# 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 June 30, 2006**

**Commission File Number: 1-12997**

# MAXIMUS, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Virginia**<br>(State or other jurisdiction of incorporation or organization) | **54-1000588**<br>(I.R.S. Employer Identification No.) |
| **11419 Sunset Hills Road**<br>**Reston, Virginia**<br>(Address of principal executive offices) | **20190**<br>(Zip Code) |

**(703) 251-8500**
(Registrant's telephone number, including area code)

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 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 ☒

As of August 1, 2006, there were 21,533,656 shares of the registrant's common stock (no par value) outstanding.

**MAXIMUS, Inc.**

**Quarterly Report on Form 10-Q
For the Quarter Ended June 30, 2006**

**INDEX**

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

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## PART I. FINANCIAL INFORMATION

### Item 1. Condensed Consolidated Financial Statements.

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

| | September 30, 2005 (Note 1) | June 30, 2006 (unaudited) |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 59,073 | $ 32,732 |
| Marketable securities | 119,290 | 137,715 |
| Restricted cash | 2,193 | 1,272 |
| Accounts receivable — billed, net of reserves of $6,013 and $8,486 | 124,477 | 139,198 |
| Accounts receivable — unbilled | 43,774 | 45,343 |
| Income taxes receivable | — | 9,120 |
| Deferred income taxes | — | 7,991 |
| Prepaid expenses and other current assets | 7,270 | 8,582 |
| Total current assets | 356,077 | 381,953 |
| | | |
| Property and equipment, at cost | 64,730 | 67,810 |
| Less accumulated depreciation and amortization | (33,574) | (35,240) |
| Property and equipment, net | 31,156 | 32,570 |
| Capitalized software | 40,770 | 47,242 |
| Less accumulated amortization | (16,817) | (21,130) |
| Capitalized software, net | 23,953 | 26,112 |
| Deferred contract costs, net | 22,162 | 18,465 |
| Goodwill | 86,832 | 86,832 |
| Intangible assets, net | 7,756 | 6,230 |
| Other assets, net | 6,626 | 6,743 |
| Total assets | $ 534,562 | $ 558,905 |
| **LIABILITIES AND SHAREHOLDERS’ EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 38,151 | $ 65,433 |
| Accrued compensation and benefits | 26,828 | 25,046 |
| Deferred revenue | 32,898 | 45,353 |
| Income taxes payable | 4,695 | — |
| Deferred income taxes | 277 | — |
| Current portion of capital lease obligations | 1,502 | 1,547 |
| Other accrued liabilities | 3,386 | 1,390 |
| Total current liabilities | 107,737 | 138,769 |
| Capital lease obligations, less current portion | 3,606 | 2,440 |
| Deferred income taxes | 17,225 | 15,945 |
| Other liabilities | 40 | — |
| Total liabilities | 128,608 | 157,154 |
| | | |
| Shareholders’ equity: | | |

| | | |
|---|---|---|
| Common stock, no par value; 60,000,000 shares authorized; 21,451,302 and 21,520,783 shares issued and outstanding at September 30, 2005, and June 30, 2006, at stated amount, respectively | 150,883 | 153,639 |
| Accumulated other comprehensive loss | (522) | (1,514) |
| Retained earnings | 255,593 | 249,626 |
| Total shareholders' equity | 405,954 | 401,751 |
| Total liabilities and shareholders' equity | $ 534,562 | $ 558,905 |

*See notes to unaudited condensed consolidated financial statements.*



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

| | Three Months Ended June 30, 2005 | Three Months Ended June 30, 2006 | Nine Months Ended June 30, 2005 | Nine Months Ended June 30, 2006 |
|---|---|---|---|---|
| Revenue | $ 173,658 | $ 186,596 | $ 480,204 | $ 529,095 |
| Cost of revenue | 126,427 | 158,945 | 344,853 | 411,366 |
| Write-off of deferred contract costs (Note 3) | — | 17,109 | — | 17,109 |
| Gross profit | 47,231 | 10,542 | 135,351 | 100,620 |
| Selling, general and administrative expenses | 30,681 | 32,275 | 88,504 | 94,725 |
| Legal expense. | 1,060 | 9,078 | 1,500 | 10,303 |
| Income (loss) from operations | 15,490 | (30,811) | 45,347 | (4,408) |
| Interest and other income, net | 1,229 | 2,196 | 2,032 | 5,174 |
| Income (loss) before income taxes | 16,719 | (28,615) | 47,379 | 766 |
| Provision for income taxes (benefit) | 6,604 | (11,306) | 18,715 | 299 |
| Net income (loss) | $ 10,115 | $ (17,309) | $ 28,664 | $ 467 |
| | | | | |
| Earnings (loss) per share (Note 6): | | | | |
| Basic | $ 0.47 | $ (0.81) | $ 1.35 | $ 0.02 |
| Diluted | $ 0.47 | $ (0.81) | $ 1.33 | $ 0.02 |
| | | | | |
| Dividends per share | $ 0.10 | $ 0.10 | $ 0.20 | $ 0.30 |
| | | | | |
| Weighted average shares outstanding: | | | | |
| Basic | 21,298 | 21,472 | 21,303 | 21,442 |
| Diluted | 21,599 | 21,472 | 21,595 | 21,851 |

*See notes to unaudited condensed consolidated financial statements.*



**MAXIMUS, Inc.**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(In thousands)**
**(Unaudited)**

| | Nine Months Ended June 30, 2005 | Nine Months Ended June 30, 2006 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 28,664 | $ 467 |
| | | |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 5,392 | 6,786 |
| Amortization | 5,334 | 5,839 |
| Write-off of deferred contract costs | — | 17,109 |
| Deferred income taxes | 5,201 | (9,547) |
| | | |
| Tax benefit due to option exercises and restricted stock units vesting | 1,570 | — |
| Non-cash stock-based compensation | 927 | 4,570 |
| | | |
| Change in assets and liabilities, net of effects from acquisitions: | | |
| Accounts receivable - billed | (16,332) | (14,721) |
| Accounts receivable - unbilled | (2,399) | (1,569) |
| Prepaid expenses and other current assets | 1,128 | (1,312) |
| Deferred contract costs | (4,997) | (13,411) |
| Other assets | (329) | (961) |

| | | |
|---|---|---|
| Accounts payable | 14,166 | 27,281 |
| Accrued compensation and benefits | 2,166 | (1,782) |
| Deferred revenue | 7,338 | 12,455 |
| Income taxes | 1,722 | (13,816) |
| Other liabilities | (443) | (1,114) |
| Net cash provided by operating activities | 49,108 | 16,274 |
| **Cash flows from investing activities:** | | |
| Acquisition of businesses, net of cash acquired | (651) | — |
| Purchases of property and equipment | (6,637) | (8,200) |
| Capitalized software costs | (8,548) | (6,472) |
| Increase in marketable securities | (50,983) | (18,575) |
| Other | 442 | — |
| Net cash used in investing activities | (66,377) | (33,247) |
| **Cash flows from financing activities:** | | |
| Employee stock transactions | 7,872 | 7,268 |
| Repurchases of common stock | (11,990) | (10,139) |
| Payments on capital lease obligations | (1,230) | (1,121) |
| Tax benefit due to option exercises and restricted stock units vesting | — | 1,058 |
| Cash dividends paid | (4,259) | (6,434) |
| Net cash used in financing activities | (9,607) | (9,368) |
| Net decrease in cash and cash equivalents | (26,876) | (26,341) |
| Cash and cash equivalents, beginning of period | 91,854 | 59,073 |
| Cash and cash equivalents, end of period | $ 64,978 | $ 32,732 |

*See notes to unaudited condensed consolidated financial statements.*



**MAXIMUS, Inc.**
**Notes to Unaudited Condensed Consolidated Financial Statements**
**For the Three Months and Nine Months Ended June 30, 2006, and 2005**

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

**1. Organization and Basis of Presentation**

*General*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States 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 normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the three months and nine months ended June 30, 2006, are not necessarily indicative of the results that may be expected for the full fiscal year. The balance sheet at September 30, 2005, has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In addition to the Company's wholly owned subsidiaries, the financial statements as of and for the three months and nine months ended June 30, 2005, and 2006, include a majority (55%) owned international subsidiary in Israel.

These financial statements should be read in conjunction with the audited financial statements at September 30, 2005, and 2004, and for each of the three years in the period ended September 30, 2005, included in the Company's Annual Report on Form 10-K for the year ended September 30, 2005, (File No. 1-12997) filed with the Securities and Exchange Commission on December 12, 2005.

*Legal Expense*

Legal expense consists of costs, net of reimbursed insurance claims, related to significant legal settlements and non-routine legal matters, including future legal costs estimated to be incurred in connection with those matters. Legal expenses incurred in the ordinary course of business are included in selling, general and administrative expense.

*Stock-Based Compensation*

The Company's Board of Directors established stock option plans during 1997 pursuant to which the Company may grant non-qualified options to officers, employees, and directors of the Company to purchase the Company's common stock. At June 30, 2006, the Board of Directors had reserved 8.1 million shares of common stock for issuance under the Company's stock option plans. At June 30, 2006, approximately 1.9 million shares remained available for grants under the Company's stock option plans.

Stock options are granted at exercise prices equal to the fair market value of the Company's common stock at the date of grant. Stock options generally vest ratably over a period of four years and beginning in fiscal 2005, expire six years after date of grant. Options issued prior to fiscal 2005 expire ten years after date of grant.



The Company also issues Restricted Stock Units (RSUs) to certain executive officers and employees under its 1997 Equity Incentive Plan ("Plan"). Generally, these RSUs vest ratably over six years with full vesting upon the sixth anniversary of the date of grant, provided, however, that the vesting will accelerate if the Company meets certain earnings targets determined by the Board of Directors. The fair value of the RSUs, based on the Company's stock price at the grant date, is expensed over the vesting period. For the three and nine months ended June 30, 2006, compensation expense recognized related to RSUs was approximately $0.8 million and $1.3 million respectively, compared to $0.4 million and $0.9 million over the same time periods in fiscal 2005.

Prior to October 1, 2005, the Company accounted for its stock-based compensation plans using the intrinsic value method in accordance with the provisions of Accounting Principle Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*. Effective October 1, 2005, the Company adopted the provisions of SFAS No. 123(R),*Share-Based Payment*, using the modified-prospective-transition method.

Under the modified-prospective-transition method, compensation cost recognized in the three months and nine months ended June 30, 2006, included (i) compensation cost for all stock-based payments granted prior to but not yet vested as of October 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (ii) compensation cost for all share-based payments granted subsequent to October 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

As a result of adopting SFAS No. 123(R) on October 1, 2005, the Company's income before income taxes for the three months and nine months ended June 30, 2006, was approximately $1.1 million and $3.3 million, respectively, lower than if the Company had continued to account for share-based compensation under APB Opinion No. 25. Net income for the three and nine months ended June 30, 2006, was approximately $0.6 million and $2.0 million, respectively, lower than if the Company had continued to account for share-based compensation under APB Opinion No. 25. Basic and diluted earnings per share for the three months ended June 30, 2006 are $0.03 lower than if the Company had continued to account for shared-based compensation under APB Opinion No. 25. Basic and diluted earnings per share for the nine months ended June 30, 2006 are $0.09 lower than if the Company had continued to account for shared-based compensation under APB Opinion No. 25.

Stock-based compensation cost is recognized in selling, general and administrative expense and, under the fair value provisions of SFAS No. 123(R), was $1.9 million and $4.6 million for the three months and nine months ended June 30, 2006. The total income tax benefit recognized in the income statement for share-based compensation arrangements was $0.7 million and $1.8 million for the three months and nine months ended June 30, 2006.



The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value provisions of SFAS No. 123 to stock-based compensation for the periods prior to adoption of SFAS No. 123(R).

| | Ended June 30, 2005 | |
|---|---|---|
| **(dollars in thousands, except per share data)** | **Three Months** | **Nine Months** |
| Net income, as reported | $ 10,115 | $ 28,664 |
| Add: Stock-based compensation expense included in reported net income, net of taxes | 225 | 560 |
| Deduct: Stock-based compensation expense determined under fair value based method for all awards, net of taxes | (1,084) | (3,257) |
| Net income, as adjusted | $ 9,256 | $ 25,967 |
| | | |
| Earnings per share: | | |
| Basic — as reported | $ 0.47 | $ 1.35 |
| Basic — as adjusted | $ 0.43 | $ 1.22 |
| | | |
| Diluted — as reported | $ 0.47 | $ 1.33 |
| Diluted — as adjusted | $ 0.43 | $ 1.20 |

The Company utilizes the Black-Scholes option pricing method to establish the fair value of all option grants. During the three months and nine months ended June 30, 2006, we granted 321,868 and 542,101 stock options, respectively, with a weighted average exercise price of $31.27 and $33.12, respectively, and a weighted average fair value of $9.84 and $10.88, respectively. The following assumptions were used for options granted this quarter:

| | |
|---|---|
| Dividend yield | 1.53% |
| Risk-free interest rate | 4.6% |
| Expected volatility | 36.78% |
| Expected life of option term (in years) | 4.07 |

The dividend yield is based on historical experiences and expected future changes. The risk-free interest rate is derived from the U.S. Treasury yields in effect at the time of grant. Expected volatilities are based on the historical volatility of our common stock. The expected life of the option is derived from historical data pertaining to option exercises and employee terminations.

A summary of the Company's stock option activity for the nine months ended June 30, 2006, is as follows:

| | Options | Weighted-Average Exercise Price |
|---|---|---|

| | | | |
|---|---|---|---|
| Outstanding at September 30, 2005 | 2,297,361 | $ | 28.65 |
| Granted | 557,101 | | 33.09 |
| Exercised | (292,020) | | 35.41 |
| Forfeited or expired | (452,124) | | 30.80 |
| Outstanding at June 30, 2006 | 2,110,318 | | 29.49 |
| Exercisable at June 30, 2006 | 1,267,323 | $ | 27.29 |



The intrinsic value of exercisable stock options at June 30, 2006, was approximately $2.3 million with a weighted average remaining life of 3.8 years. The total intrinsic value of stock options exercised during the three and nine months ended June 30, 2006, was $2.0 million and $3.3 million, respectively. The weighted average grant date fair value of stock options granted during the three and nine months ended June 30, 2006, was $9.84 and $10.88, respectively. The total fair value of stock options which vested during the three and nine months ended June 30, 2006, was $1.0 million and $3.3 million respectively.

A summary of the Company's RSU activity for the nine months ended June 30, 2006, is as follows:

| | Shares | | Fair Market Value |
|---|---|---|---|
| Non-vested shares outstanding at September 30, 2005 | 228,243 | $ | 32.69 |
| Granted | 256,590 | | 34.24 |
| Vested | (41,790) | | 35.98 |
| Forfeited or expired | (69,661) | | 32.93 |
| Non-vested shares outstanding at June 30, 2006 | 373,382 | $ | 33.20 |

As of June 30, 2006, the total remaining unrecognized compensation cost related to unvested stock options and RSUs was $11.4 million and $12.4 million, respectively.

The Company also offers an employee stock purchase plan (ESPP) that allows eligible employees to purchase shares of the Company's common stock each quarter at 95% of the market value on the last day of the quarter. The ESPP is not considered compensatory under the provisions of SFAS No. 123(R) and therefore no portion of the costs related to ESPP purchases are included in the Company's stock-based compensation expense.

Prior to the adoption of SFAS No. 123(R), the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the consolidated statement of cash flows. SFAS No. 123(R) requires the cash flows resulting from the tax benefits generated from tax deductions in excess of the compensation costs recognized for those options (excess tax benefits) to be classified as financing cash flows.



**2. Comprehensive Income**

Comprehensive income includes net income, plus changes in the net unrealized gain (loss) on investments, net of taxes, and changes in cumulative foreign currency translation adjustments. The components of comprehensive income for the three months and nine months ended June 30, 2005, and 2006, are as follows:

| | Three months Ended June 30, | | | | Nine months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| **(dollars in thousands)** | | **2005** | | **2006** | | **2005** | | **2006** |
| Net income | $ | 10,115 | $ | (17,309) | $ | 28,664 | $ | 467 |
| Foreign currency translation adjustments | | (14) | | (476) | | 17 | | (842) |
| Unrealized investment gains (loss) | | 6 | | — | | 57 | | (7) |
| Reclassification adjustment for gains/losses realized in net income, net of tax | | — | | — | | 174 | | (143) |
| Comprehensive income | $ | 10,107 | $ | (17,785) | $ | 28,912 | $ | (525) |

**3. Deferred Contract Costs**

Deferred contract costs consist of contractually recoverable direct set-up costs relating to long-term service contracts in progress. These costs included system development and facility build-out costs totaling $29.0 million and $33.2 million at September 30, 2005, and June 30, 2006, respectively, of which $7.6 million consisted of leased equipment. Deferred contract costs are expensed ratably as services are provided under the contracts. Accumulated amortization of deferred contract costs was $6.8 million and $14.7 million, at September 30, 2005, and June 30, 2006, respectively.

During the quarter ended June 30, 2006, the Company determined that the estimated undiscounted cash flows associated with the Texas Integrated Eligibility project over its remaining term were insufficient to recover the project's deferred contract costs. As a result, the Company recognized a non-cash impairment charge of $17.1 million to write off the project's deferred contract costs. The write-off is included in the results of the Operations segment.

**4. Goodwill and Intangible Assets**

The changes in the carrying amount of goodwill, by each of the Company's business segments, for the nine months ended June 30, 2006, are as follows (dollars in thousands):

| | Consulting | Systems | Operations | Total |
|---|---|---|---|---|
| Balance as of September 30, 2005 | $ 6,825 | $ 45,196 | $ 34,811 | $ 86,832 |
| Goodwill activity during period | — | — | — | — |
| Balance as of June 30, 2006 | $ 6,825 | $ 45,196 | $ 34,811 | $ 86,832 |

The following table sets forth the components of intangible assets (dollars in thousands):

| | As of September 30, 2005 | | | As of June 30, 2006 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated amortization | Intangible assets, net | Cost | Accumulated amortization | Intangible assets, net |
| Non-competition agreements | $ 3,475 | $ 3,141 | $ 334 | $ 3,475 | $ 3,250 | $ 225 |
| Technology-based intangibles | 4,870 | 1,644 | 3,226 | 4,870 | 2,310 | 2,560 |
| Customer contracts and relationships | 7,475 | 3,279 | 4,196 | 7,475 | 4,030 | 3,445 |
| Total | $ 15,820 | $ 8,064 | $ 7,756 | $ 15,820 | $ 9,590 | $ 6,230 |



Intangible assets from acquisitions are amortized over five to ten years. The weighted-average amortization period for intangible assets is approximately seven years. Intangible amortization expense was $0.5 and $1.5 million for the three months and nine months ended June 30, 2006, respectively. The estimated amortization expense for the years ending September 30, 2006, 2007, 2008, 2009, and 2010, is $2.0 million, $2.0 million, $1.6 million, $1.1 million, and $0.4 million, respectively.

**5. Commitments and Contingencies**

*Litigation*

The Company is involved in various legal proceedings, including contract and employment claims, in the ordinary course of its business. Management does not expect the ultimate outcome of these legal proceedings to have either individually or in the aggregate a material adverse effect on the Company's financial condition or its results of operations.

(a) In the third quarter of fiscal 2004, the Company learned that two former employees, who were principals in a small business MAXIMUS acquired in 2000, had signed fraudulent guarantees on behalf of MAXIMUS for computer equipment leases. The equipment was leased from Solarcom LLC which, in turn, assigned certain of the payments under the leases to various financial institutions including Fleet Business Credit LLC ("Fleet"). The Company did not have knowledge of the leases or guarantees, and much of the equipment appears to have been used in businesses unrelated to MAXIMUS. When the leases went into default, Solarcom demanded payment of the remaining amounts due under the leases from MAXIMUS based on the guarantees.

Solarcom filed suit against MAXIMUS to enforce the guarantees on August 17, 2004, in state court in Gwinnett County, Georgia. On August 24, 2004, Fleet sued MAXIMUS and Solarcom in the federal District Court for the Northern District of Georgia. The Solarcom and Fleet actions were consolidated in the federal District Court for the Northern District of Georgia on September 29, 2004. MAXIMUS settled the Solarcom and Fleet claims and recorded a charge of $10.0 million in the quarter ended June 30, 2006 in connection with that settlement.

As previously disclosed, MAXIMUS settled a related lawsuit in Pennsylvania filed by De Lage Landen Financial Services, Inc., which was another assignee of the lease payments. In connection with that settlement, MAXIMUS recorded a charge of $7.0 million for the fiscal year ended September 30, 2005. That amount included the settlement amount paid to De Lage Landen and the associated legal expenses for fiscal year 2005, as well as a liability for estimated probable future legal defense costs of the Georgia lawsuit. In April 2006, the Company received an insurance settlement in the amount of $0.8 million relating to this matter.

The Company has also reported the matter to law enforcement authorities, and has filed claims against the former employees. Those claims have been referred to arbitration for resolution.

(b) In October 2004, MAXIMUS received a subpoena from the Criminal Division of the U.S. Department of Justice acting through the U.S. Attorney's Office for the District of Columbia. The subpoena requested records pertaining to the Company's work for the District of Columbia, primarily relating to the preparation and submission of federal Medicaid reimbursement claims on behalf of the District. The U.S. Attorney's Office is investigating issues pertaining to MAXIMUS' compliance with the federal laws governing Medicaid claims. We are fully cooperating with the U.S. Attorney's Office in producing documents in response to the subpoena and making employees available for interviews, and we have conducted an internal review of this matter through independent outside legal counsel. Based on the anticipated legal costs of the internal review, we recorded a charge of $0.5 million in connection with this matter in the quarter ended December 31, 2005. We are unable to quantify the probability or magnitude of any other expenditure we may incur in connection with this matter at this time.



(c) In June 2005, MAXIMUS received a subpoena pursuant to the Illinois Whistleblower Reward and Protection Act from the Office of the Attorney General of Illinois in connection with a purported whistleblower investigation of potential false claims. The subpoena requested records pertaining to the Company's work for agencies of the Executive Branch of Illinois State Government. Discussions with the Attorney General's office have indicated that MAXIMUS was one of nine contractors that received such subpoenas and that the investigation is primarily focused at this time on the procurement and contracting activities of the Illinois Department of Central Management Services. Although there can be no assurance of a favorable outcome and we are unable to quantify the probability or magnitude of any expenditures we may incur in connection with this matter, the Company does not believe that this matter will have a material adverse effect on its financial condition or results of operations, and the Company has not accrued for any loss related to this matter.

*Credit Facilities and Performance Bonds*

In June 2003, in connection with a long-term contract, the Company issued a standby letter of credit in an initial amount of up to $20.0 million, which amount was reduced to $10.0 million on April 1, 2005. The letter of credit, which expires on March 31, 2009, may be called by the customer in the event the Company defaults under the terms of the contract. In March 2006, in connection with another long-term contract, the Company issued a standby letter of credit in the amount of $4.0 million. The letter of credit, which expires on September 30, 2008, may be called by the customer in the event the Company defaults under the terms of the contract. The letters of credit contain financial covenants that establish minimum levels of tangible net worth and earnings before interest, tax, depreciation and amortization (EBITDA) and require the maintenance of certain cash balances. As of June 30, 2006, the Company was not in compliance with the EBITDA financial covenant in either letter of credit. On July 31, 2006, the Company and its lender signed an agreement to waive this financial covenant for the fiscal quarter ended on June 30, 2006. The Company was in compliance with all other letters of credit obligations and financial covenants as of June 30, 2006.

At June 30, 2006, the Company had performance bond commitments totaling approximately $109.0 million.

*Lease Obligations*

On July 15, 2003, the Company entered into a capital lease financing arrangement with a financial institution, whereby the Company acquired assets pursuant to an equipment lease agreement. Rental payments for assets leased are payable over a 60-month period at an interest rate of 4.05% commencing in January 2004. On March 29, 2004, the Company entered into a supplemental capital lease financing arrangement with the same financial institution whereby the Company acquired additional assets pursuant to an equipment lease agreement. Rental payments for assets leased under the supplemental arrangement are payable over a 57-month period at an interest rate of 3.61% commencing in April 2004. Capital lease obligations of $5.1 million and $4.0 million were outstanding related to these lease arrangements for new equipment at September 30, 2005, and June 30, 2006, respectively.



**6. Earnings (Loss) Per Share**

The following table sets forth the components of basic and diluted earnings (loss) per share (dollars in thousands):

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2005 | 2006 | 2005 | 2006 |
| Numerator: | | | | |
| Net income (loss) | $ 10,115 | $ (17,309) | $ 28,664 | $ 467 |
| Denominator: | | | | |
| Basic weighted average shares outstanding | 21,298 | 21,472 | 21,303 | 21,442 |
| Effect of dilutive securities: | | | | |
| Employee stock options and unvested restricted stock units | 301 | — | 292 | 409 |
| Denominator for diluted earnings (loss) per share | 21,599 | 21,472 | 21,595 | 21,851 |

In computing diluted loss per share for the three months ended June 30, 2006, employee stock options and unvested restricted stock units were excluded from the computation of diluted loss per share as a result of their antidilutive effect.

**7. Stock Repurchase Program**

Under resolutions adopted in May 2000, July 2002, and March 2003, the Board of Directors has authorized the repurchase, at management's discretion, of up to an aggregate of $90.0 million of the Company's common stock. In addition, in June 2002, the Board of Directors authorized the use of option exercise proceeds for the repurchase of the Company's common stock. During the three months and nine months ended June 30, 2006, the Company repurchased 25,000 shares and 282,100 shares, respectively. At June 30, 2006, $26.3 million remained authorized for future stock repurchases under the program.

**8. Segment Information**

The following table provides certain financial information for each of the Company's business segments. The segment results for the 2005 periods have been adjusted to reflect the organizational change that occurred on October 1, 2005, as reported in a Current Report on Form 8-K filed with the Securities and Exchange Commission on January 19, 2006:



| **(dollars in thousands)** | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2005 | 2006 | 2005 | 2006 |
| Revenue: | | | | |
| Consulting | $ 27,272 | $ 26,714 | $ 74,919 | $ 76,717 |
| Systems | 35,105 | 28,686 | 100,557 | 97,205 |
| Operations | 111,281 | 131,196 | 304,728 | 355,173 |
| Total | $ 173,658 | $ 186,596 | $ 480,204 | $ 529,095 |
| Income (loss) from Operations: | | | | |
| Consulting | $ 4,473 | $ 3,818 | $ 8,640 | $ 9,330 |
| Systems | 2,959 | (3,010) | 9,846 | 1,155 |
| Operations | 8,396 | (23,121) | 26,176 | (6,509) |
| Consolidating adjustments | 722 | 580 | 2,185 | 1,919 |

| | | | | |
|---|---|---|---|---|
| Legal expense | (1,060) | (9,078) | (1,500) | (10,303) |
| Total | $ 15,490 | $ (30,811) | $ 45,347 | $ (4,408) |

**9. Recent Accounting Pronouncements**

On July 13, 2006, the Financial Accounting Standards Board issued Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes*, which is effective in fiscal years beginning after December 15, 2006 which is the Company's fiscal year 2008. The purpose of FIN 48 is to clarify and set forth consistent rules for accounting for uncertain tax positions in accordance with FAS 109, *Accounting for Income Taxes*. The cumulative effect of applying the provisions of this interpretation are required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. We are in the process of reviewing and evaluating FIN 48, and therefore the ultimate impact of its adoption is not yet known.

**10. Subsequent Event**

Effective July 7, 2006, the Company's Board of Directors declared a quarterly cash dividend of $0.10 for each share of the Company's common stock outstanding. The dividend is payable on August 31, 2006, to shareholders of record on August 15, 2006. Based on the current number of shares outstanding, the payment will be approximately $2.2 million.

**11. Texas Integrated Eligibility Project**

On June 21, 2006, MAXIMUS amended its subcontract agreement with Accenture related to its work on the Texas Integrated Eligibility project, as reported in a Current Report on Form 8-K filed with the Securities and Exchange Commission on June 27, 2006. As a result of operations and the reassignment of responsibilities under the amended subcontract, the Company recorded a $34.3 million loss in its third fiscal quarter on the Texas Integrated Eligibility project. The loss includes a $17.2 million operating loss and a $17.1 million write-off of deferred contract costs. The Company expects to incur additional losses in its fourth fiscal quarter related to this project. The future financial impact of this project has been estimated, but changes to assumptions could impact the expected future performance in fiscal 2007 and beyond. (See Exhibit 99.1 — Special Considerations and Risk Factors).



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

*The following discussion and analysis of financial condition and results of operations is provided to enhance the understanding of, and should be read in conjunction with, our Consolidated Financial Statements and related Notes included both herein and in our Annual Report on Form 10-K for the year ended September 30, 2005, filed with the Securities and Exchange Commission on December 12, 2005.*

**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 revenue, results of operations, profitability, current and future contracts, market opportunities, market demand or acceptance of our products and services. Any statements contained in this Quarterly Report on Form 10-Q that are not statements of historical fact may be forward-looking statements. The words "could," "estimate," "future," "intend," "may," "opportunity," "potential," "project," "will," "believes," "anticipates," "plans," "expect" and similar expressions are intended to identify forward-looking statements. These statements may involve risks and uncertainties that could cause our actual results to differ materially from those indicated by such forward-looking statements. These risks are detailed in Exhibit 99.1 to this Quarterly Report on Form 10-Q and incorporated herein by reference.

**Business Overview**

We are a leading provider of consulting, systems solutions, and operations program management primarily to government. 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 while improving the quality of services provided to program beneficiaries. We operate primarily in the United States, and we have had contracts with government agencies in all 50 states, Canada, Australia, Israel, and the United Kingdom. We have been profitable every year since we were founded in 1975. For the fiscal year ended September 30, 2005, we had revenue of $647.5 million and net income of $36.1 million. For the nine months ended June 30, 2006, we had revenue of $529.1 million and net income of $0.5 million.



**Results of Operations**

*Consolidated*

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

| | Three months ended June 30, | | Nine months ended June 30, | |
|---|---|---|---|---|
| **(dollars in thousands, except per share data)** | **2005** | **2006** | **2005** | **2006** |
| Revenue | $ 173,658 | $ 186,596 | $ 480,204 | $ 529,095 |
| Write-off of deferred contract costs | — | 17,109 | — | 17,109 |
| Gross profit | $ 47,231 | $ 10,542 | $ 135,351 | $ 100,620 |
| Legal expense | 1,060 | 9,078 | 1,500 | 10,303 |
| Income (loss) from Operations | $ 15,490 | $ (30,811) | $ 45,347 | $ (4,408) |
| | | | | |
| Operating margin (loss) percentage | 8.9% | (16.5)% | 9.4% | (0.8)% |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Selling, general and administrative expense | $ | 30,681 | $ | 32,275 | $ | 88,504 | $ | 94,725 |
| Selling, general and administrative expense as a percentage of revenue | | 17.7% | | 17.3% | | 18.4% | | 17.9% |
| | | | | | | | | |
| Net income (loss) | $ | 10,115 | $ | (17,309) | $ | 28,664 | $ | 467 |
| | | | | | | | | |
| **Earnings (loss) per share:** | | | | | | | | |
| Basic | $ | 0.47 | $ | (0.81) | $ | 1.35 | $ | 0.02 |
| Diluted | $ | 0.47 | $ | (0.81) | $ | 1.33 | $ | 0.02 |

Consolidated revenue increased 7.5% for the three months ended June 30, 2006, compared to the same period in fiscal 2005. The increase in revenue was driven by $12.1 million of hardware delivered on a voter contract in the Operations Segment.

Loss from operations for the three months ended June 30, 2006 was $30.8 million, compared to income from operations of $15.5 million for the same period in fiscal 2005. The decrease in income from operations of $46.3 million was primarily attributable to (1) the $34.3 million loss on the Texas Integrated Eligibility project, which included a $17.1 million write-off of deferred contract costs, (2) legal settlement expenses of $9.1 million (net of insurance reimbursements) recognized in the quarter resulting from a lawsuit filed against the Company in Georgia pertaining to fraudulent guarantees of computer equipment leases signed by two former employees, and (3) in the System Segment software license slippage as well as weak performance in the ERP Division within the segment.

Selling, general and administrative expense (SG&A) consists of costs related to general management, marketing and administration. These costs include salaries, benefits, bid and proposal efforts, travel, recruiting, continuing education, employee training, non-chargeable labor costs, facilities costs, printing, reproduction, communications, equipment depreciation, intangible amortization, and legal expenses incurred in the ordinary course of business. SG&A increased for the three months ended June 30, 2006, compared to the same period in fiscal 2005 principally from the impact of expensing stock options as a result of implementing FAS 123(R) which the Company implemented on a prospective basis beginning October 1, 2005. However, our SG&A as a percentage of revenue decreased to 17.3% for the three months ended June 30, 2006, compared to 17.7% for the same period in fiscal 2005.



Also included in SG&A were approximately $1.9 million and $0.4 million of non-cash stock-based compensation expense for each of the three months ended June 30, 2006, and 2005, respectively. Prior to fiscal 2006, this expense related to restricted stock units issued by the Company. Beginning in fiscal 2006, this expense relates to stock options granted and restricted stock units issued. If the Company had expensed stock options in fiscal 2005, the non-cash stock-based compensation expense for the three months ended June 30, 2005, would have been $1.4 million. In future periods, the quarterly expense related to these stock options and restricted stock units is estimated to be approximately $1.3 million, which amount may increase if certain earnings targets are achieved and restricted stock unit vesting is accelerated.

Our provision for income taxes (benefit) for each of the three months ended June 30, 2006 and 2005 was 39.5% of income (loss) before income taxes. Our provision for income taxes for the nine months ended June 30, 2006 and 2005 was 39.0% and 39.5%, respectively.

Net loss for the three months ended June 30, 2006, was $17.3 million, or $0.81 per diluted share, compared with net income of $10.1 million, or $0.47 per diluted share, for the same period in fiscal 2005. The decrease in net income of $27.4 million is primarily attributable to the after-tax impact of the loss from operations as discussed in more detail above.

*Consulting Segment*

| | Three months ended June 30, | | | | Nine months ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| **(dollars in thousands)** | **2005** | | **2006** | | **2005** | | **2006** | |
| Revenue | $ | 27,272 | $ | 26,714 | $ | 74,919 | $ | 76,717 |
| Gross profit | $ | 12,254 | $ | 11,418 | $ | 32,391 | $ | 31,512 |
| Operating income | $ | 4,473 | $ | 3,818 | $ | 8,640 | $ | 9,330 |
| | | | | | | | | |
| Operating margin percentage | | 16.4% | | 14.3% | | 11.5% | | 12.2% |

The Consulting Segment is comprised of financial services (which includes child welfare, cost services, and revenue maximization), technology support, Unison (airport financial consulting), and educational services (school-based claiming). Revenue from our Consulting Segment decreased 2.0% for the three months ended June 30, 2006, compared to the same period in fiscal 2005 and increased 2.4 % for the nine months ended June 30, 2006, compared to the same period in fiscal 2005. Operating margin decreased to 14.3% for the three months ended June 30, 2006, compared to 16.4% for the same period in fiscal 2005 and increased to 12.2% for the nine months ended June 30, 2006, from 11.5% for the same period in fiscal 2005. The decrease in revenue and operating income for the three months ended June 30, 2006 compared to the same period a year ago is a result of an educational services engagement that had higher activity levels in fiscal 2005. The increase in revenue and operating margin for the nine months ended June 30, 2006 compared to the same period in fiscal 2005 is primarily attributable to improved performance in financial services.



*Systems Segment*

| | Three months ended June 30, | | | | Nine months ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| **(dollars in thousands)** | **2005** | | **2006** | | **2005** | | **2006** | |
| Revenue | $ | 35,105 | $ | 28,686 | $ | 100,557 | $ | 97,205 |
| Gross profit | $ | 12,329 | $ | 6,644 | $ | 37,859 | $ | 30,511 |
| Operating income (loss) | $ | 2,959 | $ | (3,010) | $ | 9,846 | $ | 1,155 |
| | | | | | | | | |
| Operating margin (loss) percentage | | 8.4% | | (10.5)% | | 9.8% | | 1.2% |

The Systems Segment develops and implements both third party and proprietary software in the areas of justice, asset, student information systems, and enterprise resource planning (ERP) solutions and provides system development and integration from the security solutions division. Revenue decreased 18.3% and 3.3%, respectively, for the three and nine months ended June 30, 2006, over the same periods in fiscal 2005. An operating loss of $3.0 million was generated for the three months ended June 30, 2006, compared to operating income of $3.0 million for the same period in fiscal 2005. Operating income was $1.1 million for the nine months ended June 30, 2006, compared to $9.9 million for the same period in fiscal 2005. The declines in revenue and operating income for the three and nine month periods ended June 30, 2006, compared to the same periods in fiscal 2005 were primarily due to software license slippage as well as weak performance in the ERP Division.

*Operations Segment*

| (dollars in thousands) | Three months ended June 30, 2005 | Three months ended June 30, 2006 | Nine months ended June 30, 2005 | Nine months ended June 30, 2006 |
|---|---|---|---|---|
| Revenue | $ 111,281 | $ 131,196 | $ 304,728 | $ 355,173 |
| Write-off of deferred contract costs | — | $ 17,109 | — | $ 17,109 |
| Gross profit (loss) | $ 22,648 | $ (7,250) | $ 65,101 | $ 38,597 |
| Operating income (loss) | $ 8,396 | $ (23,121) | $ 26,176 | $ (6,509) |
| | | | | |
| Operating margin (loss) percentage | 7.5% | (17.6)% | 8.6% | (1.8)% |

The Operations Segment includes our health operations, human services operations, and federal outsourcing and operations work. Revenue increased 17.9% and 16.6%, respectively, for the three and nine months ended June 30, 2006, over the same periods in fiscal 2005. The revenue increase over fiscal 2005 was primarily attributable to (1) the British Columbia Health Operations project, which commenced operations on April 1, 2005, (2) $12.1 million associated with hardware cost on a voter contract recognized in the third quarter of 2006, and (3) new and expanding work primarily in the federal operations. The operating loss was $23.1 million for the three months ended June 30, 2006, compared to operating income of $8.4 million for the same period in fiscal 2005. The decrease in operating income was primarily attributable to the $34.3 million loss on the Texas Integrated Eligibility project. The operating loss was $6.5 million for the nine months ended June 30, 2006, compared to operating income of $26.2 million for the same period in fiscal 2005. The decrease in operating income was primarily attributable to losses on the Texas Integrated Eligibility and British Columbia Health Operations projects.

On June 21, 2006, MAXIMUS amended its subcontract agreement with Accenture related to its work on the Texas Integrated Eligibility project, as reported in a Current Report on Form 8-K filed with the Securities and Exchange Commission on June 27, 2006. As a result of operations and the reassignment of responsibilities under the amended subcontract, the Company recorded a $34.3 million loss in its third fiscal quarter on the Texas Integrated Eligibility project. The loss includes a $17.2 million operating loss and a $17.1 million write-off of deferred contract costs. The Company expects to incur additional losses in its fourth fiscal quarter related to this project. The future financial impact of this project has been estimated, but changes to assumptions could impact the expected future performance in fiscal 2007 and beyond. (See Exhibit 99.1 — Special Considerations and Risk Factors).



**Other Income, Net**

| (dollars in thousands) | Three months ended June 30, 2005 | Three months ended June 30, 2006 | Nine months ended June 30, 2005 | Nine months ended June 30, 2006 |
|---|---|---|---|---|
| Interest and other income, net | $ 1,229 | $ 2,196 | $ 2,032 | $ 5,174 |
| Percentage of revenue | 0.7% | 1.2% | 0.4% | 1.0% |

The overall increase in interest and other income for the three months and nine months ended June 30, 2006, compared to the same period in fiscal 2005 was due primarily to higher interest rates earned on our increased cash and marketable securities, as well as $0.7 million and $0.9 million of foreign transaction gains in the three months and nine months ended June 30, 2006, respectively, and $0.2 million of realized gains on sales of marketable securities. Additionally, interest and other income for the first quarter of fiscal 2005 included the recognition of losses from certain marketable securities.

**Liquidity and Capital Resources**

| | Nine months ended June 30, 2005 | Nine months ended June 30, 2006 |
|---|---|---|
| | (dollars in thousands) | |
| Net cash provided by (used in): | | |
| Operating activities | $ 49,108 | $ 16,274 |
| Investing activities | (66,377) | (33,247) |
| Financing activities | (9,607) | (9,368) |
| Net (decrease) increase in cash and cash equivalents | $ (26,876) | $ (26,341) |

For the nine months ended June 30, 2006, cash provided by our operations was $16.3 million as compared to $49.1 million for the same period in fiscal 2005. Cash provided by operating activities for the nine months ended June 30, 2006, consisted of net income of $0.5 million and non-cash items aggregating $24.8 million, less cash used by working capital of $9.0 million. Non-cash items consisted of $12.6 million of depreciation and amortization, $(9.5) million from deferred income tax benefits, $4.6 million from non-cash stock-based compensation, and a $17.1 million write-off of deferred contract costs related to the Texas Integrated Eligibility project. The net cash used by working capital changes reflect increases in accounts receivable-billed, net, of $14.7 million, accounts receivable-unbilled of $1.6 million, deferred contract costs of $13.4 million and accrued compensation of $1.8 million, offset by increases in accounts payable of $27.3 million, deferred revenue of $12.5 million and an increase in prepaid expense of $1.3 million. Other working capital changes using cash were decreases in income taxes payable of $13.8 million and decreases in other liabilities of $1.1 million.

For the nine months ended June 30, 2006, cash used in investing activities was $33.2 million as compared to $66.4 million for the same period in fiscal 2005. Cash used in investing activities for the nine months ended June 30, 2006 consisted of $18.6 million in purchases of marketable securities, $6.5 million in expenditures for capitalized software costs, and $8.2 million in purchases of property and equipment.

For the nine months ended June 30, 2006, cash used in financing activities was $9.4 million as compared to $9.6 million for the same period in fiscal 2005. Cash used in financing activities for the nine months ended June 30, 2006, consisted of $10.1 million of common stock repurchases, $1.1 million of principal payments on capital leases and $6.4 million of cash dividends paid, offset by $7.3 million of sales of stock to employees through our Employee Stock Purchase Plan and Equity Incentive Plan.

Under resolutions adopted in May 2000, July 2002, and March 2003, the Board of Directors has authorized the repurchase, at management's discretion, of up to an aggregate of $90.0 million of our common stock. In addition, in June 2002, the Board of Directors authorized the use of option exercise proceeds for the repurchase of our common stock. During the three months and nine months ended June 30, 2006, we repurchased 25,000 and 282,100 shares. At March 31, 2006, $26.3 million remained available for future stock repurchases under the program.

Our working capital at June 30, 2006, was $243.2 million. At June 30, 2006, we had cash, cash equivalents, and marketable securities of $170.4 million and no debt, except for lease obligations. Management believes this liquidity and financial position will allow us to continue our stock repurchase program (depending on the price of the Company's common stock), to pursue selective acquisitions, and to consider the continuation of dividends on a quarterly basis. Restricted cash represents amounts collected on behalf of certain customers and its use is restricted to the purposes specified under our contracts with these customers.

In June 2003, in connection with a long-term contract, the Company issued a standby letter of credit in an initial amount of up to $20.0 million, which amount was reduced to $10.0 million on April 1, 2005. The letter of credit, which expires on March 31, 2009, may be called by the customer in the event the Company defaults under the terms of the contract. In March 2006, in connection with another long-term contract, the Company issued a standby letter of credit in the amount of $4.0 million. The letter of credit, which expires on September 30, 2008, may be called by the customer in the event the Company defaults under the terms of the contract. The letters of credit contain financial covenants that establish minimum levels of tangible net worth and earnings before interest, tax, depreciation and amortization (EBITDA) and require the maintenance of certain cash balances. As of June 30, 2006, the Company was not in compliance with the EBITDA financial covenant in either letter of credit. On July 31, 2006, the Company and its lender signed an agreement to waive this financial covenant for the fiscal quarter ended on June 30, 2006. The Company was in compliance with all other letters of credit obligations and financial covenants as of June 30, 2006.

In July 2003, we entered into a capital lease financing arrangement with a financial institution whereby we acquired assets pursuant to an equipment lease agreement. Rental payments for assets leased are payable over a 60-month period at an interest rate of 4.05% commencing in January 2004. In March 2004, we entered into a supplemental capital lease financing arrangement with the same financial institution whereby we acquired additional assets pursuant to an equipment lease agreement. Rental payments for assets leased under the supplemental arrangement are payable over a 57-month period at an interest rate of 3.61% commencing in April 2004. At June 30, 2006, capital lease obligations of $4.0 million were outstanding related to these lease arrangements for new equipment.

At June 30, 2006, we classified accounts receivable of $6.6 million, net of a $1.1 million discount, as long-term receivables and reported them within the other assets category on our consolidated balance sheets. These receivables have extended payment terms and collection is expected to exceed one-year.

Effective July 7, 2006, the Company's Board of Directors declared a quarterly cash dividend of $0.10 for each share of the Company's common stock outstanding. The dividend is payable on August 31, 2006, to shareholders of record on August 15, 2006.

We believe that we will have sufficient resources to meet our currently anticipated capital expenditures and working capital requirements for at least the next twelve months.



**Critical Accounting Policies and Estimates**

Our discussion and analysis of financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities and the reported amounts of revenue and expenses. On an ongoing basis, we evaluate our estimates including those related to revenue recognition and cost estimation on certain contracts, the realizability of goodwill, and amounts related to income taxes, certain accrued liabilities and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results could differ from those estimates.

We believe that we have limited off-balance sheet risk or exposure to liabilities that are not recorded or disclosed in our financial statements. While we have 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 and standby letters of credit, we have not had any defaults resulting in draws on performance bonds or letters of credit. Also, we do not speculate in derivative transactions.

We believe the following critical accounting policies affect the significant judgments and estimates used in the preparation of our consolidated financial statements:

*Revenue Recognition*. In fiscal 2005, approximately 78% of our total revenue was derived from state and local government agencies; 7% from federal government agencies; 8% from foreign customers; and 7% from other sources, such as commercial customers. Revenue is generated from contracts with various pricing arrangements, including: (1) fixed-price; (2) performance-based criteria; (3) costs incurred plus a negotiated fee ("cost-plus"); and (4) time and materials. Also, some contracts contain "not-to-exceed" provisions. For fiscal 2005, revenue from fixed-price contracts was approximately 33% of total revenue; revenue from performance-based contracts was approximately 40% of total revenue; revenue from cost-plus contracts was approximately 15% of total revenue; and revenue from time and materials contracts was approximately 12% of total revenue. A majority of the contracts with state and local government agencies have been fixed-price and performance-based, and our contracts with the federal government generally 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.

We recognize revenue on fixed-priced contracts when earned, as services are provided. For certain fixed-price contracts, primarily systems design, development and implementation, we recognize revenue based on costs incurred using estimates of total expected contract revenue and costs to be incurred in accordance with the provisions of AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* ("SOP 81-1"). The cumulative impact of any revisions in estimated revenue and costs is recognized in the period in which the facts that give rise to the revision become known. For other fixed-price contracts, revenue is recognized on a straight-line basis unless evidence suggests that revenue is earned or obligations are fulfilled in a different pattern. With fixed-price contracts, we are subject to the risk of potential cost overruns. For fixed-price contracts accounted for under SOP 81-1, provisions for estimated losses on incomplete contracts are provided in full in the period in which such losses become known. We recognize revenue on performance-based contracts as such revenue becomes fixed or determinable, which generally occurs when amounts are billable to customers. For certain contracts, this may result in revenue being recognized in irregular increments. Additionally, costs related to contracts may be incurred in periods prior to recognizing revenue. These costs are generally expensed. However, certain direct and incremental set-up costs may be deferred until services are provided and revenue begins to be recognized, when such costs are recoverable from a contractual arrangement. Set-up costs are costs related to activities that enable us to provide contractual services to a client. These factors may result in irregular revenue and profit margins.

Revenue on cost-plus contracts is recognized based on costs incurred plus an estimate of the negotiated fee earned. Revenue on time and materials contracts is recognized based on hours worked and expenses incurred.

Our most significant expense is cost of revenue, which consists primarily of project-related costs such as employee salaries and benefits, subcontractors, computer equipment and travel expenses. Our management uses its judgment and experience to estimate cost of revenue expected on projects. Our management's 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 gross margins related to our fixed-price, performance-based and time and materials contracts. If actual costs are higher than our management's estimates, profitability may be adversely affected. Service cost variability has little impact on cost-plus arrangements because allowable costs are reimbursed by the customer.

We also license software under license agreements. License fee revenue is recognized when a non-cancelable license agreement is in force, the product has been delivered, the license fee is fixed or determinable, and collection is probable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. In addition, when software license contracts contain post-contract customer support as part of a multiple element arrangement, revenue is recognized based upon the vendor-specific objective evidence of the fair value of each element. Maintenance and post-contract customer support revenue are recognized ratably over the term of the related agreements, which in most cases is one year. Revenue from software-related consulting services under time and material contracts and for training is recognized as services are performed. Revenue from other software-related contract services requiring significant modification or customization of software is recognized under the percentage-of-completion method.

*Impairment of Goodwill***.** We adhere to the Financial Accounting Standards Board's Statements of Financial Accounting Standards No. 141,*Business Combinations* ("FAS 141"), and No. 142, *Goodwill and Other Intangible Assets*("FAS 142"). Under these rules, goodwill is not amortized but is subject to annual impairment tests in accordance with FAS 141 and FAS 142. Goodwill is tested on an annual basis, or more frequently as impairment indicators arise. Annual impairment tests involve the use of estimates related to the fair market values of our reporting units with which goodwill is associated. Losses, if any, resulting from annual impairment tests will be reflected in operating income in our income statement.

*Capitalized Software Development Costs*. Capitalized software development costs are capitalized in accordance with FAS No. 86,*Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed.* We capitalize both purchased software that is ready for resale and costs incurred internally for software development projects from the time technological feasibility is established. Capitalized software development costs are reported at the lower of unamortized cost or estimated net realizable value. Upon the general release of the software to customers, capitalized software development costs for the products are amortized based on the straight-line method of amortization over the remaining estimated economic life of the product, which ranges from three to five years. The establishment of technological feasibility and the ongoing assessment for recoverability of capitalized development costs require considerable judgment by management including, but not limited to, technological feasibility, anticipated future gross revenues, estimated economic life, and changes in software and hardware technologies. Any changes to these estimates could impact the amount of amortization expense and the amount recognized as capitalized software development costs in the consolidated balance sheet.

*Allowance for Doubtful Accounts.* We maintain an allowance for doubtful accounts at an amount we estimate to be sufficient to cover the risk of collecting less than full payment on our receivables. On a regular basis we re-evaluate our client receivables, especially receivables that are past due, and reassess our allowance for doubtful accounts based on specific client collection issues. If our clients were to express dissatisfaction with the services we have provided, additional allowances may be required.



*Deferred Contract Costs.* Deferred contract costs consist of recoverable direct and incremental set-up costs relating to long-term service contracts. These costs include system development and facility build-out costs that are expensed ratably as services are provided under the contracts. We review deferred contract costs for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Our review is based on our projection of the undiscounted future operating cash flows of the related customer project. To the extent such projections indicate that future undiscounted cash flows are not sufficient to recover the carrying amount, we recognize a non-cash impairment charge to reduce the carrying amount to equal projected future discounted cash flows.

*Income Taxes.* To record income tax expense, we are required to estimate our income taxes in each of the jurisdictions in which we operate. In addition, income tax expense at interim reporting dates requires us to estimate our expected effective tax rate for the entire year. This process involves estimating our actual current tax liability together with assessing temporary differences that result in deferred tax assets and liabilities and expected future tax rates. Circumstances that could cause our estimates of income tax expense to change include: the impact of information that subsequently becomes available as we prepare our tax returns; revision to tax positions taken as a result of further analysis and consultation; changes in the geographic mix of our business; the actual level of pre-tax income; changes in tax rules, regulations and rates; and changes mandated as a result of audits by taxing authorities.

We may also establish tax reserves when, despite our belief that our tax return positions are fully supportable, we believe that certain positions are subject to challenge and that we may not fully succeed. We adjust these reserves in light of changing facts, such as the progress of a tax audit, new case law, or expiration of a statute of limitations.

## 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 and equity prices with regard to instruments entered into for trading or for other purposes is not significant.

## Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our principal executive officer and principal financial officer concluded that these disclosure controls and procedures were effective and designed to ensure that the information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the requisite time periods.

(b) Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) identified in connection with the evaluation of our internal control that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings.

The Company is involved in various legal proceedings, including contract and employment claims, in the ordinary course of its business. Management does not expect the ultimate outcome of these legal proceedings to have either individually or in the aggregate a material adverse effect on the Company's financial condition or its results of operations.

(a) In the third quarter of fiscal 2004, the Company learned that two former employees, who were principals in a small business MAXIMUS acquired in 2000, had signed fraudulent guarantees on behalf of MAXIMUS for computer equipment leases. The equipment was leased from Solarcom LLC which, in turn, assigned certain of the payments under the leases to various financial institutions including Fleet Business Credit LLC ("Fleet"). The Company did not have knowledge of the leases or guarantees, and much of the equipment appears to have been used in businesses unrelated to MAXIMUS. When the leases went into default, Solarcom demanded payment of the remaining amounts due under the leases from MAXIMUS based on the guarantees.

Solarcom filed suit against MAXIMUS to enforce the guarantees on August 17, 2004, in state court in Gwinnett County, Georgia. On August 24, 2004, Fleet sued MAXIMUS and Solarcom in the federal District Court for the Northern District of Georgia. The Solarcom and Fleet actions were consolidated in the federal District Court for the Northern District of Georgia on September 29, 2004. MAXIMUS settled the Solarcom and Fleet claims and recorded a charge of $10.0 million in the quarter ended June 30, 2006 in connection with that settlement.

As previously disclosed, MAXIMUS settled a related lawsuit in Pennsylvania filed by De Lage Landen Financial Services, Inc. which was another assignee of the lease payments. In connection with that settlement, MAXIMUS recorded a charge of $7.0 million for the fiscal year ended September 30, 2005. That amount included the settlement amount paid to De Lage Landen and the associated legal expenses for fiscal year 2005, as well as a liability for estimated probable future legal defense costs of the Georgia lawsuit. In April 2006, the Company received an insurance settlement relating to this matter in the amount of $0.8 million.

The Company has also reported the matter to law enforcement authorities, and has filed claims against the former employees. Those claims have been referred to arbitration for resolution.

(b) In October 2004, MAXIMUS received a subpoena from the Criminal Division of the U.S. Department of Justice acting through the U.S. Attorney's Office for the District of Columbia. The subpoena requested records pertaining to the Company's work for the District of Columbia, primarily relating to the preparation and submission of federal Medicaid reimbursement claims on behalf of the District. The U.S. Attorney's Office is investigating issues pertaining to compliance with the federal laws governing Medicaid claims. We are fully cooperating with the U.S. Attorney's Office in producing documents in response to the subpoena and making employees available for interviews, and we have conducted an internal review of this matter through independent outside legal counsel. Based on the anticipated legal costs of the internal review, we recorded a charge of $0.5 million in connection with this matter in the quarter ended December 31, 2005. We are unable to quantify the probability or magnitude of any other expenditure we may incur in connection with this matter at this time.

(c) In June 2005, MAXIMUS received a subpoena pursuant to the Illinois Whistleblower Reward and Protection Act from the Office of the Attorney General of Illinois in connection with a purported whistleblower investigation of potential false claims. The subpoena requested records pertaining to the Company's work for agencies of the Executive Branch of Illinois State Government. Discussions with the Attorney General's office have indicated that MAXIMUS was one of nine contractors that received such subpoenas and that the investigation is primarily focused at this time on the procurement and contracting activities of the Illinois Department of Central Management Services. Although there can be no assurance of a favorable outcome and we are unable to quantify the probability or magnitude of any expenditures we may incur in connection with this matter, the Company does not believe that this matter will have a material adverse effect on its financial condition or results of operations, and the Company has not accrued for any loss related to this matter.



### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

(c) The following table sets forth the information required regarding repurchases of common stock that we made during the three months ended June 30, 2006:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans (1) | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plan (in thousands) |
|---|---|---|---|---|
| April 1, 2006 – April 30, 2006 | — | — | — | $ 25,077 |
| May 1, 2006 – May 31, 2006 | 25,000 | $ 34.89 | 25,000 | $ 26,188 |
| June 1, 2006 – June 30, 2006 | — | — | — | $ 26,319 |
| Total | 25,000 | $ 34.89 | 25,000 | |

(1) Under resolutions adopted and publicly announced on May 12, 2000, July 10, 2002, and April 2, 2003, our Board of Directors has authorized the repurchase, at management's discretion, of up to an aggregate of $90.0 million of common stock under our 1997 Equity Incentive Plan. In addition, in June 2002, the Board of Directors authorized the use of option exercise proceeds for the repurchase of our common stock.

### Item 6. Exhibits.

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

## SIGNATURES

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: August 8, 2006

By: /s/ David N. Walker
David N. Walker
Chief Financial Officer
(On behalf of the registrant and as Principal Financial and Accounting Officer)



EXHIBIT INDEX

| Exhibit No. | Description |
|---|---|
| 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Section 906 Principal Executive Officer Certification. |
| 32.2 | Section 906 Principal Financial Officer Certification. |
| 99.1 | Special Considerations and Risk Factors. |

**EXHIBIT 31.1**

**Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Richard A. Montoni, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of MAXIMUS, Inc. for the period ended June 30, 2006;

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 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 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.

Dated: August 8, 2006

/s/ Richard A. Montoni
Richard A. Montoni
Chief Executive Officer

**EXHIBIT 31.2**

**Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, David N. Walker, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of MAXIMUS, Inc. for the period ended June 30, 2006;

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 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 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.

Dated: August 8, 2006

/s/ David N. Walker
David N. Walker
Chief Financial Officer

**EXHIBIT 32.1**

**Section 906 CEO Certification**

I, Richard A. Montoni, Chief Executive Officer of MAXIMUS, Inc. ("the Company"), do hereby certify, under the standards set forth in and solely for the purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2006 (the "Quarterly Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78m or 78o(d)) and

2. The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 8, 2006

/s/ Richard A. Montoni
Richard A. Montoni
Chief Executive Officer

**EXHIBIT 32.2**

**Section 906 CFO Certification**

I, David N. Walker, Chief Financial Officer of MAXIMUS, Inc. ("the Company"), do hereby certify, under the standards set forth in and solely for the purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2006 (the "Quarterly Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78m or 78o(d)) and

2. The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 8, 2006

/s/ David N. Walker
David N. Walker
Chief Financial Officer

**EXHIBIT 99.1**

## Special Considerations and Risk Factors

From time to time, we may make forward-looking public statements, such as statements concerning our then-expected future revenue 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 a circumstance 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 or meet performance standards, our contracts may be terminated and we may incur significant costs or liabilities, including liquidated damages and penalties, which could adversely impact our operating results, financial condition and our ability to compete for future contracts.**

Our contracts may be terminated for our failure to satisfy our contractual obligations or to meet performance standards and often require us to indemnify customers. In addition, some of our contracts contain substantial liquidated damages provisions and financial penalties related to performance failures. Although we have liability insurance, the policy coverage and limits may not be adequate to provide protection against all potential liabilities. Further, for certain contracts, we have posted significant performance bonds or issued letters of credit to secure our indemnification and other obligations. If a claim is made against a performance bond or letter of credit, we would be required to reimburse the issuer for the amount of the claim. Consequently, as a result of the above matters, we may incur significant costs or liabilities, including penalties, which could adversely impact our operating results, financial condition and our ability to compete for future contracts.

Earlier in 2006, the Texas Health and Human Services Commission announced that the phased roll out of the integrated eligibility project was being delayed. MAXIMUS is a subcontractor to Accenture for that project. The delay was a result of needed technical and operational improvements stemming from the complexity of the systems development and interfacing as well as start-up readiness. This project is large, complex and in many ways leading-edge innovation, with commensurate risks and challenges.

On June 27, 2006, we filed a Form 8-K describing amendments to our subcontract with Accenture, including reassignment of certain program responsibilities and the corresponding financial impacts to us. Even with the reassignment of responsibilities, the program carries a substantial degree of performance risk for MAXIMUS. Failure to satisfactorily implement required improvements could result in financial penalties, loss of work scope, or partial or complete termination of the subcontract, all of which could adversely affect our operating results, financial condition and our ability to compete for future contracts.



**We may be subject to fines, penalties and other sanctions if we fail to comply with federal, state and local laws governing our business.**

Our business lines operate within a variety of complex regulatory schemes, including but not limited to the Federal Acquisition Regulation (FAR), Cost Accounting Standards, the Truth in Negotiations Act, the Fair Debt Collection Practices Act (and analogous state laws), as well as the regulations governing Medicaid and Medicare. 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. Further, as a government contractor subject to the types of regulatory schemes described above, we are subject to an increased risk of investigations, criminal prosecution, civil fraud, whistleblower lawsuits and other legal actions and liabilities to which private sector companies are not, the result of which could have a material adverse effect on our operations.

**We are subject to review and audit by federal, state and local governments at their sole discretionand, if any improprieties are found, we may be required to refund revenue we have received, or forego anticipated revenue, which could have a material adverse impact on our revenues and our ability to bidin response to RFPs.**

As a provider of services to government agencies, we are subject to periodic audits and other reviews by federal, state and local governments of our costs and performance, accounting and general business practices relating to our contracts with those government agencies. 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. Based on the results of these audits, government agencies may demand refunds or adjust our contract-related costs and fees, including internal costs and expense allocation. Although adjustments arising from government audits and reviews have not had a material adverse effect on our results of operations in the past, there can be no assurance that future audits and reviews would not have such effects.

**If we fail to accurately estimate the factors upon which we base our contract pricing, we may generate less profit than expected or incur losses on those contracts.**

We derived approximately 33% of our fiscal 2005 revenue from fixed-price contracts and approximately 40% of our fiscal 2005 revenue from performance-based contracts. For fixed-price contracts, we receive our fee based on services provided. Those services might include operating a Medicaid enrollment center pursuant to specified standards, designing and implementing computer systems or applications, 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 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. Although we believe that we have recorded adequate provisions in our financial statements for losses on our fixed-price and cost-plus contracts, as required under U.S. generally accepted accounting principles, we cannot assure you that our contract loss provisions will be adequate to cover all actual future losses.

**Adverse judgments or settlements in legal disputes could harm our financial condition and operating results.**

We are subject to a variety of litigation or other claims and suits that arise from time to time in the ordinary course of our business such as contract and employment claims and lawsuits involving compliance with laws governing debt collections and child support enforcement. Adverse judgments or settlements in some or all of these legal disputes may result in significant monetary damages or injunctive relief against us. In addition, the litigation and other claims described in our periodic report are subject to inherent uncertainties and management's view of these matters may change in the future. Those uncertainties include, but are not limited to, costs of litigation, unpredictable court or jury decisions, and the differing laws and attitudes regarding damage awards among the states.

**We may incur significant costs before receiving related contract payments that could result in increasing the use of cash and accounts receivable.**

When we are awarded a contract, we may incur significant expenses before we receive contract payments, if any. These expenses may include leasing office space, purchasing office equipment and hiring personnel. In other situations, contract terms provide for billing upon achievement of specified project milestones. As a result, in these situations, we are required to expend 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. These factors could impact us by increasing the use of cash and accounts receivable. Moreover, these impacts could be exacerbated if we fail to either invoice the government agency or collect our fee in a timely manner.

**We obtain most of our business through competitive bidding in response to government RFPs. We may not be awarded contracts through this process on the same level in the future as in the past, and contracts we are awarded may not be profitable.**

Substantially all of our customers are government agencies. To market our services to government customers, we are often required to respond to government RFPs which may result in contract awards on a competitive basis. 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 a RFP's rigid timetable. Our ability to respond successfully to RFPs will greatly impact our business. There is no assurance that we will continue to obtain contracts in response to government RFPs and our proposals may not result in profitable contracts. In addition, competitors may protest contracts awarded to us through the RFP process which may cause the award to be delayed or overturned or may require the customer to reinitiate the RFP process.

**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, and they may elect not to exercise them for budgetary, performance, or any other reason. Our contracts also typically contain provisions permitting a government customer to terminate the contract on short notice, with or without cause. Termination without cause provisions generally allow the government to terminate a contract at any time, and enable us to recover only our costs incurred or committed, and settlement expenses and profit, if any, on the work completed prior to termination. 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 customer might terminate its contracts with us.



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**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.

**We rely on key contracts with state and local governments for a significant portion of our sales. A substantial reduction in those contracts would materially adversely affect our operating results.**

In fiscal 2005, approximately 78% of our total revenue was derived from contracts with state and local government agencies. Any significant disruption or deterioration in our relationship with state and local governments and a corresponding reduction in these contracts would significantly reduce our revenues and could substantially harm our business.

**Government unions may oppose outsourcing of government programs to outside vendors such as us, which could limit our market opportunities and could impact us adversely. In addition, our unionized workers could disrupt our operations.**

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 applied, and are likely to continue to apply, political pressure on legislators and other officials seeking to outsource government programs. Union opposition to these programs may result in fewer opportunities for us to service government agencies and/or longer and more complex procurements.

We do operate outsourcing programs using unionized employees in Canada. We have experienced opposition from the union which does not favor the outsourcing of government programs. As a result, we have received negative press coverage as the union continues to oppose our program operations. Such press coverage and union opposition may have an adverse affect on the willingness of government agencies to outsource such projects as well as certain contracts that are operated within a unionized environment. Our unionized workers could also declare a strike which could adversely affect our performance and financial results.

**We may be precluded from bidding and performing certain work due to other work we currently perform.**

Various laws and regulations prohibit companies from performing work for government agencies that might be viewed as an actual or apparent conflict of interest. These laws may limit our ability to pursue and perform certain types of work. For example, some of our Consulting Segment divisions assist government agencies in developing requests for proposals (RFPs) for various government programs. In those situations, the divisions involved in operating such programs would likely be precluded from bidding on those RFPs. Similarly, rules governing the independence of enrollment brokers could prevent us from providing services to other organizations such as health plans.

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

The ability of our executive officers and our senior managers to generate business and execute projects successfully is important to our success. While we have employment agreements with some of our executive officers, those agreements do not prevent them from terminating their employment with us. The loss of an executive officer or senior manager could impair our ability to secure and manage engagements, which could harm our business, prospects, financial condition and results of operations.

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

Because of the public nature of many of our business lines, the media frequently focus their 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 focus their attention on the activities of political consultants engaged by us, and we may be tainted by adverse media coverage about their activities, even when those activities are unrelated to our business. 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 may be unable to attract and retain sufficient qualified personnel 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; 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. There can be no assurance that we will be able 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. In that circumstance, 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. This situation could eliminate a contracting opportunity or reduce the value of an existing contract.



**Our business could be adversely affected by future legislative or government budgetary and spending changes.**

The market for our services depends largely on federal and state legislative programs and the budgetary capability to support programs, including the continuance of existing programs. These programs can be modified or amended at any time by acts of federal and state governments.

Moreover, part of our growth strategy includes aggressively pursuing new opportunities and continuing to serve existing programs scheduled for re-bid, which are or may be created by federal and state initiatives, principally in the area of health services, human services and child welfare.

State budgets were adversely impacted by a general economic slowdown in fiscal 2003, creating state budget deficits, which trend, although to a lesser extent, continued into fiscal 2004 and 2005. All but one state must operate under a balanced budget. There are a number of alternatives to states in managing a possible budget deficit, including:

· Accessing previously set aside or “rainy day” funds;

· Increasing taxes;

· Elimination or reduction in services;

· Cost containment and savings;

· Pursuit of additional federal assistance; and

· Developing additional sources of revenue, such as the legalization of gaming.

While we believe that the demand for our services remains substantial, and that some service offerings may experience increased demand in the current environment, continued state budget deficits may adversely impact our existing and anticipated business as well as our future financial performance.

Also, changes in federal initiatives or in the level of federal spending due to budgetary or deficit considerations may have a significant impact on our future financial performance. For example, increased or changed spending on defense, security or anti-terrorism threats may impact the level of demand for our services. Many state programs, such as Medicaid, are federally mandated and fully or partially funded by the federal government. Changes, such as program eligibility, benefits, or the level of federal funding may impact the demand for our services. Certain changes may present new opportunities to us and other changes may reduce the level of demand for services provided by us, which could materially adversely impact our future financial performance.

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

Business combinations involve a number of factors that affect operations, including:

- diversion of management's attention;
- loss of key personnel;
- entry into unfamiliar markets;
- 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.

Businesses we acquire may not achieve the revenue and earnings we anticipated. Customer dissatisfaction or performance problems with an acquired firm could materially and adversely affect our reputation as a whole. As a result, 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 materially negatively impact our business and results of operations.



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

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 obtaining federal funding reimbursements. If state and local officials are dissuaded from engaging us for revenue maximization services, we will not receive contracts for, or revenue from, those services.

**We may rely on subcontractors and partners to provide clients with a single-source solution.**

From time to time, we may engage subcontractors, teaming partners or other third parties to provide our customers with a single-source solution. While we believe that we perform appropriate due diligence on our subcontractors and teaming partners, we cannot guarantee that those parties will comply with the terms set forth in their agreements. We may have disputes with our subcontractors, teaming partners or other third parties arising from the quality and timeliness the subcontractor's work, customer concerns about the subcontractor or other matters. Subcontractor performance deficiencies could result in a customer terminating our contract for default. We may be exposed to liability, and we and our clients may be adversely affected if a subcontractor or teaming partner failed to meet its contractual obligations.

**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 Consulting Segment typically competes for consulting contracts with large consulting firms such as Accenture Ltd., as well as smaller niche players, such as Public Consulting Group.

Our Systems Segment competes for system products sales and system service contracts with a large number of competitors, including Unisys Corporation, SAP America, Inc., Oracle Corporation, BearingPoint, Inc., Accenture Ltd., Deloitte & Touche LLP, Northrop Grumman Corporation, and Electronic Data Systems Corporation.

Our Operations Segment competes for program management contracts with the following:

- government services divisions of large organizations such as Affiliated Computer Services, Inc., Electronic Data Systems Corporation, and International Business Machines Corporation;
- specialized service providers; and
- local non-profit organizations such as the United Way of America, Goodwill Industries and Catholic Charities, USA.

Many of these companies are national and international in scope, are larger than us and have greater financial resources, name recognition and larger technical staffs. 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. There can be no assurance that we will be able to compete successfully against our existing or any new competitors.



**A number of factors may cause our cash flows and results of operations to vary from quarter to quarter.**

Factors which may cause our cash flows and results of operations to vary from quarter to quarter include:

- the terms and progress of contracts;
- the levels of revenue earned and profitability of fixed-price and performance-based contracts;

- expenses related to certain contracts which may be incurred in periods prior to revenue being recognized;
- 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 flows and results of operations because a large amount of our expenses are fixed.

**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.