public sector; and
- information technology professionals who have designed or implemented complex information technology projects.

Innovative, experienced and technically proficient individuals are in great demand and are likely to remain a limited resource. We may be unable to continue to attract and retain desirable executive officers and senior managers. Our inability to hire sufficient personnel on a timely basis or the loss of significant numbers of executive officers and senior managers could adversely affect our business.

If we fail to establish and maintain important relationships with government entities and agencies, our ability to successfully bid for RFPs may be adversely affected.

To facilitate our ability to prepare bids in response to RFPs, we rely in part on establishing and maintaining relationships with officials of various government entities and agencies. These relationships enable us to provide informal input and advice to the government entities and agencies prior to the development of an RFP. We also engage marketing consultants, including lobbyists, to establish and maintain relationships with elected officials and appointed members of government agencies. The effectiveness of these consultants may be reduced or eliminated if a significant political change occurs. We may be unable to successfully manage our relationships with government entities and agencies and with elected officials and appointees. Any failure to maintain positive relationships with government entities and agencies may adversely affect our ability to bid successfully in response to RFPs.

The Federal government may refuse to grant consents and/or waivers necessary to permit private entities, such as us, to perform certain elements of government programs.

Under current law, in order to privatize certain functions of government programs, the federal government must grant a consent and/or waiver to the petitioning state or local agency. If the federal government does not grant a necessary consent or waiver, the state or local agency will be unable to outsource that function to a private entity, such as us, which could eliminate a contracting opportunity or reduce the value of a contract.

Our business could be adversely affected by future legislative changes.

The market for our services depends largely on federal and state legislative programs. These programs can be modified or amended at any time by acts of federal and state governments. For example, in 1996, Congress amended the Social Security Act to eliminate social security and supplemental income benefit payments based solely on drug and alcohol disabilities. That amendment resulted in the termination of our substantial contract with the Social Security Administration that related to the referral and treatment monitoring of recipients of these benefits.

Moreover, part of our growth strategy includes aggressively pursuing opportunities created by the Welfare Reform Act and other federal and state initiatives that we believe will be implemented to encourage long-term changes in the nation's welfare system by seeking new contracts to administer and new health and welfare programs to manage. However, there are many opponents of welfare reform and, as a result, future progress in the area of welfare reform is uncertain. The repeal of the Welfare Reform Act, in whole or in part, could adversely affect our business. Further, if additional reforms are not proposed or enacted, or if previously enacted reforms are challenged, repealed or invalidated, our growth strategy could be adversely impacted.

If we do not successfully integrate the businesses that we acquire, our results of operations could be adversely affected.

We may be unable to profitably manage businesses that we have acquired or that we may acquire or we may fail to integrate them successfully without incurring substantial expenses, delays or other problems that could negatively impact our results of operations. Since the beginning of our 2000 fiscal year, we have combined with five firms and purchased substantially all of the assets of two firms and a division of another firm. We are still in the process of integrating the operations of several of these firms.

Business combinations involve additional risks, including:

- diversion of management’s attention;
- loss of key personnel;
- assumption of unanticipated legal or financial liabilities;

- becoming significantly leveraged as a result of incurring debt to finance an acquisition;
- unanticipated operating, accounting or management difficulties in connection with the acquired entities;
- impairment of acquired intangible assets, including goodwill; and
- dilution to our earnings per share.

Also, client dissatisfaction or performance problems with an acquired firm could materially and adversely affect our reputation as a whole. Further, the acquired businesses may not achieve the revenues and earnings we anticipated.

Federal government officials may discourage state and local governmental entities from engaging us, which may result in a decline in revenues.

To avoid higher than anticipated demands for federal funds, federal government officials occasionally discourage state and local authorities from engaging private consultants to advise them on maximizing federal funding. If state and local officials are dissuaded from engaging us for revenue maximization services, we will not receive contracts for, or revenues from, those services.

We face competition from a variety of organizations, many of which have substantially greater financial resources than we do; we may be unable to compete successfully with these organizations.

Our Health Management Services Group and Human Services Group competes for program management contracts with the following:

- government services divisions of large organizations such as Lockheed Martin Corporation, Electronic Data Systems, Inc. and Accenture;
- specialized service providers such as Benova, Inc., Policy Studies Incorporated, Affiliated Computer Services, Inc. and America Works, Inc.; and
- local non-profit organizations such as the United Way, Goodwill Industries and Catholic Charities.

Our Consulting Group competes with the consulting divisions of the “Big 5” accounting firms and small, specialized consulting firms.

Our Systems Group competes with a large number of competitors, including Unisys, KPMG, Accenture, Litton PRC (a Northrop Grumman Company), Peregrine Systems, Inc. and Electronic Data Systems, Inc.

Many of these companies are national and international in scope and have greater resources than we have. Substantial resources could enable certain competitors to initiate severe price cuts or take other measures in an effort to gain market share. In addition, we may be unable to compete for the limited number of large contracts because we may not be able to meet an RFP’s requirement to obtain and post a large cash performance bond. Also, in some geographic areas, we face competition from smaller consulting firms with established reputations and political relationships. We may be unable to compete successfully against our existing or any new competitors.

As a consequence of the terrorist attacks on September 11, 2001, if the unanticipated expenses of heightened security measures implemented by Federal, state and local governmental agencies exceed budgeted amounts, then the amounts budgeted for our services by governmental agencies may be reduced or reallocated, in some cases significantly, which would adversely affect our business and results of operations.

As a consequence of the terrorist attacks on September 11, 2001, we believe that the unanticipated expenses of heightened security measures implemented by federal, state and local governmental agencies may exceed budgeted amounts. In the near term, we believe that these government agencies will have sufficient resources to continue to fund increased security measures without significant budget adjustments. Therefore, we currently expect that the market for our services will remain relatively unchanged. However, our expectation assumes that the terrorist attacks on September 11 were a one-time event and that there will be no additional events of this magnitude. If additional events should occur that result in significantly greater expenditures for tighter security measures, or such additional security measures are required to be sustained for extended periods of time, then the amounts budgeted for our services by governmental agencies may be reduced or reallocated, in some cases significantly, which would adversely affect our business and results of operations.

We may not receive sufficient payments in a quarter to cover all of our costs in that quarter.

A number of factors cause our payments and operating results to vary from quarter to quarter, including:

- the progression of contracts;
- the levels of revenues earned on fixed-price and performance-based contracts (including any adjustments in expectations for revenue recognition on fixed-price contracts);
- the commencement, completion or termination of contracts during any particular quarter;
- the schedules of government agencies for awarding contracts;
- the term of awarded contracts; and
- potential acquisitions.

Changes in the volume of activity and the number of contracts commenced, completed or terminated during any quarter may cause significant variations in our cash flow from operations because a large amount of our expenses are fixed. Moreover, we incur significant operating expenses during the start-up and early stages of large contracts and typically do not receive corresponding payments in that same quarter.

Our stock price is volatile.

We first publicly issued common stock on June 13, 1997 at $16.00 per share in our initial public offering. Between June 13, 1997 and February 8, 2002, the sales price of our common stock has ranged from a high of $49.25 per share to a low of $17.00 per share. The market price of our common stock could continue to fluctuate substantially due to a variety of factors, including:

- quarterly fluctuations in results of operations;
- the failure to be awarded a significant contract on which we have bid;
- the termination by a government client of a material contract;
- the announcement of new services by competitors;
- political and legislative developments adverse to the privatization of government services;
- changes in or failure to meet earnings estimates by securities analysts;
- sales of common stock by existing shareholders or the perception that these sales may occur;

- adverse judgments or settlements obligating us to pay damages;
- negative publicity; and
- loss of key personnel.

In addition, overall volatility has often significantly affected the market prices of securities for reasons unrelated to a company's operating performance. In the past, securities class action litigation has often been commenced against companies that have experienced periods of volatility in the price of their stock. Securities litigation initiated against us could cause us to incur substantial costs and could lead to the diversion of management's attention and resources.

Our articles of incorporation and bylaws include provisions that may have anti-takeover effects.

Our Articles of Incorporation and bylaws include provisions that may delay, deter or prevent a takeover attempt that shareholders might consider desirable. For example, our Articles of Incorporation provide that our directors are to be divided into three classes and elected to serve staggered three-year terms. This structure could impede or discourage an attempt to obtain control of us by preventing stockholders from replacing the entire board in a single proxy contest, making it more difficult for a third party to take control of us without the consent of our board of directors. Our Articles of Incorporation further provide that our shareholders may not take any action in writing without a meeting. This prohibition could impede or discourage an attempt to obtain control of us by requiring that any corporate actions initiated by shareholders be adopted only at properly called shareholder meetings.

Our president and chief executive officer owns sufficient shares of our common stock to significantly affect the results of any shareholder vote.

Our President and Chief Executive Officer, Dr. David Mastran, beneficially owns approximately 11.4% of our common stock. As a result, Dr. Mastran has the ability to significantly influence the outcome of matters requiring a shareholder vote, including the election of the board of directors, amendments to our organizational documents, or approval of any merger, sale of assets or other major corporate transaction. The interests of Dr. Mastran may differ from the interests of our other shareholders, and Dr. Mastran may be able to delay or prevent us from entering into transactions that would result in a change in control, including transactions in which our shareholders might otherwise receive a premium over the then- current market price for their shares.