

SRA INTERNATIONAL INC  
Form 10-K  
August 25, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K**

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(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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

Commission File Number 001-31334

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**SRA International, Inc.**

(Exact name of Registrant as Specified in its Charter)

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Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)

54-1360804  
(I.R.S. Employer  
Identification No.)

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4300 Fair Lakes Court, Fairfax, Virginia  
(Address of Principal Executive Offices)

22033  
(Zip Code)

Registrant's telephone number, including area code: (703) 803-1500

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Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Class</u>	<u>Name of Exchange on Which Registered</u>
Class A common stock, \$0.004 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

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 Act). Yes  No

The aggregate market value of common stock held by non-affiliates of the registrant as of December 31, 2005, based upon the closing price of SRA International, Inc. class A common stock on the New York Stock Exchange for such date, was \$1,176,888,859.

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As of August 18, 2006, there were 41,539,795 shares outstanding of the registrant's class A common stock and 14,459,828 shares outstanding of class B common stock.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Certain portions of the definitive Proxy Statement to be used in connection with the SRA International, Inc. annual meeting of stockholders, to be held on October 27, 2006, and to be mailed to stockholders of record as of September 15, 2006, are incorporated by reference into Part III of this Form 10-K.

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**PART I**

**Forward-Looking Statements**

Some of the statements under Business, Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this Form 10-K constitute forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, will, and would or similar words. You should read statements that contain carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to predict or control accurately. The factors listed in the section captioned Risk Factors, as well as any cautionary language in this Form 10-K, provide examples of risks, uncertainties, and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Form 10-K. Subsequent events and developments may cause our views to change. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so.

**Item 1. BUSINESS**

**OVERVIEW**

We are a leading provider of technology and strategic consulting services and solutions to clients in national security, civil government, and health care and public health. Our largest market, national security, includes the Department of Defense, the National Guard, the Department of Homeland Security, the intelligence agencies, and other federal organizations with homeland security missions. We offer a broad range of services that spans the information technology life-cycle: strategic consulting; systems design, development, and integration; and outsourcing and managed services. In addition, to address recurring client needs, we develop business solutions for contingency and disaster response planning, information assurance, business intelligence, privacy protection, enterprise architecture, infrastructure management, and wireless integration. We combine a comprehensive knowledge of our clients' business processes with the practical application of advanced information technology tools, techniques, and methods to create value-added solutions for our clients.

We have provided information technology services and solutions to federal government clients for over 28 years and have longstanding relationships with many of them. We have served clients within the Departments of the Army, Navy, and Air Force, the Joint Chiefs of Staff, the Office of the Secretary of Defense, the Department of the Treasury, and the Federal Emergency Management Agency for over 20 years. We currently serve over 275 government clients on over 900 active engagements. Our business is diversified, with no single client or client group accounting for more than 13% of our revenue during any of the last three fiscal years. For each of the last three fiscal years, we have been the prime contractor on engagements representing over 86% of our total revenue.

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Our executive team includes the core group of senior executives that has built the company over the past two decades. Our founder and chairman, Ernst Volgenau, has been with us since our inception. Our 91 officers have an average tenure with our company of approximately 14 years, including any prior service with acquired companies. Our management team is supported by a high quality staff of more than 4,900 people, approximately

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96% of whom are professional staff. Our professional staff is highly educated, with approximately one-third possessing advanced degrees. In addition, over half of our employees hold federal government security clearances.

From fiscal 2001 to fiscal 2006, we increased our revenue at a compound annual growth rate of approximately 34.4%. Our revenue for the fiscal year ended June 30, 2006 was \$1.18 billion, a 33.7% increase over the prior fiscal year. As of June 30, 2006, our backlog was approximately \$3.3 billion, of which \$512.8 million was funded. As of June 30, 2005, our backlog was over \$2.7 billion, of which \$453.2 million was funded. In January 2002, we acquired The Marasco Newton Group, Ltd., or MNG, our first government services acquisition. In January 2003, we acquired Adroit Systems, Inc., or Adroit, for its expertise in the areas of command and control, communications, computers, intelligence, surveillance, and reconnaissance, or C4ISR. In January 2004, we acquired ORION Scientific Systems, or Orion, a privately-held company focused on counterterrorism and counterintelligence. In April 2005, we acquired Touchstone Consulting Group, Inc., or Touchstone, a privately-held management consultancy with an established track record of serving senior executives in the federal government. In July 2005, we acquired Galaxy Scientific Corporation, or Galaxy, a provider of systems engineering, information technology, and tactical communications services and solutions to the federal government. In November 2005, we acquired Spectrum Solutions Group, Inc., or Spectrum, a privately-held provider of enterprise solutions to clients throughout the federal government. In April 2006, we acquired Mercomms Unlimited, Inc., or Mercomms, which specializes in advanced maritime and defense communications technologies for the federal government. We expect these acquisitions will enable us to sell a more comprehensive set of services and solutions to a larger client base and to jointly pursue potential new opportunities.

## **INDUSTRY BACKGROUND**

The federal government is the largest consumer of information technology services and solutions in the United States. Although the information technology market is currently facing challenges as a result of a shift in expenditures to pay for the war against terrorism and other international conflicts, we believe that the federal government's spending on information technology will continue to increase over the next several years. The increase will be driven by the expansion of national defense and homeland security programs, increased reliance on information technology outsourcing, demand for greater government efficiency and effectiveness, and the continuing impact of federal procurement reform. According to the *Federal IT Market Forecast, FY 2006 - FY 2011* report published by INPUT, an independent federal government market research firm, the contracted portion of federal government spending on information technology is forecasted to grow at an annual rate of 5.0% from \$63.3 billion in federal fiscal year 2006 to \$80.5 billion in federal fiscal year 2011.

*Increased Spending on National Defense and Homeland Security.* The terrorist attacks of September 11, 2001, the war in Iraq, and other recent international events have intensified the federal government's commitment to strengthen our country's military, intelligence, and homeland security capabilities and increased the need for information technology capable of supporting these functions. We believe intelligence agencies will increase demand for data and text mining solutions to enable them to extract, analyze, and present data gathered from the massive volumes of information available through open sources such as the Internet. This increased focus on national security, homeland security, and intelligence has also reinforced the need for interoperability among the many disparate information technology systems throughout the federal government. We believe the Department of Homeland Security, or DHS, and the intelligence agencies are increasingly interested in enterprise systems that enable better coordination and communication within and among agencies and departments.

*Increased Reliance on Information Technology Outsourcing.* Outsourcing of information technology operations is becoming an increasingly attractive alternative for federal agencies that are striving to maintain their core functions with limited technical resources and a shrinking information technology workforce, while at the same time upgrading technology and standardizing and streamlining operations. We expect reductions in the federal information technology workforce to continue due to, among other factors, a projected increase in the number of retiring government employees.





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*Demand for Greater Government Efficiency and Effectiveness.* Budget-constrained federal government agencies are under increasing pressure to cut costs, while at the same time continuing to improve and upgrade their technological capabilities. The President's Management Agenda makes it clear that the Bush administration is focused on governing with accountability and is looking to more tightly link spending with performance. We believe government chief information officers will increasingly pursue initiatives such as adopting an enterprise architecture and requiring a business justification for program approvals. We believe new services, including web and wireless services, will be particularly important as government agencies respond to the necessity for interoperability among the information technology systems throughout the government and the demand for comprehensive electronic services to the public.

*Continuing Impact of Federal Procurement Reform.* Over the past decade, federal government agencies have adopted procurement processes that are more similar to typical commercial contract acquisition practices. Changes in the procurement process have streamlined the process of purchasing information technology services by reducing procurement time and acquisition costs. These changes provide increased flexibility and enable government entities to award contracts based on factors other than price alone, such as successful past performance and distinguishing corporate and technical capabilities.

There are currently two widely used contract methods in federal procurement, single award/defined statement of work contracts and indefinite delivery/indefinite quantity contracts:

*Single award/defined statement of work contracts.* Under this contract method, which can take a year or more to complete, an agency solicits, qualifies, and then requests proposals from interested contractors. The agency then evaluates the bids and typically awards the contract to a single contractor for a specified service. Historically, single award/defined statement of work contracts were the most prevalent type of contract award used by federal government clients; however, the use of this type of contract has been declining for the past several years.

*Indefinite delivery/indefinite quantity contracts.* Under this contract method, a federal government agency can form preferred provider relationships with one or more contractors. This category includes agency-specific indefinite delivery/indefinite quantity contracts; blanket purchase agreements, or BPAs; government-wide acquisition contracts, or GWACs; and General Services Administration, or GSA, schedule contracts. These umbrella contracts outline the basic terms and conditions under which federal government agencies may order services. Indefinite delivery/indefinite quantity, or ID/IQ, contracts are typically managed by one agency, the sponsoring agency, and may be either for the use of a specific agency or available for use by any agency of the federal government. Indefinite delivery/indefinite quantity contracts available for use by any agency of the federal government are commonly referred to as GWACs. Contractors within the industry compete to be pre-selected to perform work under an ID/IQ contract. An ordering agency then issues delivery orders for services to be performed under the contract. If the indefinite delivery/indefinite quantity contract has a single prime contractor, only that contractor may be awarded delivery orders. If the contract has multiple prime contractors, the award of each delivery order typically will be competitively determined among the pre-selected contractors.

GSA schedules are listings of services and products, along with their respective prices, offered by federal government contractors. The schedules are maintained by the GSA for use by any federal agency or other authorized entity, including state and local governments. In order for a contractor to enter into a contract with the GSA and be listed on a GSA schedule, the contractor must be pre-qualified and selected by the GSA. When an agency selects services under a GSA schedule contract, the user agency, or the GSA on its behalf, will typically conduct a competitive process, limited to qualified GSA schedule contractors.

Due to the lower contract procurement costs, reduced procurement time, and increased flexibility associated with ID/IQ contracts, BPAs, GWACs and GSA schedule contracts, these vehicles have been utilized frequently in the last several years.

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*Market Opportunity.* The federal government's demand for information technology services has increased, and is expected to continue to increase, as a result of planned increases in spending for national defense and homeland security; increased reliance on outsourced information technology programs; demand for greater government efficiency and effectiveness; and the continuing impact of federal procurement reform. We believe that for information technology providers to win contract awards from the federal government they must possess strong and stable management, highly skilled personnel, a deep knowledge of the government's business processes, demonstrated technological expertise, a strong record of past performance, and key positioning on multiple award contract vehicles such as GSA schedule contracts, GWACs and agency-specific ID/IQ contracts.

## **OUR APPROACH**

We are a high-end technology and strategic consulting services and solutions provider focused on delivering results that create tangible value for our clients. We maintain the comprehensive information technology skills required to support the entire life-cycle of our clients' systems, from strategic planning to operational support. We employ interdisciplinary teams to staff our engagements, which enables us to deliver services and solutions that combine our comprehensive knowledge of our clients' business processes with the necessary technical expertise. Depending on client needs, we may integrate commercially available products with existing systems or develop a comprehensive solution that involves designing, integrating, maintaining, and upgrading a custom-built system.

To maximize our ability to deliver consistent results that successfully meet client needs, we have developed a proprietary project management and technical execution methodology, which we call ELITE. We train our project managers and technical leaders on this methodology, which emphasizes using mature, repeatable processes that reduce risk and maximize successful project completion. As a result, our company, including all its sectors and business units, has received a Capability Maturity Model Integrated, or CMMI, level 3 rating under the standards established by the Software Engineering Institute. This rating reflects that we have mature, repeatable processes that we believe help reduce risk, improve technical delivery, improve product quality, contain costs, and meet demanding schedules. Often the federal government requires a CMMI level 3 rating as a qualification to bid on complex software development and systems integration projects.

We believe we are able to execute our approach successfully as a result of five core strengths:

### ***Strong, Stable Management and Highly Skilled Personnel***

Our executive team includes the core group of senior executives that has built our company over the past two decades. Our 91 officers have an average tenure with our company of approximately 14 years, including any prior service with acquired companies, providing extensive industry experience and strong continuity of management. Several members of our management team are former senior military officers or government officials who have deep knowledge of the federal government and its information technology needs. Our corporate culture fosters teamwork and excellence, which has contributed to our being named in 2006 by *Fortune* magazine as one of the 100 Best Companies to Work For for the seventh straight year. This, in turn, has enhanced our ability to recruit and retain highly skilled personnel. Our professional staff is highly educated, with approximately one-third holding advanced degrees.

### ***Knowledge of Government Clients' Business Processes***

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We have served clients within the Departments of the Army, Navy, and Air Force, the Joint Chiefs of Staff, the Office of the Secretary of Defense, the Department of the Treasury, and the Federal Emergency Management Agency for over 20 years. As a result of these longstanding relationships, we have an in-depth knowledge of our clients' business processes, which enables us to design solutions that address their strategic goals and integrate with their existing systems. We have also recruited strategic hires with significant governmental or technical experience who have added to our knowledge of our clients' business processes and who have extended our expertise into new areas.

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### ***Technical Expertise***

We invest in research and development in areas such as data mining, natural language understanding, knowledge management, information assurance, and wireless applications in order to offer clients the most up-to-date technological solutions. We continue to use our domain expertise and advanced technical knowledge to anticipate, identify, and develop forward-looking technologies to enable clients to meet their mission objectives. We use our proprietary intellectual property, including our ELITE life-cycle methodology, to provide value-added solutions for our clients.

### ***Proven Record of Past Performance***

We have provided information technology services and solutions to the federal government for over 28 years and have longstanding relationships with many of our clients. In order to promote high quality results and client satisfaction, we emphasize long-term assignment of required staff and consistently review our project performance, including regularly surveying our customers regarding their perceptions of our performance. On competitively awarded engagements on which we were the incumbent, we have a renewal rate of at least 91% for each of the last three fiscal years. We calculate our contract renewal rate based on the number of engagements that come up for recompetition during the period and the number of those recompetitions that we win.

### ***Key Positioning as a Prime Contractor***

We are currently a prime contractor on three of the federal government's four largest information technology services GWACs: Millennia, Millennia Lite, and CIO-SP2i. We hold five GSA schedule contracts and we are a prime contractor on more than 35 agency-specific indefinite delivery/indefinite quantity contracts. This broad contract portfolio gives us extensive reach as a preferred provider and enables us to deliver the full range of our services and solutions to any organization in the federal government. Serving as a prime contractor positions us to achieve better client relationships, to exert more control and influence over quality results, to have clearer visibility into future opportunities, and to earn enhanced profit margins.

## **GROWTH STRATEGY**

Our objective is to continue to profitably grow our business as a leading provider of technology and strategic consulting services and solutions to a wide variety of federal government organizations. Our growth strategy includes the following.

### ***Leverage Our Longstanding Client Relationships to Cross-Sell Our Full Range of Services***

We plan to continue expanding the scope of the services we provide to our existing clients. We are adept at penetrating, cross-selling to, and building-out existing client accounts through our successful performance and comprehensive knowledge of their business, which has led to many long-term contract relationships. We believe our high level of client satisfaction and deep knowledge of our clients' business processes enhance our ability to cross-sell additional services.

*Expand Our Client Base*

We believe that the federal government's increasing reliance on outsourcing and the increased emphasis on national security and homeland security, coupled with the changes in procurement reform, have significantly increased our market opportunity. We have a longstanding heritage of supporting the federal government in the areas of contingency and disaster response planning; information assurance; critical infrastructure protection; and command and control, communications, and intelligence. We intend to leverage this broad experience to expand our client base to include organizations in the federal government for which we have not historically worked. We believe our ability to win new clients is enhanced by our position as a prime contractor on three of the four largest information technology services GWACs. These contracts enable us to sell our services and solutions to virtually any federal government agency. In addition, we intend to continue strategic hiring to expand the breadth of our expertise into new areas of the federal government or new technologies. We have used strategic hires as a cost-effective way to build-out client accounts, to establish new competencies, and to penetrate new markets.

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### ***Focus Our Applied Research and Development Investments to Enhance Our Core Business***

We intend to continue to invest in applied research and development initiatives to enhance our competitive position within our business. For example, we have employed proprietary intellectual property developed through these initiatives in engagements relating to hyperspectral imagery, a virtual operations center, a sensor network analytical platform, visual radio frequency identification analyzer, foreign language text analysis, and information extraction systems which can automatically adapt to new extraction requirements.

### ***Pursue Strategic Acquisitions***

We plan to continue to pursue strategic acquisitions to complement internal growth and to position ourselves to capitalize on anticipated high growth areas. For example, we acquired MNG in January 2002, Adroit in January 2003, Orion in January 2004, Touchstone in April 2005, Galaxy in July 2005, Spectrum in November 2005, and Mercomms in April 2006. Our acquisition strategy is focused on firms that will enable us to cost-effectively add new clients, specific agency knowledge, or technical expertise. We intend to continue to selectively acquire high quality companies that accelerate our access to existing or new markets that we believe have strong growth dynamics.

## **OUR SERVICES AND BUSINESS SOLUTIONS**

### ***Our Services***

We offer a broad range of technology and strategic consulting services that spans the information technology life cycle, including: strategic consulting; systems design, development, and integration; and outsourcing and managed services.

*Strategic Consulting.* We help clients formulate business and execution plans to improve performance, cost effectiveness, and quality of service. We assess current operations, develop targeted strategies and plans for improvement, define key priorities and accountabilities, and design enterprise architectures that capitalize on client investments in legacy systems while enabling them to make a seamless transition to modern technology environments. We work with leaders and their management teams to develop specific implementation plans that achieve the established strategies, effectively track and manage implementation efforts, and measure and validate results.

*Systems Design, Development, and Integration.* Our services include project management, systems design, network and systems integration, security engineering, software development, database design and development, and independent test and evaluation. We analyze systems concepts, define requirements, develop operational prototypes, and integrate complex mission-critical systems that comply with a client's enterprise architecture. Based on client requirements, we may design custom-built systems; integrate and implement commercial off-the-shelf solutions, such as those for supply chain management, enterprise resource planning, and case management; or a combination of both using service-oriented architecture principles and other industry best practices.

*Outsourcing and Managed Services.* We partner with clients to consolidate and modernize existing infrastructures, improve customer service, and reduce the total cost of operations through effective use of industry best practices and performance-based contracting methods. We

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also support clients with operations management services, sometimes referred to as co-sourcing. Based on client needs, we may oversee their technical infrastructure, manage their applications and networks, or even operate their entire business processes in accordance with service-level agreements.

### ***Our Business Solutions***

We have developed business solutions that focus on specific business requirements that are common to many of our clients. These business solutions apply to clients within each of our target markets. Our core business solutions include business intelligence; text and data mining; contingency and disaster response planning; enterprise architecture and portfolio management; identity management; information assurance;

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information sharing and management; outsourcing, managed services, and infrastructure management; privacy protection; training, modeling, and simulation; and wireless integration services. These business solutions consist of repeatable tools, techniques, and methods that reflect the specific competencies we have gained from significant experience in these areas. Our current business solutions are enhanced through our focus on applied research and development in the areas of data mining, natural language understanding, knowledge management, and wireless applications.

*Business Intelligence: Text and Data Mining.* Our business intelligence solutions give clients the means to extract value from enormous amounts of electronic information. We use text and data mining algorithms and technologies to help clients get the most benefit from information in their internal data repositories and vast amounts of information online.

We combine the capabilities of our NetOwl<sup>®</sup> text mining software tools and of our ORIONMagic<sup>®</sup> knowledge management software to offer clients improved methods of managing, exploiting, and analyzing large amounts of enterprise data. ORIONMagic helps clients cull through gigabytes of information, store the most relevant pieces, and analytically scour each piece. NetOwl tools collect, search, organize, and analyze large amounts of unstructured text data. Our text mining software applies advanced natural language understanding technologies to English, Arabic, Chinese, Farsi, French, Korean, and Spanish text and extracts valuable content that would otherwise be unobtainable.

We provide data mining solutions to help clients analyze and identify hidden patterns and relationships in large collections of data in databases, data marts and warehouses, spreadsheets, and text. We store the data in an analytical data warehouse, apply patterns to it to identify desired conditions, and apply data mining techniques to locate activities and relationships of interest. This aids clients in predicting future data trends and discovering actionable information.

In fiscal year 2006, we were a member of the Perot Systems team selected as a new Medicare Drug Integrity Contractor by the Centers for Medicare & Medicaid Services. We are building the data warehouse and supporting data analytics to identify potential fraud, waste, and abuse in the new Medicare prescription drug program. For the Defense Advanced Research Projects Agency's, or DARPA, Command Post of the Future, we applied a combination of data and text mining, statistical analysis, and data warehousing techniques to a large repository of structured and unstructured data to find tactical and operational data patterns that DARPA can use to enhance real-time command decision-making on the battlefield. For the Internal Revenue Service, or IRS, we continue to develop predictive models that are applied to income tax refund requests to detect fraud at lower cost than previous labor-intensive solutions. We are also developing business rules and statistical models to help detect noncompliance in tax-exempt entity filings.

*Contingency and Disaster Response Planning.* We play a leading role in helping clients prepare for, respond to, and recover from natural disasters, national security incidents, and technological emergencies. Our services include continuity of operations and government, disaster response and recovery, crisis communications, and critical infrastructure planning.

In fiscal year 2006, we delivered continuity planning support throughout the executive and legislative branches of the federal government, including development of a comprehensive test and exercise program for the U.S. House of Representatives Office of Emergency Planning, Preparedness, and Operations. For the Department of Defense, Chairman of the Joint Chiefs of Staff, we designed complex exercises and war games to simulate response to a variety of threats, including international and domestic terrorist incidents. Under a new contract awarded this year, we continue our work with the Headquarters Air Force to develop a continuity program to ensure its mission-essential functions continue unabated during a national security emergency or contingency affecting operations at its primary facilities. We also continue to deliver robust emergency management planning, training, exercise, and disaster operations support to help the U.S. Coast Guard enhance its ability to respond to a catastrophic oil spill.





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*Enterprise Architecture and Portfolio Management.* An enterprise architecture, or EA a framework or blueprint that identifies and links processes, systems, databases, and technology to outcomes can help federal agencies function at top efficiency, effectiveness, and responsiveness. Agencies use EA to streamline and standardize their business processes and computer systems with common hardware and software, facilitate communication between components, and more easily share and reuse data. We provide EA program planning, policy, and management support; development and maintenance of as-is, target, and transition architectures; and change management and architecture governance strategies. We also have expertise in implementing and executing EA guidance from the Office of Management and Budget, the Federal Chief Information Officer, or CIO, Council, and the Government Accountability Office, or GAO.

We have extensive EA experience gained from ongoing work with clients including the Environmental Protection Agency, or EPA, GAO, Missile Defense Agency, National Institutes of Health, or NIH, and the U.S. Air Force. In fiscal year 2006 we received a contract to provide EA development support to the Department of Veterans Affairs while continuing work with the National Aeronautics and Space Administration, or NASA, Army Network Enterprise Technology Command, or NETCOM, and the IRS.

We have expanded our EA offering to include capital planning and portfolio management. We use information technology, or IT, investment and governance processes to help federal agencies better manage their portfolio of IT projects and programs while reducing risks and lowering costs. We also work with best-of-breed vendors to deliver total solutions that address agencies mission objectives and help them to comprehensively inventory, evaluate, and track programs and investments for better management.

*Identity Management.* Homeland Security Presidential Directive-12, or HSPD-12, establishes a mandatory, government-wide standard for secure, reliable forms of identification issued by the federal government to its employees and contractors. Government agencies, with an increased need to know who they employ, contract with, and grant access to their physical and IT assets, need identity management expertise to provide the security and standardization to meet HSPD-12.

We provide services across every phase of the identity management life cycle, from registration and badge issuance to synchronizing and publishing data that allow government employees and contractors physical access to facilities and logical access to computer resources. We combine our years of experience in providing public key-enabled applications, smart card technology, and directory technologies with proven processes, techniques, and methodologies to address the privacy, security, technology, and program and change management issues facing our clients. These clients include the Departments of Defense, Health and Human Services, and Justice; the EPA; and the Federal Deposit Insurance Corporation, or FDIC.

*Information Assurance.* Our comprehensive program helps clients meet current and evolving risks that include cyber-security and cyber-terrorist thieves, natural disasters, internal and external threats, and physical attacks. We provide services that include security planning and engineering, threat and vulnerability analysis, systems certification and accreditation, regulatory compliance, penetration testing, intrusion detection and response system support, IT contingency (business continuity, backup and recovery) planning, incident response and forensic services, and security awareness training program support. Our extensive experience with all aspects of information assurance is a result of ongoing engagements with the Departments of Commerce, Defense, Justice, Health and Human Services, Homeland Security, and the Treasury; the EPA; the FDIC; GAO; the Securities and Exchange Commission; and the United States Agency for International Development, or USAID.

*Information Sharing and Management.* To meet homeland security mandates and exploit the potential of the Internet for real-time analysis and decision-making, federal agencies need to develop and improve secure, efficient information sharing solutions. We provide strategic advice on information sharing and we use our text and data mining, privacy, security, and identity management expertise to design solutions to meet client needs.

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We also provide knowledge management services and solutions to ensure that agencies can effectively access, capture, manage, use, and share enterprise knowledge to maximize communication and productivity. We integrate commercial off-the-shelf, or COTS, and custom applications to increase organizational knowledge

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flow. We perform knowledge audits, portal design and configuration, usability analysis, taxonomy and metadata services, and enterprise information management governance and architectures (including access, content, document, and records management) to enhance information sharing across systems and organizations. We have also developed an enterprise content management policy and approach for the U.S. Navy; and we have designed and deployed COTS information portals for Department of Defense's Defense Information Systems Agency and Missile Defense Agency, and the Department of Veterans Affairs.

*Outsourcing, Managed Services, and Infrastructure Management.* Our outsourcing and managed services solutions help clients consolidate and modernize their existing infrastructures, improve customer service, and reduce their total cost of operations through the effective use of industry best practices and performance-based contracting methods. We support our clients with operations management services and may oversee their technical infrastructures, manage their applications and networks, or operate their entire business processes in accordance with service-level agreements. We provide these services for the Health Resources and Services Administration, for whom we maintain and operate the National Practitioner Data Bank; and the National Guard Bureau, for whom we operate and manage the Army National Guard enterprise network that supports over 80,000 users. Our clients also include the FDIC, GAO, and USAID.

We deliver infrastructure management solutions including enterprise systems management to support our clients' critical business operations and missions. We help them to successfully reduce the costs and complexity of managing their large, geographically disparate IT infrastructures by aligning infrastructure and application performance measures with business performance measures to support their strategic visions, enterprise architectures, and governance planning. We enable them to obtain the most value from their existing information and knowledge assets and to quickly, efficiently, and securely transfer information through network design, implementation, and migration; systems and database administration; proactive monitoring for network performance and availability; enterprise backup and recovery; and video and data network consolidation.

Our solutions are consistent with the full spectrum of IT Infrastructure Library standards-based processes, such as incident and problem management, change management, release management, service-level management, capacity and availability management, and continuity and configuration management. We integrate our well-developed IT service management methodology with our CMMI Level 3 processes to ensure that we give our clients consistent, high-quality services to manage their infrastructures.

*Privacy Protection.* While the increasing maturity of data mining, data warehousing, and identification technologies and management systems (including radio frequency identification and biometrics) has resulted in enhanced business capabilities, it has also increased the potential for new privacy-related issues. Our privacy protection program helps clients ensure the protection of personal data gathered by systems, ensure that privacy protections are integrated with security throughout planning and operation of IT systems, and enhance privacy risk mitigation through proactive approaches. Our Privacy Information Life Cycle Assessment Road Map (PILLAR<sup>®</sup>) offers an innovative approach to integrate privacy and security into the system development life cycle. We also offer privacy training for personnel, develop privacy impact assessments, help integrate privacy policy across an organization, and deliver strategic consulting on business processes that support privacy.

We currently work with DHS's Chief Privacy Officer to assist with the integration of privacy policy across the Department and offer strategic consulting on business processes that support privacy assurance. As a member of the Smart Border Alliance team led by Accenture, we have the lead responsibility in providing privacy services. We also work with the Department of Health and Human Services and the IRS to determine appropriate measures to safeguard personal identification information and comply with federal privacy requirements.

*Training, Modeling, and Simulation.* From custom tools to integration of commercial systems, our training services and solutions are designed to enhance workforce performance at any level. Our capability ranges from a total integrated training and education solution to simple stand-alone CD-ROM solutions. In all cases, our solutions emphasize using highly interactive, engaging, learn-by-doing techniques. We are skilled practitioners of the Instructional System Design, or ISD, process and apply our systematic ISD development approach to



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curriculum, computer- or Web-based distance learning, and e-learning solutions. Coupled with our rigorous software engineering practice, we provide full life cycle services for implementing learning management systems and integrating the systems with legacy or COTS products.

In fiscal year 2006 we supported the U.S. Army's Communications-Electronics Command Rapid Response Program by developing a state-of-the-art training system that gives combat soldiers the ability to apply knowledge gained during training in real-life situations. We also provided the Defense Threat Reduction Agency with knowledge management, training, and reachback support systems to enable them to deliver the benefit of over 50 years of experience to the warfighter. The systems include the Center for Special Weapons Effects, Nuclear, Biological, and Chemical Threats, Technology Transfer and Resources portal; the Joint Science and Technology Office, or JSTO, portal; a document management system that facilitates collaboration for more than 2,000 JSTO users; and software development and maintenance for the Inspection Planning Module application in support of arms treaty verification.

*Wireless Integration Services.* Our wireless integration services, which include full life cycle consulting and security planning, enterprise deployment and integration, and application development, enable our clients to expand their infrastructures to the wireless enterprise cost-effectively, making information more accessible while providing essential portability, flexibility, security, and reliability.

In fiscal year 2006, we were chosen to develop and deploy wireless solutions for the Missile Defense Agency. We are enhancing the mobile communications capabilities of personnel in multiple locations through implementation of state-of-the-art wireless solutions. For USAID, we are creating wireless infrastructures to support government officials. By deploying wireless technology and Voice over Internet Protocol, or VoIP, solutions, we have assisted in transforming the communications process of the NIH Clinical Center environment, enabling location-based services to ensure proper patient escort while also protecting patients' privacy and security.

## **TARGET MARKETS**

We deliver our technology and strategic consulting services and solutions primarily to federal government clients within three target markets:

national security, which consists of two components:

command and control, communications, computers, intelligence, surveillance, and reconnaissance, or C4ISR, and

information systems for the Department of Defense;

civil government; and

health care and public health.

We also provide technology and strategic consulting services and solutions to a few commercial clients.

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The following is a summary of our business in each of our markets:

<b>Market</b>	<b>Total Revenue</b>		<b>Contract</b>
	<b>Fiscal year ended June 30, 2006</b>	<b>Fiscal year ended June 30, 2005</b>	<b>Backlog as of June 30, 2006</b>
		(in millions)	
National security	\$ 697.2	\$ 528.4	\$ 1,861.3
Civil government	374.5	262.7	1,110.1
Health care and public health	100.0	85.6	280.3
Commercial	7.6	5.1	9.9
<b>Total</b>	<b>\$ 1,179.3</b>	<b>\$ 881.8</b>	<b>\$ 3,261.6</b>

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### ***National Security***

We view the national security market as consisting of two distinct components: C4ISR and defense information systems.

*Command and Control, Communications, Computers, Intelligence, Surveillance, and Reconnaissance.* We apply advanced technology and management science to support national security, law enforcement, and intelligence agencies and organizations. The broad range of services we provide for clients in the Departments of Defense and Homeland Security include program management; research, systems analysis, and engineering; intelligence, surveillance, and reconnaissance; and counterintelligence, counterterrorism, and law enforcement.

We have extensive experience designing and engineering integrated information systems and facilities, or command centers, that help ensure secure, redundant, and survivable communications to monitor status, assess alternatives, and execute plans. As part of the General Dynamics Information Technology team, we continued this support to the Department of Defense by providing project management, network engineering, systems integration, briefing and display systems design and implementation, and transition planning for the National Military Command Center, the NMCC Service Watch Cells for the four military services, and the combined services Resource Situation Awareness Center.

We provide concept development, design, systems engineering, modeling and simulation, and long-range acquisition planning of tactical command, control and communications systems for the Department of Defense, as well as for allied and coalition nations. The programs we support include the Joint Tactical Radio System, Link 16, Link 22, Joint Range Extension, Weapons Data Link Networking Advanced Concept Technology Demonstration, and the Flexible Access Secure Transfer Link 16 networking enhancements initiative.

The Knowledge and Information Management System we are developing for the Office of the Deputy Undersecretary of Defense (Advanced Systems and Concepts) provides a Web-based capability to track, collaborate, report, and assimilate data and information and supports business process automation. The system was developed by integrating commercial off-the-shelf products and uses a relational database management system.

We are a member of the Smart Border Alliance team led by Accenture. As a major subcontractor to Accenture, we have lead responsibility in providing privacy, performance engineering, continuity of operations and risk assessments, biometric data management, and information assurance and IT security services.

Under a new contract awarded in fiscal year 2006, we deliver a range of technical services for researching and analyzing the Air Force Distributed Command Ground System, or DCGS, weapon system and other ISR systems. Our services include program management, systems analysis and engineering support for ISR airborne and ground systems, and communications engineering for the DCGS.

We apply advanced technology to help clients across the U.S. intelligence community collect, analyze, and disseminate critical, time-sensitive information, including geospatial data. We provide solutions in foreign language text understanding, information extraction, data mining, enterprise architecture, decision support, systems integration management, high-performance computing, network engineering, information sharing, and information assurance. Our intelligence analysis capability uses our text mining and Web-based technologies to explore massive amounts of domain information and data available in classified and unclassified environments.



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Our services and solutions for the law enforcement community focus on automated products, systems for investigative analysis, analytical tools, technical and analytical on-site support, and interactive training development and presentation. For example, our GangNet® database system is used in states across the U.S.; by the Bureau of Alcohol, Tobacco, Firearms and Explosives; the Department of Homeland Security's Immigration and Customs Enforcement; and the FBI; and is used in Canada to identify, locate, and apprehend gang members engaged in a variety of crimes. GangNet can also be used to track illicit groups, outlaw motorcycle gangs, and other criminal organizations.

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*Defense Information Systems.* We play a major role in the Defense Department's transformation to a network-centric warfare environment that uses information as an asset and develops the fighting force for the 21<sup>st</sup> century. Our clients across the Department of Defense include the Office of the Secretary of Defense, the defense agencies, the Joint Chiefs of Staff organizations, the three military departments, the four military services, and the command structure. We are recognized for designing, developing, integrating, and implementing large, complex information systems. We also have expertise in logistics, transportation, acquisition, personnel, finance, and installation management.

Under a new contract awarded in fiscal year 2006, we provide logistics support services to the U.S. Army to enhance unit readiness. We deliver management, consulting, and technical services to support the Army Forces Command Contract Maintenance Facility for the 101<sup>st</sup> Airborne Division at Fort Campbell, Kentucky, and other locations. We maintain a key satellite communications system that enables personnel to relay information rapidly within a theatre of operation and a secure wireless local area network that enhances connectivity between combat service support systems and a base network.

We are the single systems integrator providing enterprise-wide technology services to the Army's reserve components, the Army National Guard, or ARNG, and the U.S. Army Reserve to support the Reserve Component Automation System, or RCAS. Our team maintains the RCAS, which integrates state and local networks, computers, and software applications supporting the Reserve Component; and fielding and support of the ARNG Distributive Training Technology Project, a nationwide network of 355 distributed training centers. We also used video tele-training to deliver applications training to teach soldiers how to use mobilization, planning, safety, and occupational health software. This year, we completed major upgrades to the ARNG storage area network infrastructure, enhancing continuity of operations and disaster recovery capabilities. The VoIP implementation we are leading will combine Army Reserve data and voice networks.

We operate and maintain the enterprise operations center for GuardNet XXI, a nationwide communications structure that serves as the communication channel for voice, video, and data between the Department of the Army and the 54 states, U.S. territories, and the District of Columbia. The 24x7x365 services we deliver include network security, enterprise directory services, e-mail systems, video operations, and engineering support. Our team operates and manages the ARNG wide-area network that consistently exceeds 99.8% availability for both data and video network services and manages a centralized help desk that receives, routes, and quickly resolves all information technology support requests from 80,000 users. Our support after the 2005 Gulf Coast hurricanes helped reestablish critical network connectivity in affected areas and enabled key leaders from the National Guard Bureau to communicate with other government officials via video teleconferencing.

The Defense Manpower Data Center, or DMDC, maintains Department of Defense's archive of personnel, manpower, training, security, and financial data and provides real-time electronic authentication and verification for Department of Defense personnel identification. For over twenty years, we have supported DMDC programs and systems including the TRICARE National Enrollment System, Defense Cross-Credentialing and Identification System, Defense Biometric Identification System, and Common Access Card that are vital to security and allow and maintain authorized access to Department of Defense medical and other benefits. We received a new contract to continue to support these and other DMDC programs with enterprise architecture, database design, software development services, and research on smart card related issues. Using biometric and software technologies, we help DMDC realize cost savings and enhance personnel security and benefit authorization processes.

The enterprise-wide network management and custom and commercial applications we provide to the Puget Sound Naval Shipyard, or PSNS, support thousands of users worldwide. Our services include network engineering and operations, database engineering, systems security, and project management. This year we developed new security policies and procedures, conducted security training and education, provided on-site network infrastructure support at a remote site in Japan, and continued to manage the acquisition of IT equipment to help PSNS control costs and enhance user support.

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### ***Civil Government and Health Care and Public Health***

We help clients in civil agencies develop and implement strategies and use advanced technology to enable operational efficiencies and delivery of service-oriented solutions to citizens. Our clients include the Departments of Agriculture, Commerce, Justice, Labor, Transportation, the Treasury, and Veterans Affairs; the Environmental Protection Agency; the Federal Deposit Insurance Corporation; the Government Accountability Office; the Library of Congress; the National Archives and Records Administration; the U.S. Agency for International Development; and the Department of Health and Human Services including such agencies as the National Institutes of Health and the Food and Drug Administration.

The 24x7 enterprise-wide information technology infrastructure management services we provide to FDIC support approximately 7,000 users at 94 field offices nationwide. Our team delivers program management; client and help desk support; data center and local-area network operations; information security operations; systems and telecommunications engineering and integration support; and hardware/software procurement, distribution, and maintenance. In fiscal year 2006, we assisted FDIC with the design and launch of a new dedicated disaster recovery data center and supported multiple upgrades to its IT infrastructure, improving the selection and availability of office automation tools and wireless and remote access for end users. The Capability Maturity Model processes we implemented helped improve management visibility and control over the infrastructure, and storage area networks we established increased data storage capacity.

The Small Business Administration, or SBA, plays a major role in the government's disaster relief efforts by making low-interest recovery loans to both homeowners and businesses. Since 2002, we have worked with the Office of Disaster Assistance to develop a disaster credit management system (DCMS), a Web-enabled electronic loan application processing system to accelerate the loan-making process. This year we worked with the SBA to successfully scale the system to meet increased loan processing activity created by the 2005 hurricane disasters. The system processed over 400,000 recovery loan applications for victims and helped accelerate the direct-loan making process for over \$9 billion in approved loans. We received a contract award to continue to upgrade the system by implementing software changes and hardware upgrades, maintaining software and hardware architecture, updating system documentation, providing ongoing support to users, and supporting all IT operations associated with the system.

We deliver IT services and solutions across the Department of Justice, or DOJ. We work with the Office of Justice Programs, or OJP, to provide systems development, maintenance, and integration services for its critical grants management system. This system automates the application and approval process for the federal funds OJP grants to state, local, and private organizations. In fiscal year 2006, we were awarded a new task order to design and implement a DOJ-wide enterprise directory and messaging solution that will enable public-key infrastructure deployment and compliance with government identity management mandates.

We received a new contract this year to continue to deliver enterprise messaging and IT infrastructure support services to NIH's Center for Information Technology. We develop, maintain, and upgrade IT systems that over 40,000 users rely on for scientific, administrative, and other business applications. Our services include systems engineering, operation and maintenance, software development, systems security, and evaluation and deployment of emerging technologies in wireless applications.

EPA's Brownfields Program empowers states, local governments, communities, and other participants in community revitalization to work together to prevent, assess, safely clean up, and sustainably reuse brownfields' real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant. We apply industry best practices in legislation and policy analysis, technical research and analytical support, program planning, communications and outreach, and facilitation to help EPA effectively manage the program. Under our Brownfields Analytical and Technical Support contract, we worked on a pilot assessment of land use and reuse data to develop program baselines and help identify appropriate cross-program measures. We also assisted EPA and its federal partners with two new initiatives to better facilitate the cleanup and revitalization of contaminated



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lands from mining and port operations. The extensive research and analysis we provided on a variety of brownfields and community revitalization projects, from state and tribal programs to best practices for petroleum properties, resulted in the development of new and revised guidance and policies, communications materials, and technical assistance tools.

We develop and support key eGovernment systems for the Pension Benefit Guaranty Corporation, or PBGC, responsible for protecting the pensions of over 44 million American workers and retirees in more than 30,000 private-sector defined benefit pension plans. We enhanced two systems that enable customers to conduct business transactions in a secure online environment, added new features to an e-filing system that enables companies to submit financial information online, and developed and launched the redesigned PBGC Web site ([www.pbgc.gov](http://www.pbgc.gov)).

**EXISTING CONTRACT PROFILE**

*Contract Types.* As of June 30, 2006 we had over 900 active contract engagements, each employing one of three types of price structures: cost-plus-fee, time-and-materials, and fixed-price.

*Cost-plus-fee contracts.* Cost-plus-fee contracts provide for reimbursement of allowable costs and the payment of a fee, which is our profit. Cost-plus-fixed-fee contracts specify the contract fee in dollars. Cost-plus-award-fee contracts may provide for a base fee amount plus an award fee that varies, within specified limits, based upon the client's assessment of our performance as compared to contractual targets for factors such as cost, quality, schedule, and performance.

*Time-and-materials contracts.* Under a time-and-materials contract, we are paid a fixed hourly rate for each direct labor hour expended and we are reimbursed for allowable material costs and out-of-pocket expenses. To the extent our actual direct labor and associated costs vary in relation to the fixed hourly billing rates among various labor categories provided in the contract, we will generate more or less profit or could incur a loss.

*Fixed-price contracts.* Under a fixed-price contract, we agree to perform the specified work for a pre-determined price. To the extent our actual costs vary from the estimates upon which the price was negotiated, we will generate more or less than the anticipated amount of profit or could incur a loss. Some fixed-price contracts have a performance-based component, pursuant to which we can earn incentive payments or incur financial penalties based on our performance. We generally do not undertake complex, high-risk work under fixed-price terms.

Our historical contract mix, measured as a percentage of total revenue for the periods indicated, is summarized in the table below.

	Year Ended June 30,		
	2006	2005	2004
Cost-plus-fee	45%	46%	44%
Time-and-materials	40	34	38
Fixed-price	15	20	18

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*Government Wide Acquisition Contracts and GSA Schedule Contracts.* We are a leading supplier of technology and strategic consulting services and solutions to federal government clients under GWACs and are currently a prime contractor on three of the four largest information technology services GWACs, measured by the aggregate dollar amount of delivery order awards as of June 30, 2006. We also hold five GSA schedule contracts: Schedule 70, MOBIS, Environmental Advisory Services, Professional Engineering Services, and Logistics Worldwide. Despite recent reorganization challenges at GSA, GWACs and GSA schedule contracts remain popular contract award methods, offering flexible, cost-effective, and rapid procurement processes.

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The following table sets forth our GSA schedule contracts and the GWAC contracts on which we currently act as a prime contractor. The period of performance indicated below includes all option years.

<b>Contract name</b>	<b>Host agency</b>	<b>Period of performance</b>	<b>Contract ceiling value</b>
			(in billions)
CIO-SP2i	NIH	December 2000 - December 2010	\$ 20.0
Millennia	GSA FAS	April 1999 - April 2009	25.0
Millennia Lite	GSA FAS	June 2000 - June 2010	20.0
GSA Schedule 70	GSA FAS	May 1997 - May 2007	No ceiling
GSA MOBIS	GSA FAS	June 1998 - September 2007	No ceiling
GSA EAS	GSA FAS	September 1999 - August 2009	No ceiling
GSA PES	GSA FAS	October 2000 - October 2010	No ceiling
GSA LOGWORLD	GSA FAS	August 2004 - August 2009	No ceiling

Revenue under our GWAC and GSA schedule contracts accounted for 59% of our total federal government revenue in fiscal year 2006, 60% in fiscal year 2005 and 64% in fiscal year 2004.

The GSA intends to combine two of its large GWACs, Millennia and ANSWER, and other specialized contracts under a new Alliant contract to be competitively awarded. We expect the GSA to award the new Alliant contract in 2007. However, task orders on the Millennia contract may be extended for up to five years beyond April 2009, the current end date for its period of performance.

**BACKLOG**

As of June 30, 2006, our backlog was approximately \$3.3 billion, of which \$512.8 million was funded. As of June 30, 2005, our backlog was over \$2.7 billion, of which \$453.2 million was funded. We currently expect to recognize revenue during fiscal year 2007 from approximately 21% of our total backlog as of June 30, 2006. Our backlog includes orders under contracts that in some cases extend for several years, with the latest expiring at the end of calendar year 2016.

We define backlog to include funded and unfunded orders for services under existing signed contracts, assuming the exercise of all options relating to those contracts, less the amount of revenue we have previously recognized under those contracts. Backlog includes all contract options that have been priced but not yet funded. Backlog also includes the contract value under single award ID/IQ contracts against which we expect future task orders to be issued without competition. Backlog does not take contract ceiling value into consideration under multiple award contracts, nor does it include any estimate of future potential delivery orders that might be awarded under multiple award ID/IQ vehicles, GWAC contracts, or GSA schedules. We define funded backlog to be the portion of backlog for which funding currently is appropriated and obligated to us under a contract or other authorization for payment signed by an authorized purchasing authority.

We cannot guarantee that we will recognize any revenue from our backlog. Further, our estimate of the portion of the backlog as of June 30, 2006 from which we expect to recognize revenue during fiscal year 2007 is likely to be inaccurate because the receipt and timing of any revenue is subject to various contingencies, many of which are beyond our control. In addition, we may never realize revenue from some of the engagements that are included in our backlog, and there is a higher degree of risk in this regard with respect to unfunded backlog. The federal government has the prerogative to cancel any contract or delivery order at any time. However, most of our contracts and delivery orders have cancellation terms that would permit us to recover all or a portion of our incurred costs and potential fees in such cases.

**SUBCONTRACTORS**

When we act as a prime contractor, we derive revenue primarily through our own direct labor services, but also through the efforts of our subcontractors. As part of the contract bidding process, we may enter into teaming agreements with subcontractors to enhance our ability to bid on large, complex engagements or to more



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completely address a particular client's requirements. Teaming agreements and subcontracting relationships are useful because they permit us as a prime contractor to compete more effectively on a wider range of projects. In addition, we may engage a subcontractor to perform a discrete task on a project, or a subcontractor may approach us because of our position as a prime contractor. When we are a prime contractor on an engagement, we are ultimately responsible for the overall engagement as well as the performance of our subcontractors. Revenue derived from work performed by our subcontractors represented approximately 30%, 32%, and 30% of our revenue for fiscal years 2006, 2005, and 2004, respectively. No single subcontractor performed work that accounted for more than 5% of our revenue during any of the last three fiscal years.

## **APPLIED RESEARCH AND DEVELOPMENT AND INTELLECTUAL PROPERTY**

We are dedicated to giving our clients the innovative solutions they need to meet their most difficult technology challenges, both now and in the future. Our research and development, or R&D, team works with professionals across the company to assess client needs and ensure that our investments focus on meeting them.

For over twenty-five years, we have pursued internally- and government-funded R&D in such areas as data mining, natural language understanding, knowledge management, information assurance, and wireless applications. We continue to use our domain expertise and advanced technical knowledge to anticipate, identify, and develop forward-looking technologies to enable clients to meet their mission objectives.

We rely upon a combination of nondisclosure and other contractual arrangements and copyright, trademark, patent, and trade secret laws to protect our proprietary rights. We also enter into confidentiality and intellectual property agreements with all of our employees that require them to disclose any inventions created during employment, that convey all rights to inventions to us, and that restrict the distribution of proprietary information.

## **CLIENTS**

Our federal government clients typically exercise independent contracting authority, and even offices or divisions within an agency or department may directly, or through a prime contractor, use our services as a separate client so long as that client has independent decision-making and contracting authority within its organization. We consider each office or division within an agency or department, which engages us directly or through a prime contractor, to be a separate client. The National Guard, as a client group, accounted for approximately 10%, 11%, and 13% of our revenue in fiscal years 2006, 2005, and 2004, respectively. The United States Agency for International Development, as a client, accounted for approximately 10%, 12%, and 10% of our revenue in fiscal years 2006, 2005, and 2004, respectively. No other client or client group accounted for more than 10% of our revenue in any of the last three fiscal years.

In our fiscal year ended June 30, 2006, federal government clients accounted for 99% of our revenue, with less than 1% attributable to commercial clients. In our fiscal year ended June 30, 2006, we derived approximately 59% of our revenue from national security clients, approximately 32% from civilian agencies and departments, approximately 9% from health care and public health clients, and less than 1% from commercial clients. We currently support 14 of the 15 federal departments in the executive branch, all branches of the military services, and the judicial and legislative branches of the federal government.

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The following table sets forth some of our current clients for each of our federal government businesses.

**Selected current federal government clients**

<b>National security</b>	<b>Civil government</b>	<b>Health care and public health</b>
Department of Defense:	Department of the Treasury:	Department of Health and Human Services:
Department of the Army	Internal Revenue Service	Office of the Secretary
Department of the Navy	Department of Education	National Institutes of Health
Department of the Air Force	Department of Energy	Food and Drug Administration
U.S. Army Reserves	Department of Justice	Centers for Disease Control and Prevention
U.S. Marine Corps	Department of the Interior	Health Resources and Services Administration
Joint Chiefs of Staff	Department of Labor	Administration for Children and Families
U.S. Transportation Command	Department of State	Centers for Medicare & Medicaid Services
Air Mobility Command	Department of Commerce	Department of Defense:
Military Sealift Command	Department of Veterans Affairs	Assistant Secretary of Defense for Health Affairs
Surface Deployment and Distribution Command	Department of Transportation:	Army Medical Command
U.S. Army Forces Command	Federal Aviation Administration	Office of the Army Surgeon General
Office of the Secretary of Defense	Department of Agriculture	
Defense Manpower Data Center	U.S. Agency for International Development	
Defense Advanced Research Projects Agency	Environmental Protection Agency	
Defense Logistics Agency	Small Business Administration	
Defense Information Systems Agency	National Archives and Records Administration	
National Guard Bureau	Library of Congress	
Various intelligence agencies	General Services Administration	
Department of Homeland Security	Government Accountability Office	
Defense Threat Reduction Agency	Administrative Office of the U.S. Courts	
	Pension Benefit Guaranty Corporation	

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National Aeronautics and Space  
Administration

Office of Personnel Management

Federal Deposit Insurance Corporation

Securities and Exchange Commission

Executive Office of the President

Office of Management and Budget

US Nuclear Regulatory Commission

### **SALES AND MARKETING**

We have a highly disciplined sales and marketing process that relies upon the business units addressing each of our target markets to further penetrate and build-out their existing accounts and our centralized federal sales and marketing organization to win new competitive procurements. Primary responsibility for selling additional services to existing clients, including client account build-out and capture of follow-on work, rests with our business units. Recognizing the importance of client account management, we assign entrepreneurial managers and executives to oversee our major accounts.

Primary responsibility for identifying, qualifying, bidding, and winning new competitive procurements, either for new clients or for large strategic new programs within existing clients, rests with our centralized federal sales and marketing organization. We have approximately 70 experienced sales and marketing professionals that perform business development, task order sales, corporate communications, market research, pricing, and proposal development. Members of our sales and marketing organization work closely with their counterparts in our business units as we compete to win new business.

### **COMPETITION**

We compete to win single award contracts and multiple award contracts, such as agency-specific indefinite delivery/indefinite quantity, GWACs, and GSA schedule contracts. After we have won a multiple award contract, we then compete for individual delivery orders under the contract. For example, GSA schedule contracts and

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prime contractor positions on GWACs are typically awarded to multiple contractors. A multiple award contract will list both the providers and the labor categories of products and services that can be performed under the contract. An individual agency that desires to obtain a service typically invites approved providers to compete based on technological expertise, resources, price, or some other basis.

We encounter many of the same competitors in each of our three target markets. These competitors include:

Federal systems integrators such as BoozAllen & Hamilton Inc., CACI International Inc., Computer Sciences Corporation, Electronic Data Systems Corporation, ManTech International Corporation, Science Applications International Corporation, and Unisys Corporation;

Divisions of large defense contractors such as General Dynamics Corporation, Lockheed Martin Corporation, Northrop Grumman Corporation, and Raytheon Company;

Consulting firms such as Accenture Ltd., BearingPoint, Inc., and International Business Machines Corporation; and

Other smaller and specialized government information technology contractors.

## **EMPLOYEES AND CORPORATE CULTURE**

Our success as a technology and strategic consulting services and solutions company is highly dependent on our employees. We believe we have been successful in developing a culture that enables our employees to succeed. We emphasize three essential attributes – an ethic of honesty and service, quality work and client satisfaction, and caring about our people. We reinforce these principles regularly in our recruiting process, training programs, proposals, company meetings, and internal communications. Our active recruiting effort is aligned with our strategic business units and relies heavily on employee referrals in addition to a variety of other recruiting methods. Our primary source of our new recruits is employee referrals, which accounted for approximately 47% of our new hires in fiscal 2006. We have found these referrals to be a reliable source of excellent employees. As a result of our continued focus on our employees, in 2006 we were named by *FORTUNE* magazine as one of the 100 Best Companies to Work for for the seventh consecutive year.

As of June 30, 2006, we had over 4,900 employees. Over half of our employees have federal government security clearances. Approximately 96% of our employees are professionals or managers with technology or domain expertise, and approximately 4% are administrative managers or support specialists. Our professional staff is highly educated, with approximately one-third holding advanced degrees. We have no employees represented by collective bargaining agreements, and we consider our relations with our employees to be good.

## **CORPORATE INFORMATION**

We were incorporated as Systems Research and Applications Corporation in Virginia in 1976 and began operations in 1978. We reincorporated in Delaware as SRA International, Inc. in 1984. We generally contract with the federal government through our wholly-owned subsidiary, Systems Research and Application Corporation, but we do business as SRA International, Inc.

**WEBSITE ACCESS TO SEC REPORTS**

Our Internet website can be found at <http://www.sra.com>. Information contained on our Internet website is not part of this report. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the Section 16 filings of our officers, directors, and shareholders beneficially owning 10% or more of our common stock are available on our website, free of charge, as soon as reasonably practicable after such reports are filed with or furnished to the SEC. Alternatively, you may access these reports at the SEC's Internet website: <http://www.sec.gov>.

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Our executive officers and their ages as of July 31, 2006, are as follows:

Name	Age	Title
Renato A. DiPentima	65	President and chief executive officer
Stephen C. Hughes	49	Executive vice president, chief financial officer and chief of finance and administration
David A. Kriegman	60	Executive vice president and chief operating officer
Barry S. Landew	47	Executive vice president for corporate development
Ernst Volgenau	72	Chairman of board of directors

**Renato A. DiPentima** has served as chief executive officer since January 2005, and as president since October 2003. From October 2003 to January 2005 he served as chief operating officer. He was senior vice president and president of our consulting and systems integration division since we formed it in January 2001. From July 1997 to January 2001, he served as president of our government sector, overseeing government business, projects, and contracts. From July 1995 to July 1997, Dr. DiPentima served as vice president and as our chief information officer. Prior to joining us, Dr. DiPentima held several senior management positions in the federal government, most recently serving as deputy commissioner for systems at the Social Security Administration, from May 1990 to June 1995.

**Stephen C. Hughes** is our executive vice president, chief financial officer and chief of finance and administration. He has served as our chief financial officer since March 1996 and became executive vice president in August 2005. From May 1993 to August 2005 he served as senior vice president of finance and accounting. From March 1989 to May 1993, he was our vice president of finance; from April 1986 to March 1989, he served as our comptroller; and from 1984 to 1986, he served as our manager of accounting. Mr. Hughes practiced in the computer audit and tax groups of Coopers and Lybrand, which is now a part of PricewaterhouseCoopers LLP, from 1983 to 1984.

**David A. Kriegman** is our executive vice president and chief operating officer. Prior to assuming the chief operating officer position, he was senior vice president and director of our Defense Sector. From 1991 to 1995, he served as the deputy director of our Software Development Group. Since he joined SRA in 1983, Mr. Kriegman has served in various leadership positions with us, including project manager for several major system and software development projects.

**Barry S. Landew** is our executive vice president for corporate development. He has served as our vice president for corporate development from 1989 through April 1993 and became executive vice president in August 2005. In April 2000, Mr. Landew was also named president of SRA Ventures where he led efforts to develop our intellectual property, including creating new companies targeted at commercial markets. From 1980 to 1989, he served in various positions with us, including software engineer, program manager, and the head of our proposal development unit.

**Ernst Volgenau** is our founder and has served as our chairman of the Board of Directors since October 2003. He served as the Company's chief executive officer from October 2003 until December 2004. From 1978 to October 2003, he served as the Company's president and as a director. From 1976 to 1978, he served as the director of inspection and enforcement for the U.S. Nuclear Regulatory Commission. Dr. Volgenau retired from active duty with the U.S. Air Force as Colonel in 1976. His military service included positions in the Office of the Secretary of Defense and as director of data automation for the Air Force Logistics Command.



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### **Item 1A. RISK FACTORS**

#### **Risks Related To Our Business**

*We depend on contracts with U.S. federal government agencies for substantially all of our revenue, and if our relationships with these agencies were harmed, our business would be threatened.*

Revenue from contracts with U.S. federal government agencies accounted for 99% of our revenue for all periods presented herein. Revenue from contracts with clients in the Department of Defense and the National Guard accounted for 49%, 53%, and 59%, of our revenue for the fiscal years ended June 30, 2006, 2005, and 2004, respectively. We believe that federal government contracts will continue to be the source of substantially all of our revenue for the foreseeable future. For this reason, any issue that compromises our relationship with agencies of the federal government in general, or within the Department of Defense and the National Guard in particular would cause serious harm to our business.

Among the key factors in maintaining our relationships with federal government agencies and departments are our performance on individual contracts and delivery orders, the strength of our professional reputation, and the relationships of our senior management with client personnel. The relationships and reputation that many members of our senior management team have established and maintain with government personnel contribute to our ability to maintain good client relations and to identify new business opportunities. The loss of any member of our senior management could impair our ability to identify and secure new contracts, to maintain good client relations, and otherwise to manage our business. Additionally, to the extent that our performance does not meet client expectations, or our reputation with one or more key clients is impaired, our revenue and operating results could be materially harmed.

*We face intense competition from many competitors that have greater resources than we do, which could result in price reductions, reduced profitability, and loss of market share.*

We operate in highly competitive markets and generally encounter intense competition to win contracts. If we are unable to successfully compete for new business or win recompetitions of existing business, our revenue growth and operating margins may decline. Many of our competitors are larger and have greater financial, technical, marketing, and public relations resources, larger client bases, and greater brand or name recognition than we do. Larger competitors include federal systems integrators such as Computer Sciences Corporation and Science Applications International Corporation, divisions of large defense contractors such as General Dynamics Corporation, Lockheed Martin Corporation, and Northrop Grumman Corporation, and consulting firms such as Accenture Ltd. and BearingPoint, Inc. Our larger competitors may be able to compete more effectively for very large-scale government contracts. Our larger competitors also may be able to provide clients with different or greater capabilities or benefits than we can provide in areas such as technical qualifications, past performance on large-scale contracts, geographic presence, the ability to provide a broader range of services without creating conflicts of interest or intra-organizational conflicts of interest, price, and the availability of key professional personnel. Our competitors also have established or may establish relationships among themselves or with third parties, including through mergers and acquisitions, to increase their ability to address client needs. Accordingly, it is possible that new competitors or alliances among competitors may emerge.

*We derive significant revenue from contracts awarded through a competitive bidding process, which can impose substantial costs upon us, and we will lose revenue if we fail to compete effectively.*



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We derive significant revenue from federal government contracts that are awarded through a competitive bidding process. We expect that most of the government business we seek in the foreseeable future will be awarded through competitive bidding. Competitive bidding imposes substantial costs and presents a number of risks, including:

the need to bid on engagements in advance of knowing the complete design or full requirements, which may result in unforeseen difficulties in executing the engagement and cost overruns;

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the substantial cost and managerial time and effort that we spend to prepare bids and proposals for contracts that may not be awarded to us;

the need to accurately estimate the resources and costs that will be required to service any contract we are awarded;

the possibility that difficult market conditions will cause our competitors to strive for growth by reducing their bid pricing and compel us to choose between bidding at unprofitable levels or losing contracts and foregoing revenue;

the expense and delay that may arise if our competitors protest or challenge contract awards made to us pursuant to competitive bidding, and the risk that any such protest or challenge could result in the resubmission of bids on modified specifications, or in termination, reduction, or modification of the awarded contract; and

the opportunity cost of not bidding on and winning other contracts we might otherwise pursue.

To the extent we engage in competitive bidding and are unable to win particular contracts, we not only incur substantial costs in the bidding process that would negatively affect our operating results, but we may be precluded from operating in the market for services that are provided under those contracts for a number of years. Even if we win a particular contract through competitive bidding, our profit margins may be depressed as a result of the costs incurred through the bidding process.

***Loss of our General Services Administration, or GSA, schedule contracts or our position as a prime contractor on one or more of our government-wide acquisition contracts, or GWACs, or our other multiple-award contracts would impair our ability to win new business.***

We believe that one of the key elements of our success is our position as the holder of five GSA schedule contracts and as a prime contractor under three GWACs and more than 35 agency-specific ID/IQ contracts. For the fiscal years ended June 30, 2006, 2005, and 2004, revenue from GSA schedule contracts, GWACs, and other ID/IQ contracts accounted for approximately 76%, 77%, and 83%, respectively, of our revenue from federal government clients. If we were to lose our position on one or more of these contracts, we could lose revenue and our operating results could suffer.

The GSA intends to combine two of its large GWACs, Millennia and ANSWER, and other specialized contracts under a new Alliant contract to be competitively awarded. We expect the GSA to award the new Alliant contract in 2007. If we do not win a position as a prime contractor on the new Alliant contract, we could lose revenue and our operating results could suffer.

The Department of Defense issued guidance providing that procurements of services that are not performance-based or that are to be procured using a contract vehicle outside of the Department of Defense must be approved in advance. This could result in the Department of Defense limiting its future use of GWACs and GSA schedule contracts. Initiatives taken by the Department of Defense or other government agencies and departments, or the impact of the ongoing reorganization by the GSA, could cause services we provide on existing contracts to migrate to contract vehicles on which we are not a prime contractor. Should this occur, our ability to compete for business from these organizations in the future may be harmed.

Orders under GSA schedule contracts, GWACs, and other ID/IQ contracts typically have a one- or two-year initial term with multiple options that may be exercised by our government clients to extend the contract for successive periods of one or more years. We can provide no

assurance that our clients will exercise these options.

*If subcontractors on our prime contracts are able to secure positions as prime contractors, we may lose revenue.*

For each of the past several years we have received substantial revenue from government clients relating to work performed by other information technology providers acting as subcontractors to us. In some cases,

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companies that have not held GSA schedule contracts or secured positions as prime contractors on GWACs have approached us in our capacity as a prime contractor, seeking to perform services as our subcontractor for a government client. Some of these providers that are currently acting as subcontractors to us may in the future secure positions as prime contractors. If one or more of our current subcontractors are awarded prime contractor status in the future, it could reduce or eliminate our revenue for the work they were performing as subcontractors to us. Revenue derived from work performed by our subcontractors represented approximately 30%, 32%, and 30% of our revenue for the fiscal years ended June 30, 2006, 2005, and 2004, respectively.

***If our subcontractors fail to perform their contractual obligations, our performance and reputation as a prime contractor and our ability to obtain future business could suffer.***

As a prime contractor, we often rely significantly upon other companies as subcontractors to perform work we are obligated to deliver to our clients. Revenue derived from work performed by our subcontractors represented approximately 30%, 32%, and 30% of our revenue for the fiscal years ended June 30, 2006, 2005, and 2004, respectively. A failure by one or more of our subcontractors to satisfactorily perform the agreed-upon services on a timely basis may compromise our ability to perform our obligations as a prime contractor. In some cases, we have limited involvement in the work performed by the subcontractor and may have exposure as a result of problems caused by the subcontractor. In extreme cases, performance deficiencies on the part of our subcontractors could result in a government client terminating our contract for default. A default termination could expose us to liability for the agency's costs of re-procurement, damage our reputation, and hurt our ability to compete for future contracts. Additionally, we may have disputes with our subcontractors that could impair our ability to execute our contracts as required.

***Our quarterly operating results may fluctuate significantly as a result of factors outside of our control, which could cause the market price of our class A common stock to decline.***

Our revenue and operating results could vary significantly from quarter to quarter. In addition, we cannot predict with certainty our future revenue or results of operations. As a consequence, our operating results may fall below the expectations of securities analysts and investors, which could cause the price of our class A common stock to decline. Factors that may affect our operating results include:

fluctuations in revenue earned on contracts;

commencement, completion, or termination of contracts during any particular quarter;

variable purchasing patterns under GSA schedule contracts, GWACs, and agency-specific indefinite delivery/indefinite quantity contracts;

providing services under a share-in-savings or performance-based contract;

additions and departures of key personnel;

strategic decisions by us or our competitors, such as acquisitions, divestitures, spin-offs, joint ventures, strategic investments, or changes in business strategy;

timing of significant bid and proposal costs;

contract mix, the extent of use of subcontractors, and the level of third-party hardware and software purchases for customers;

changes in presidential administrations and senior federal government officials or their priorities that affect the timing of technology procurement;

changes in policy or budgetary measures that adversely affect government contracts in general;

interruption by events beyond our control such as earthquakes, power losses, telecommunications failures, hurricanes, and incidents of terrorism; and

the seasonality of our business.

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Reductions in revenue in a particular quarter could lead to lower profitability in that quarter because a relatively large amount of our expenses are fixed in the short-term. We may incur significant operating expenses during the start-up and early stages of large contracts and may not receive corresponding payments or revenue in that same quarter. We may also incur significant or unanticipated expenses when contracts expire, when they are terminated, or when they are not renewed. In addition, payments due to us from government agencies may be delayed due to billing cycles or as a result of failures of governmental budgets to gain Congressional and administration approval in a timely manner.

***If we fail to attract and retain skilled employees, we might not be able to staff recently awarded engagements and sustain our profit margins and revenue growth.***

We must continue to hire significant numbers of highly qualified individuals who have advanced information technology and technical services skills and who work well with our clients in a government environment. In some cases, they are required to have security clearances issued by the Department of Defense or other government agencies. These employees are in great demand and are likely to remain a limited resource for the foreseeable future. If we are unable to recruit and retain a sufficient number of these employees, our ability to staff recently awarded engagements and to maintain and grow our business could be limited. We are operating in a tight labor market and, if it continues to tighten, we could be required to engage larger numbers of subcontractor personnel, which could cause our profit margins to suffer. In addition, some of our contracts contain provisions requiring us to commit to staff an engagement with personnel the client considers key to our successful performance under the contract. In the event we are unable to provide these key personnel or acceptable substitutions, the client may terminate the contract, and we may not be able to recover our costs.

***We may lose revenue and our cash flow and profitability could be negatively affected if expenditures are incurred prior to final receipt of a contract or contract funding modification.***

We provide professional services and sometimes procure materials on behalf of our government clients under various contract arrangements. From time to time, in order to ensure that we satisfy our clients' delivery requirements and schedules, we may elect to initiate procurements or provide services in advance of receiving formal contractual authorization from the government client or a prime contractor. If our government or prime contractor requirements should change or the government directs the anticipated procurement to a contractor other than us, or if the materials become obsolete or require modification before we are under contract for the procurement, our investment might be at risk. If we do not receive the required funding, our cost of services incurred in excess of contractual funding may not be recoverable. This could reduce anticipated revenue or result in a loss, negatively affecting our cash flow and profitability.

***We may lose money on some contracts if we underestimate the resources we need to perform under the contract.***

We provide services to the federal government under three types of contracts: cost-plus-fee, time-and-materials, and fixed-price. For the year ended June 30, 2006, we derived 45%, 40%, and 15% of our revenue from cost-plus-fee, time-and-materials, and fixed-price contracts, respectively. Each of these types of contracts, to differing degrees, involves the risk that we could underestimate our cost of fulfilling the contract, which may reduce the profit we earn or lead to a financial loss on the contract.

Under cost-plus-fee contracts, which are subject to a ceiling amount, we are reimbursed for allowable costs and paid a fee, which may be fixed or performance-based. However, if our costs exceed the ceiling or are not allowable under the terms of the contract or applicable regulations, we may not be able to recover those costs.

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Under time-and-materials contracts, we are reimbursed for labor at negotiated hourly billing rates along with the cost of certain expenses, and we assume the risk that our costs of performance may exceed the negotiated hourly rates.

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Under fixed-price contracts, we perform specific tasks for a fixed price. Compared to cost-plus-fee contracts and time-and-materials contracts, fixed-price contracts involve greater financial risk due to the potential for cost overruns. To the extent our actual costs exceed the estimates upon which the price was negotiated, we will generate less than the anticipated amount of profit or could incur a loss.

For all three contract types, we bear varying degrees of risk associated with the assumptions we use to formulate our pricing for the work. To the extent our working assumptions prove inaccurate, we may lose money on the contract, which would adversely affect our operating results.

*We may lose money or incur financial penalties if we agree to provide services under a performance-based contract arrangement.*

Under certain performance-based contract arrangements, we are paid only to the extent our customer actually realizes savings or achieves some other performance-based improvements that result from our services. In addition, we may also incur certain penalties. Performance-based contracts could impose substantial costs and risks, including:

the need to accurately understand and estimate in advance the improved performance that might result from our services;

the lack of experience both we and our primary customers have in using this type of contract arrangement; and

the requirement that we incur significant expenses with no guarantee of recovering these expenses or realizing a profit in the future.

Even if we successfully execute a performance-based contract, our interim operating results and cash flows may be negatively affected by the fact that we may be required to incur significant up-front expenses prior to realizing any related revenue.

*Contracts with state and local governments, other governments, international entities, or other organizations with special standing, could impose substantial additional liability and costs upon us.*

As organizations seek to enhance their security, particularly state and local governments, other governments, international entities, and other organizations with special standing, such as the World Bank, we have the opportunity to expand our services beyond our core federal government client base. Contracting with such entities involves additional risks that may result in additional costs to us, including:

the additional costs associated with evaluating, qualifying, and negotiating such opportunities;

a requirement to understand and comply with the specific procurement laws and/or regulations of each individual state, locality, other government, international entity, or other party with special standing;

the contractual acceptance of liability provisions that impose, for example, liquidated damages or other monetary damages in excess of the amount of services we provide, and in some cases are unlimited;



the unavailability of certain protections that would typically be available under federal or common law; and

an increased risk of additional costs associated with dispute resolution.

***We may not be successful in identifying acquisition candidates and, if we undertake acquisitions, they could be expensive, increase our costs or liabilities, or disrupt our business. Additionally, if we are unable to successfully integrate companies we acquire, our revenue and operating results may be impaired.***

One of our strategies is to augment our organic growth through acquisitions. We have completed seven acquisitions of complementary companies that provide services in one of our three target markets. We may not be able to identify suitable acquisition candidates at prices that we consider appropriate or to finance acquisitions

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on terms that are satisfactory to us. Acquisitions of businesses or other material operations may require additional debt or equity financing, resulting in leverage or dilution of ownership. Additionally, negotiations of potential acquisitions and the integration of acquired business operations could disrupt our business by diverting management attention away from day-to-day operations. We also may not realize cost efficiencies or synergies that we anticipated when selecting our acquisition candidates. Acquired companies may have liabilities or adverse operating issues that we fail to discover through due diligence. Any costs, liabilities, or disruptions associated with future acquisitions could harm our operating results. In addition, following the integration of acquired companies, we may experience increased attrition, including but not limited to key employees of acquired companies, which could reduce our future revenue.

*Unfavorable government audit results could force us to adjust previously reported operating results and could subject us to a variety of penalties and sanctions.*

The federal government audits and reviews our performance on contracts, pricing practices, cost structure, and compliance with applicable laws, regulations, and standards. Like most large government contractors, our contracts are audited and reviewed on a continual basis by federal agencies, including the Defense Contract Management Agency, or DCMA and the Defense Contract Audit Agency, or DCAA. An audit of our work, including an audit of work performed by companies we have acquired or may acquire or subcontractors we have hired or may hire, could result in a substantial adjustment to our previously reported operating results.

DCAA issued audit guidance suggesting that a Federal Acquisition Regulation billing clause prohibits billing subcontractor or third-party consultant hours using the prime contract hourly rates under time-and-material contracts, stating that these hours must be billed at cost. This is contrary to previously issued instructions from many customers, and contrary to industry practice. If the DCAA were to prevail with this new interpretation, cash we have already collected may need to be refunded, which could materially reduce profits and revenue on time-and-material orders.

Audits for costs incurred on work performed after fiscal year 2004 have not yet been completed. In addition, non-audit reviews by the government may still be conducted on all our government contracts. If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. federal government agencies. In addition, we could suffer serious harm to our reputation if allegations of impropriety were made against us, whether or not true.

If we were suspended or debarred from contracting with the federal government generally, or any specific agency, if our reputation or relationship with government agencies were impaired, or if the government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenue and operating results would be materially harmed.

*If we experience systems, service, or product failure, our reputation could be harmed and our clients could assert claims against us for damages or refunds.*

We create, implement, and maintain information technology solutions, as well as sell products, that are often critical to our clients' operations, including operations in war-zones and other hazardous environments. We have experienced and may in the future experience some systems and service failures, schedule or delivery delays, and other problems in connection with our work. If our solutions, services, products, including third party products we may resell to our clients, or other applications have significant defects or errors, are subject to delivery delays, or fail to meet our clients' expectations, we may:

lose revenue due to adverse client reaction;

be required to provide additional services to a client at no charge;

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receive negative publicity, which could damage our reputation and adversely affect our ability to attract or retain clients; or

suffer claims for substantial damages against us.

In addition to any costs resulting from product or service warranties, contract performance, or required corrective action, these failures may result in increased costs or loss of revenue if clients postpone subsequently scheduled work or cancel or fail to renew contracts.

While many of our contracts limit our liability for consequential damages that may arise from negligence in rendering services to our clients, these contractual provisions may not be legally sufficient to protect us if we are sued. In addition, our errors and omissions and product liability insurance coverage may not continue to be available on reasonable terms or in sufficient amounts to cover one or more large claims, or the insurer may disclaim coverage as to some types of future claims. As we continue to grow and expand our business into new areas, our insurance coverage may not be adequate. The successful assertion of any large claim against us could seriously harm our business. Even if not successful, these claims could result in significant legal and other costs, may be a distraction to our management, and may harm our reputation.

*Our business commitments require our employees to travel to potentially dangerous places, which may result in injury to our employees.*

Our business involves providing services that require our employees to operate in various countries around the world, including Iraq. These countries may be experiencing political upheaval or unrest, and in some cases war or terrorism. Senior level employees or executives may, on occasion, be part of the teams deployed to provide services in these countries. As a result, it is possible that certain of our employees or executives will suffer injury or bodily harm in the course of these deployments. It is also possible that we will encounter unexpected costs in connection with additional risks inherent with sending our employees to dangerous locations, such as increased insurance costs, as well as the repatriation of our employees or executives for reasons beyond our control.

*Our employees may engage in misconduct or other improper activities, which could harm our business.*

We are exposed to the risk that employee fraud or other misconduct could occur. Misconduct by employees could include intentional failures to comply with federal government procurement regulations, engaging in unauthorized activities, seeking reimbursement for improper expenses or falsifying time records. Employee misconduct could also involve the improper use of our clients' sensitive or classified information, which could result in regulatory sanctions against us and serious harm to our reputation. It is not always possible to deter employee misconduct, and the precautions we take to prevent and detect this activity may not be effective in controlling unknown or unmanaged risks or losses, which could harm our business.

*Our failure to obtain and maintain necessary security clearances may limit our ability to perform classified work for government clients, which could cause us to lose business.*

Some government contracts require us to maintain facility security clearances and require some of our employees to maintain individual security clearances. We have seen a recent increase in the number of clients requiring special security clearances and the types of clearances required. If our employees lose or are unable to timely obtain security clearances, or we lose a facility clearance, the government client can terminate the contract or decide not to renew it upon its expiration. As a result, to the extent we cannot obtain the required security clearances for our

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employees working on a particular contract, or we fail to obtain them on a timely basis, we may not derive the revenue anticipated from the contract, which could harm our operating results.

*Security breaches in sensitive government systems could result in loss of clients and negative publicity.*

Many of the systems we develop, install, and maintain involve managing and protecting information used in intelligence, national security, and other sensitive or classified government functions. A security breach in one of

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these systems could cause serious harm to our business, damage our reputation, and prevent us from being eligible for further work on sensitive or classified systems for federal government clients. We could incur losses from such a security breach that could exceed the policy limits under our insurance. Damage to our reputation or limitations on our eligibility for additional work resulting from a security breach in one of our systems could materially reduce our revenue.

*We depend on our intellectual property and our failure to protect it could enable competitors to market products and services with similar features that may reduce demand for our products.*

Our success depends in part upon the internally developed technology, proprietary processes, and other intellectual property that we utilize to provide our services and incorporate in our products. If we are unable to protect our intellectual property, our competitors could market services or products similar to our services and products, which could reduce demand for our offerings. Federal government clients typically retain a perpetual, world-wide, royalty-free right to use the intellectual property we develop for them in any manner they deem appropriate, including providing it to our competitors in connection with their performance of other federal government contracts. We typically seek governmental authorization to re-use intellectual property developed for the federal government or to secure export authorization. Federal government clients typically grant contractors the right to commercialize software developed with federal funding. However, if we were to improperly use intellectual property even partially funded by the federal government, the federal government could seek damages or royalties from us, sanction us, or prevent us from working on future government contracts.

We may be unable to prevent unauthorized parties from attempting to copy or otherwise obtain and use our technology. Policing unauthorized use of our technology is difficult, and we may not be able to prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our intellectual property as fully as those in the United States. Others, including our employees, may compromise the trade secrets and other intellectual property that we own. Although we require our employees to execute non-disclosure and intellectual property assignment agreements and comply with related policies and procedures, these agreements may not be legally or practically sufficient to protect our rights. Litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets, and to determine the validity and scope of the proprietary rights of others. Any litigation could result in substantial costs and diversion of resources, with no assurance of success.

*We may be harmed by intellectual property infringement claims.*

We may become subject to claims from our employees or third parties who assert that software and other forms of intellectual property that we use in delivering services and business solutions to our clients infringe upon intellectual property rights of such employees or third parties. Our employees develop much of the software and other forms of intellectual property that we use to provide our services and business solutions to our clients, but we also license technology from other vendors. If our vendors, our employees, or third parties assert claims that we or our clients are infringing on their intellectual property, we could incur substantial costs to defend those claims. In addition, if any of these infringement claims are ultimately successful, we could be required to:

cease selling or using products or services that incorporate the challenged software or technology;

obtain a license or additional licenses from our vendors or other third parties; or

redesign our products and services that rely on the challenged software or technology.

*Activation of military and National Guard reserves could significantly reduce our revenue and profits.*

Activation of military reserves, in connection with international conflicts or otherwise, could result in some clients and client contracting staff being activated into the military services. This could delay contract awards that might be in the evaluation or award process, which could in turn reduce our revenue until such time as our clients are able to complete the evaluation and award process, or could even result in the loss of the potential contract award.

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As of June 30, 2006 we had approximately 200 employees who serve as reserves for a branch of the military or the National Guard. In the event of a significant call-up we will pay these employees the differential between their military pay and their salary for up to six months. Our standard practice in the absence of a significant call-up is to provide for up to two weeks of differential pay for military leave. To the extent those called for military duty are directly billable on our contracts, our revenue could be reduced. Additionally, our fringe benefit expenses would be increased by any differential payments, which could reduce our profits.

## **Risks Related To Our Industry**

*A reduction in the U.S. defense budget could result in a substantial decrease in our revenue.*

Revenue from contracts with clients in the Department of Defense and the National Guard accounted for 49%, 53%, and 59% of our revenue for the fiscal years ended June 30, 2006, 2005, and 2004, respectively. The growing federal deficit, among other factors, could result in a decline in overall U.S. military expenditures, or in the portion of those expenditures allocated to information technology services and solutions, which could decrease our revenue and profitability. The reduction in the U.S. defense budget during the early 1990s caused some defense-related government contractors to experience decreased sales, reduced operating margins and, in some cases, net losses. Defense spending levels may not continue at present levels, and future levels of expenditures and authorizations for existing programs may decline, remain constant, or shift to agencies or programs in areas where we do not currently have contracts. A significant decline in defense expenditures, or a shift in expenditures away from agencies or programs that we support, could cause a material decline in our revenue.

*A reduction in U.S. civil government agency budgets, including a reduction caused by the diversion of funding to support the war against terrorism, the reconstruction of Iraq, or natural disaster recovery, could result in a substantial decrease in our revenue.*

Revenue from contracts with civil agency clients accounted for 50%, 46%, and 40% of our revenue for the fiscal years ended June 30, 2006, 2005, and 2004, respectively. We expect civil agency clients will continue to represent a substantial portion of our future revenue. A decline in expenditures by civil agencies, or in the portion of those expenditures allocated to information technology services and solutions, could cause a material decrease in our revenue and profitability. In particular, a shift of funds away from civil agencies to pay for programs within other agencies, for example the Department of Defense, to reduce federal budget deficits, or to fund tax reductions, could cause a material decline in our revenue. In particular, it is possible that funding for civil agencies may be diverted to support the ongoing war against terrorism, the reconstruction of Iraq, natural disaster recovery, or other international conflicts.

*Changes in the spending policies or budget priorities of the federal government could cause us to lose revenue.*

We derived 99% of our revenue for all periods presented herein, from contracts with federal government agencies. We believe that contracts with federal government agencies and departments will continue to be the primary source of our revenue for the foreseeable future. Accordingly, changes in federal government fiscal or spending policies could directly affect our financial performance. Among the factors that could harm our federal government contracting business are:

the curtailment of the federal government's use of technology services firms;



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a significant decline in spending by the federal government in general, or by specific departments or agencies in particular;

a reduction in spending or shift of expenditures from existing programs to pay for an international conflict or related reconstruction efforts;

a failure of Congress to pass adequate supplemental appropriations to pay for an international conflict, or to pay for the cost of related reconstruction efforts;

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reductions in federal government programs or requirements;

the adoption of new laws or regulations that affect companies that provide services to the federal government;

delays in the payment of our invoices by government payment offices;

new legislation, procurement regulations, or union pressure that cause federal agencies to adopt restrictive procurement practices regarding the use of outside information technology providers;

changes in policy and goals by the government providing set aside funds to small businesses, disadvantaged businesses, and other socio-economic requirements in the allocation of contracts; and

general economic and political conditions.

These or other factors could cause federal government agencies and departments to reduce their purchases under contracts, to exercise their right to terminate contracts, or not to exercise options to renew contracts, any of which could cause us to lose revenue. We have substantial contracts in place with many federal departments and agencies, and our continued performance under these contracts, or award of additional contracts from these agencies, could be materially harmed by federal government spending reductions or budget cutbacks at these departments or agencies.

***The failure by Congress to approve budgets on a timely basis for the federal agencies we support could delay or reduce spending and cause us to lose revenue.***

On an annual basis, Congress must approve budgets that govern spending by each of the federal agencies we support. When Congress is unable to agree on budget priorities and is unable to pass the annual budget on a timely basis, Congress typically enacts a continuing resolution. A continuing resolution allows government agencies to operate at spending levels approved in the previous budget cycle. When government agencies must operate under a continuing resolution, it may delay funding we expect to receive from clients on work we are already performing and will likely result in any new initiatives being delayed, and potentially cancelled.

***The Office of Management and Budget process for ensuring government agencies properly support capital planning initiatives, including information technology investments, could reduce or delay federal information technology spending and cause us to lose revenue.***

The Office of Management and Budget, or OMB, supervises spending by federal agencies, including enforcement of the Government Performance Results Act. This Act requires, among other things, that federal agencies make an adequate business justification to support capital planning initiatives, including all information technology investments. The factors considered by the OMB include, among others, whether the proposed information technology investment is expected to achieve an appropriate return on investment, whether related processes are contemporaneously reviewed, whether inter-operability with existing systems and the capacity for these systems to share data across government has been considered, and whether existing off-the-shelf products are being utilized to the extent possible. If our clients do not adequately justify proposed information technology investments to the OMB, the OMB may refuse funding for their new or continuing information technology investments, and we may lose revenue as a result.

*Federal government contracts contain provisions giving government clients a variety of rights that are unfavorable to us, including the ability to terminate a contract at any time for convenience.*

Federal government contracts contain provisions and are subject to laws and regulations that provide government clients with rights and remedies not typically found in commercial contracts. These rights and remedies allow government clients, among other things, to:

terminate existing contracts, with short notice, for convenience, as well as for default;

reduce or modify contracts or subcontracts;

terminate our facility security clearances and thereby prevent us from receiving classified contracts;

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cancel multi-year contracts and related orders if funds for contract performance for any subsequent year become unavailable;

decline to exercise an option to renew a multi-year contract;

claim rights in products, systems, and technology produced by us;

prohibit future procurement awards with a particular agency due to a finding of organizational conflict of interest based upon prior related work performed for the agency that would give a contractor an unfair advantage over competing contractors;

subject the award of GSA schedule contracts, GWACs, and other ID/IQ contracts to protest by competitors, which may require the contracting federal agency or department to suspend our performance pending the outcome of the protest and may also result in a requirement to resubmit bids for the contract or in the termination, reduction, or modification of the awarded contract; and

suspend or debar us from doing business with the federal government or with a particular governmental agency.

If a government client terminates one of our contracts for convenience, we may recover only our incurred or committed costs, settlement expenses, and profit on work completed prior to the termination. If a federal government client were to unexpectedly terminate, cancel, or decline to exercise an option to renew with respect to one or more of our significant contracts or suspend or debar us from doing business with government agencies, our revenue and operating results would be materially harmed.

Some government procurement offices have recently issued requests for proposals, or RFPs, stating that fees will not be permitted on subcontractors that are used on time-and-material orders issued under those contracts. If this prohibition is included in these future contract awards, and we subcontract a significant component of time and material orders issued under these contracts, this could reduce our profitability on future work.

***Our failure to comply with complex procurement laws and regulations could cause us to lose business and subject us to a variety of penalties.***

We must comply with laws and regulations relating to the formation, administration, and performance of federal government contracts, which affect how we do business with our government clients and may impose added costs on our business. Among the most significant regulations are:

the Federal Acquisition Regulation, and agency regulations analogous or supplemental to the Federal Acquisition Regulation, which comprehensively regulate the formation, administration, and performance of government contracts, including provisions relating to the avoidance of conflicts of interest and intra-organizational conflicts of interest;

the Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with some contract negotiations;

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the Procurement Integrity Act, which requires evaluation of ethical conflicts surrounding procurement activity and establishing certain employment restrictions for individuals who participate in the procurement process;

the Cost Accounting Standards, which impose accounting requirements that govern our right to reimbursement under some cost-based government contracts;

laws, regulations, and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of specified products, technologies, and technical data;

laws surrounding lobbying activities a corporation may engage in and operation of a Political Action Committee established to support corporate interests; and

compliance with antitrust laws.

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If a government review or investigation uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, harm to our reputation, suspension of payments, fines, and suspension or debarment from doing business with federal government agencies. The government may in the future reform its procurement practices or adopt new contracting rules and regulations, including cost accounting standards, that could be costly to satisfy or that could impair our ability to obtain new contracts. Any failure to comply with applicable laws and regulations could result in contract termination, price or fee reductions, or suspension or debarment from contracting with the federal government, each of which could lead to a material reduction in our revenue.

## **Other Risks Related To Our Stock**

*A public market for our class A common stock has existed only for a limited period of time, and our stock price is volatile and could decline.*

Prior to May 24, 2002, there was no public market for any class of our common stock. An active trading market for our class A common stock may not be sustained, which could affect your ability to sell your shares and could depress the market price of your shares.

The stock market in general, and the market for technology-related stocks in particular, has been highly volatile. As a result, the market price of our class A common stock is likely to be similarly volatile, and holders of our class A common stock may experience a decrease in the value of their stock, including decreases unrelated to our operating performance or prospects. The price of our class A common stock could be subject to wide fluctuations in response to a number of factors, including those listed in this Risk Factors section and others such as:

our operating performance and the performance of other similar companies or companies deemed to be similar;

actual or anticipated differences in our quarterly operating results;

changes in our revenue or earnings estimates or recommendations by securities analysts;

publication of research reports about us or our industry by securities analysts;

additions and departures of key personnel;

contract mix and the extent of use of subcontractors;

strategic decisions by us or our competitors, such as acquisitions, consolidations, divestments, spin-offs, joint ventures, strategic investments, or changes in business strategy;

federal government spending levels, both generally and by our particular government clients;

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the passage of legislation or other regulatory developments that adversely affect us or our industry;

the failure by Congress to approve budgets on a timely basis;

speculation in the press or investment community;

changes in the government information technology services industry;

changes in accounting principles;

terrorist acts;

general market conditions, including economic factors unrelated to our performance; and

military action related to international conflicts, wars, or otherwise.

In the past, securities class action litigation has often been instituted against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs and divert our management's attention and resources.

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*Our chairman, whose interests may not be aligned with yours, controls our company, which could result in actions of which you or other stockholders do not approve.*

As of August 18, 2006, Ernst Volgenau, our chairman, beneficially owned 274,316 shares of class A common stock and 12,050,736 shares of class B common stock, which represented approximately 64.9% of the combined voting power of our outstanding common stock. As of August 18, 2006, our executive officers and directors as a group beneficially owned an aggregate of 2,551,220 shares of class A common stock and 14,459,828 shares of class B common stock, which represented approximately 78.4% of the combined voting power of our outstanding common stock. As a result, these individuals acting together, or Dr. Volgenau acting alone, will be able to control the outcome of all matters that our stockholders vote upon, including the election of directors, amendments to our certificate of incorporation, and mergers or other business combinations. In addition, upon the death of Dr. Volgenau and the conversion of his class B common stock into class A common stock, William K. Brehm, a current director and the former chairman of our board of directors, if he survives Dr. Volgenau, would beneficially own all of the outstanding class B common stock and could exercise significant influence over corporate matters requiring stockholder approval. This concentration of ownership and voting power may also have the effect of delaying or preventing a change in control of our company and could prevent stockholders from receiving a premium over the market price if a change in control is proposed.

*Provisions of our charter documents and Delaware law may inhibit potential acquisition bids that you and other stockholders may consider favorable, and the market price of our class A common stock may be lower as a result.*

There are provisions in our certificate of incorporation and by-laws that make it more difficult for a third party to acquire, or attempt to acquire, control of our company, even if a change in control was considered favorable by you and other stockholders. For example, our board of directors has the authority to issue up to 5,000,000 shares of preferred stock. The board of directors can fix the price, rights, preferences, privileges, and restrictions of the preferred stock without any further vote or action by our stockholders. The issuance of shares of preferred stock may delay or prevent a change in control transaction. As a result, the market price of our class A common stock and the voting and other rights of our stockholders may be adversely affected. This issuance of shares of preferred stock may result in the loss of voting control to other stockholders.

Our charter documents contain other provisions that could have an anti-takeover effect, including:

the high-vote nature of our class B common stock;

only one of the three classes of directors is elected each year;

stockholders have limited ability to remove directors without cause;

stockholders cannot take actions by written consent;

stockholders cannot call a special meeting of stockholders; and

stockholders must give advance notice to nominate directors or submit proposals for consideration at stockholder meetings.



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In addition, we are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which regulates corporate acquisitions. These provisions could discourage potential acquisition proposals and could delay or prevent a change in control transaction. They could also have the effect of discouraging others from making tender offers for our class A common stock. These provisions may also prevent changes in our management.

### **Item 1B. UNRESOLVED STAFF COMMENTS**

We have not received written comments from the commission staff regarding our periodic or current reports under the Securities Exchange Act of 1934 that remain unresolved.

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**Item 2. PROPERTIES**

We lease our office facilities and we do not own any facilities or real estate. We have leased our corporate headquarters at 4300 Fair Lakes Court in Fairfax, Virginia 22033 since 1991. Currently the two buildings comprising our headquarters are leased under separate leases with the same landlord. Both of our headquarters leases expire on December 31, 2015. We also lease facilities in the following locations:

Alexandria, Virginia	Atlanta, Georgia	Newport Beach, California
Arlington, Virginia	College Park , Georgia	Sacramento, California
Chesapeake, Virginia	Warner Robins, Georgia	San Diego, California
Falls Church, Virginia	Minneapolis, Minnesota	Sierra Vista, Arizona
Herndon, Virginia	Eatontown, New Jersey	Colorado Springs, Colorado
McLean, Virginia	Egg Harbor Township, New Jersey	Boston, Massachusetts
Newport News, Virginia	Mount Arlington, New Jersey	Portsmouth, New Hampshire
Vienna, Virginia	Shrewsbury, New Jersey	Seattle, Washington
Baltimore, Maryland	New York, New York	St. Louis, Missouri
Landover, Maryland	Durham, North Carolina	Hatboro, Pennsylvania
Lexington Park, Maryland	Fayetteville, North Carolina	Washington, DC
Rockville, Maryland	Dayton, Ohio	
Fort Walton Beach, Florida	San Antonio, Texas	

In addition, we have employees who work on engagements at other smaller operating locations around the United States.

**Item 3. LEGAL PROCEEDINGS**

From time to time, we are involved in various legal matters and proceedings concerning matters arising in the ordinary course of business. We currently believe that any ultimate liability arising out of these matters and proceedings will not have a material adverse effect on our financial position, results of operations, or cash flows.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

During the fourth quarter of fiscal year 2006, there were no matters submitted to a vote of security holders through the solicitation of proxies or otherwise.

**Table of Contents****PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

On May 2, 2005, our board of directors declared a two-for-one stock split in the form of a 100 percent stock dividend on our common stock. The dividend was paid on May 27, 2005 to shareholders of record on May 13, 2005.

Since May 24, 2002, our class A common stock has been publicly traded on the New York Stock Exchange under the symbol SRX. Prior to May 24, 2002, our class A common stock was not publicly traded. From July 1, 2004 to June 30, 2006 the ranges of high and low sale prices of our class A common stock as reported by the New York Stock Exchange for each quarter during this period, adjusted for the May 2005 stock split, were as follows:

	<u>High</u>	<u>Low</u>
Year ended June 30, 2006:		
First Quarter	\$ 38.29	\$ 32.21
Second Quarter	35.75	27.40
Third Quarter	38.28	30.15
Fourth Quarter	37.73	26.63
Year ended June 30, 2005:		
First Quarter	\$ 26.18	\$ 19.80
Second Quarter	32.97	25.10
Third Quarter	32.15	26.77
Fourth Quarter	36.05	29.97

As of August 18, 2006, there were approximately 110 holders of record of our class A common stock and two holders of record of our class B common stock. The number of holders of record of our class A common stock is not representative of the number of beneficial holders because many shares are held by depositories, brokers or nominees. As of August 18, 2006, the closing price of our class A common stock was \$26.57.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain earnings, if any, to support our growth strategy and do not anticipate paying cash dividends in the foreseeable future.

***Sale of Unregistered Securities***

We issued 56,142, 107,730, and 145,106 shares of our class A common stock to our SRA International, Inc. 401(k) Plan through matching contributions as determined by our board of directors during the fiscal years ended June 30, 2006, 2005, and 2004, respectively. These issuances were not sales within the meaning of the Act.

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On December 9, 2005, we sold 78,020 shares of class A common stock to former shareholders of Spectrum Solutions Group, Inc. for approximately \$2.3 million, or \$29.05 per share, in a private placement exempt from registration under the Act. No underwriters were involved in this sale of securities.

On May 5, 2005, we sold 29,600 shares of class A common stock to former shareholders of Touchstone for approximately \$948,000, or \$32.02 per share, in a private placement exempt from registration under the Act. No underwriters were involved in this sale of securities.

### *Equity Compensation Plan Information*

Information regarding our equity compensation plans and the securities authorized for issuance thereunder is incorporated by reference in Item 12.

**Table of Contents****Item 6. SELECTED FINANCIAL DATA**

The following selected financial data should be read in conjunction with our financial statements and the related notes, and with Management's Discussion and Analysis of Financial Condition and Results of Operations, included elsewhere in this Form 10-K. The statement of operations data for the fiscal years ended June 30, 2006, 2005, and 2004, and the balance sheet data as of June 30, 2006 and 2005, are derived from our financial statements that have been audited by Deloitte & Touche LLP, our independent registered public accounting firm, and are included in this Form 10-K. The statement of operations data for the fiscal years ended June 30, 2003 and 2002, and the balance sheet data as of June 30, 2004, 2003, and 2002, are derived from our financial statements that have been audited by Deloitte & Touche LLP and not included in this Form 10-K. The selected financial data reflect our adoption of Statement of Financial Accounting Standards, or SFAS No. 123R in July 2005 and our acquisitions of the Marasco Newton Group, Ltd. in January 2002, Adroit Systems, Inc. in January 2003, ORION Scientific Systems in January 2004, Touchstone Consulting Group in April 2005, Galaxy Scientific Corporation in July 2005, Spectrum Solutions Group, Inc. in November 2005, and Mercomms Unlimited, Inc. in April 2006. For more information on these acquisitions, see Note 16 to our financial statements.

	Year Ended June 30,				
	2006	2005	2004	2003	2002
(in thousands, except share and per share data)					
<b>Statement of Operations Data:</b>					
Revenue	\$ 1,179,267	\$ 881,770	\$ 615,802	\$ 450,375	\$ 361,197
Operating costs and expenses:					
Cost of services	880,802	653,115	442,771	316,672	258,863
Selling, general and administrative (b)	183,297	126,404	100,919	82,753	76,143
Depreciation and amortization	18,201	13,141	10,511	8,962	7,684
Total operating costs and expenses	1,082,300	792,660	554,201	408,387	342,690
Operating income	96,967	89,110	61,601	41,988	18,507
Interest income (expense), net	4,232	3,442	1,474	1,387	(101)
Gain on equity method investment				1,031	373
Gain on sale of Assentor practice				4,685	
Other income			153		1,775
Income before taxes	101,199	92,552	63,228	49,091	20,554
Provision for income taxes	38,679	34,829	24,291	19,431	9,277
Net income	\$ 62,520	\$ 57,723	\$ 38,937	\$ 29,660	\$ 11,277
<b>Earnings per share: (a)</b>					
Basic	\$ 1.14	\$ 1.09	\$ 0.76	\$ 0.69	\$ 0.39
Diluted	\$ 1.08	\$ 1.02	\$ 0.71	\$ 0.62	\$ 0.33
<b>Weighted-average shares: (a)</b>					
Basic	55,064,138	52,965,623	51,008,978	42,690,310	29,261,024
Diluted	57,738,875	56,549,303	54,738,028	47,459,972	34,061,434

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	As of June 30,				
	2006	2005	2004	2003	2002
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 173,564	\$ 162,973	\$ 143,367	\$ 158,264	\$ 87,137
Short-term investments	9,834	20,156	9,076	433	
Working capital	299,567	285,489	229,796	219,655	131,569
Total assets	721,974	569,117	461,893	364,711	226,293
Long-term debt, net of current portion					400
Total stockholders' equity	533,297	429,092	339,268	283,015	159,444

(a) Share and per share amounts have been adjusted to reflect the May 2005 two-for-one stock split.

(b) Year ended June 30, 2006 includes \$12.8 million of stock compensation expense recognized in accordance with the adoption of SFAS No. 123R on July 1, 2005.

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### **Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis in conjunction with our financial statements and the related notes included elsewhere in this Form 10-K. This discussion and analysis contains forward-looking statements that involve risks, uncertainties, and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth under RISK FACTORS and elsewhere in this Form 10-K.*

#### **ABOUT THIS MANAGEMENT'S DISCUSSION AND ANALYSIS**

The discussion and analysis that follows is organized to:

provide an overview of our business;

describe selected key metrics evaluated by management;

explain the year-over-year trends in our results of operations;

describe our liquidity and capital resources; and

explain our critical accounting policies, describe certain line items of our statements of operations, and define certain other terms we use in our discussion and analysis.

Readers who are not familiar with our company or the financial statements of federal government information technology services providers should closely review the DESCRIPTION OF CRITICAL ACCOUNTING POLICIES, the DESCRIPTION OF STATEMENT OF OPERATIONS ITEMS, and the DEFINITION OF CERTAIN TERMS USED IN THIS MANAGEMENT'S DISCUSSION AND ANALYSIS sections that appear at the end of this discussion and analysis. These sections provide background information that can help readers in understanding and analyzing our financial information.

#### **OVERVIEW**

We provide technology and strategic consulting services and solutions primarily to the federal government. Our service offerings include strategic consulting; systems design, development and integration; and outsourcing and managed services. In addition, to address recurring client needs, we develop business solutions for contingency and disaster response planning; information assurance; business intelligence; privacy protection; enterprise architecture; infrastructure management; and wireless integration. We provide services in three target markets: national security, which includes the defense and intelligence communities; civil government; and health care and public health.

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Since our founding in 1978 we have derived substantially all of our revenue from services provided to federal government clients. We expect that federal government clients will continue to account for substantially all of our revenue for the foreseeable future. INPUT expects the contracted portion of the federal information technology budget to grow at a compound annual growth rate of 5.0% over the next five years. In order to grow more rapidly than the market, we will need to take market share from our competitors. Our growth is driven in part by contract awards and how we build-out our contracts. Ideally, the level of quarterly business awards would exceed the revenue booked in the quarter to drive backlog growth.

We work with the federal government under three primary contract types: cost-plus-fee, time-and-materials, and fixed-price contracts. Cost-plus-fee contracts are typically lower risk arrangements and thus yield lower profit margins than time-and-materials and fixed-price arrangements. Time-and-materials and fixed-price contracts typically generate higher profit margins reflecting their generally higher risk. Where customer requirements are clear, we prefer to enter into time-and-materials and fixed-price arrangements rather than cost-plus-fee arrangements. Typically under time-and-materials and fixed-price, as compared with cost-plus-contracts, the customer can save money and we can earn better margins, given the more specific delivery requirements of these structures.



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Most of our revenue is generated based on services provided either by our employees or subcontractors. To a lesser degree, the revenue we earn includes reimbursable travel and other items to support the contractual effort, and may include third-party hardware and software that we purchase and integrate for customers as part of the solutions that we provide. Thus, once we win new business, the key to delivering the revenue is through hiring new employees to meet customer requirements, retaining our employees, and ensuring that we deploy them on direct-billable jobs. Therefore, we closely monitor hiring success, attrition trends, and direct labor utilization. A key challenge in growing our business is to hire enough employees with appropriate security clearances. Since we earn higher profits from the labor services that our employees provide compared with subcontracted efforts and other reimbursable items such as hardware and software purchases for customers, we seek to optimize our labor content on the contracts we win.

Cost of services includes labor, or the salaries and wages of our employees, plus fringe benefits; the costs of subcontracted labor and outside consultants; third-party materials, such as hardware and software that we purchase for customer solutions; and other direct costs such as travel incurred to support contract efforts. Since we earn higher profits on our own labor services, we expect the ratio of cost of services to revenue to decline when our labor services mix increases relative to subcontracted labor or third-party material. Conversely, as subcontracted labor or third-party material purchases for customers increase relative to our own labor services, we expect the ratio of cost of services to revenue to increase. As we continue to bid and win larger contracts, our own labor services component could decrease. This is because the larger contracts typically are broader in scope and require more diverse capabilities resulting in more subcontracted labor with the potential for more third-party hardware and software purchases. In addition, we can face hiring challenges in staffing larger contracts. While these factors could lead to a higher ratio of cost of services to revenue, the economics of these larger jobs are nonetheless generally favorable because they increase income, broaden our revenue base, and have a favorable return on invested capital.

We have been able to build and effectively use what we refer to as a central services model. This central services model employs the use of central services for marketing, business development, human resources, recruiting, finance and accounting, infrastructure and other core administrative services. This central services model allows us to reduce selling, general and administrative expenses as a percentage of revenue as revenue grows organically and through selective acquisitions, thereby contributing to the growth in operating income.

Depreciation and amortization expenses are affected by the level of our annual capital expenditures and the amount of identified intangibles related to acquisitions. We do not presently foresee significant changes in our capital expenditure requirements, which have been approximately 1.5% to 2.0% of revenue over the last three fiscal years. As we continue to make selected strategic acquisitions, the amortization of identified intangible assets may increase as a percentage of our revenue.

Our operating income, or revenue minus cost of services, selling, general and administrative expenses, and depreciation and amortization, and thus our operating margin, or the ratio of operating income to revenue, is driven by the mix and execution on our contracts, how we manage our costs, and the amortization charges resulting from acquisitions.

Our cash position is driven primarily by the level of net income, working capital in accounts receivable, capital expenditures and acquisition activities.

## **SELECTED KEY METRICS EVALUATED BY MANAGEMENT**

We manage and assess the performance of our business by evaluating a variety of metrics. Selected key metrics are discussed below.

***Revenue Growth***

Our revenue growth is primarily organic, but has been augmented by selective strategic acquisitions. Our total revenue growth rate was 33.7% in fiscal year 2006. Our organic revenue growth rate was 17.2% in fiscal

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year 2006, driven by building-out existing accounts, broadening our client base, and leveraging our research and development into high value services. The table below details our largest contract awards that have contributed to our organic growth:

<u>Client</u>	<u>Contract</u>	<u>Period of Performance</u>		<u>Initial Contract Award Value</u>
				(in millions)
Federal Deposit Insurance Corporation	Technology Infrastructure Support	September 2004	September 2009	\$ 341.0
U.S. Agency for International Development	PRIME 2.2 Enterprise Wide IT Services	December 2003	January 2010	328.0
Environmental Protection Agency	Information Technology Solutions-Business Information Strategic Support (ITS-BISS)	April 2005	April 2010	148.0
National Guard Bureau	Advanced Information Technology Services	March 2003	September 2007	115.0
Government Accountability Office	IT Infrastructure Support	February 2003	February 2009	105.0

A part of our growth strategy includes pursuing acquisitions. To date, we have made the following acquisitions:

<u>Acquisition</u>	<u>Strategic Value</u>	<u>Closing Date</u>	<u>Purchase Price</u>
			(in millions)
The Marasco Newton Group, Ltd.	Environment	January 4, 2002	\$ 16.2
Adroit Systems, Inc.	Command and Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR)	January 31, 2003	38.3
ORION Scientific Systems	Counterterrorism	January 30, 2004	34.7
Touchstone Consulting Group, Inc.	Strategic Consulting	April 21, 2005	37.0
Galaxy Scientific Corporation	Command and Control, Communications, Computers, Intelligence (C4I)	July 1, 2005	98.7
Spectrum Solutions Group, Inc.	Enterprise Resource Planning	November 2, 2005	9.7
Mercomms Unlimited, Inc.	Maritime and Defense Communications	April 10, 2006	0.6

**Contract Backlog**

Future growth is dependent upon the strength of our target markets, our ability to identify opportunities, and our ability to successfully bid and win new contracts. Our success can be measured in part based upon the growth of our backlog. The following table summarizes our contract backlog at the end of the year:

<u>Year Ended June 30,</u>		
<u>2006</u>	<u>2005</u>	<u>2004</u>
(in millions)		

Backlog:

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Funded	\$ 512.8	\$ 453.2	\$ 338.7
Unfunded	2,748.8	2,296.9	1,749.9
	<u>          </u>	<u>          </u>	<u>          </u>
Total backlog	\$ 3,261.6	\$ 2,750.1	\$ 2,088.6
	<u>          </u>	<u>          </u>	<u>          </u>

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Our total backlog of approximately \$3.3 billion as of June 30, 2006 represented an 18.6% increase over the fiscal year 2005 backlog. We currently expect to recognize revenue during fiscal year 2007 from approximately 21% of our total backlog as of June 30, 2006.

***Contract mix***

Contract profit margins are generally affected by the type of contract. We can typically earn higher profits on fixed-price and time-and-materials contracts than cost-plus-fee contracts. Thus, an important part of growing our operating income is to increase the amount of services delivered under fixed-price and time-and-materials contracts. The following table summarizes our historical contract mix, measured as a percentage of total revenue, for the periods indicated:

	<b>Year Ended June 30,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
Cost-plus-fee	45%	46%	44%
Time-and-materials	40	34	38
Fixed-price	15	20	18

While our government clients typically determine what type of contract will be awarded to us, where we have the opportunity to influence the type of contract awarded, we will pursue time-and-materials and fixed-price contracts for the reasons discussed above.

***Headcount and Labor Utilization***

Because most of our revenue derives from services delivered by our employees, our ability to hire new employees and deploy them on direct-billable jobs is critical to our success. The following table represents our headcount and our direct labor utilization over the past three years:

	<b>Year Ended June 30,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
Headcount	4,975	4,177	3,358
Direct labor utilization	78.5%	78.8%	78.1%

***Operating Margin***

Operating margin, or the ratio of operating income to revenue, is affected by the mix of our contracts and how we manage our costs. Our operating margins were 8.2%, 10.1%, and 10.0% for the years ended June 30, 2006, 2005, and 2004, respectively. The decrease in operating

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margin for the year ended June 30, 2006 is primarily due to the compensation expense related to share-based payment transactions that we are required to recognize in accordance with SFAS No. 123R which was adopted on July 1, 2005. Additionally, we experienced an increase in third-party material purchases which generate lower profit.

### *Days Sales Outstanding*

Days sales outstanding, or DSO, is a measure of how efficiently we manage the billing and collection of our accounts receivable, our most significant working capital requirement. Accounts receivable represents the most significant asset we report on our balance sheet. We reported DSO of 74 and 73 days for the years ended June 30, 2006 and 2005, respectively. The learning curve associated with the implementation of a new accounting system in July 2005 caused DSO to increase slightly from fiscal 2005; however, we expect that the system will help us to reduce DSO as we go forward. Additionally, we continue to have a number of internal process initiatives underway that we believe will enable us to improve our DSO.

**Table of Contents****RESULTS OF OPERATIONS**

The following tables set forth some items from our consolidated statements of operations, and these items expressed as a percentage of revenue, for the periods indicated.

	Year Ended June 30,				
	2006	% Change	2005	% Change	2004
	(in thousands)				
Revenue	\$ 1,179,267	33.7%	\$ 881,770	43.2%	\$ 615,802
Operating costs and expenses:					
Cost of services	880,802	34.9	653,115	47.5	442,771
Selling, general, and administrative (a)(b)	183,297	45.0	126,404	25.3	100,919
Depreciation and amortization	18,201	38.5	13,141	25.0	10,511
Total operating costs and expenses	1,082,300	36.5	792,660	43.0	554,201
Operating income	96,967	8.8	89,110	44.7	61,601
Interest income, net	4,232	23.0	3,442	133.5	1,474
Other income				(100.0)	153
Income before taxes	101,199	9.3	92,552	46.4	63,228
Provision for income taxes	38,679	11.1	34,829	43.4	24,291
Net income	\$ 62,520	8.3%	\$ 57,723	48.2%	\$ 38,937
	(as a percentage of revenue)				
Revenue	100.0%		100.0%		100.0%
Operating costs and expenses:					
Cost of services	74.7		74.1		71.9
Selling, general and administrative (b)	15.5		14.3		16.4
Depreciation and amortization	1.5		1.5		1.7
Total operating costs and expenses	91.8		89.9		90.0
Operating income	8.2		10.1		10.0
Interest income, net	0.4		0.4		0.2
Other income					0.1
Income before taxes	8.6		10.5		10.3
Provision for income taxes	3.3		4.0		4.0
Net income	5.3%		6.5%		6.3%

(a) Year ended June 30, 2006 includes \$12.8 million of stock compensation expense recognized in accordance with the adoption of SFAS No. 123R on July 1, 2005.

- (b) Excluding the SFAS No 123R expense, selling, general and administrative expense would have been 14.5% of revenue in fiscal 2006, an increase of 34.9% from fiscal 2005.

***Revenue***

Our revenue increased 33.7% to \$1.18 billion in fiscal 2006, from \$881.8 million in fiscal 2005. Organic revenue growth was 17.2% for the year, with the remainder of growth mostly attributable to our April 2005 and July 2005 acquisitions of Touchstone and Galaxy, respectively. Our organic growth has been driven in part by three large contracts, representing approximately 7.8%, or approximately half, of our fiscal 2006 organic growth. Our Federal Deposit Insurance Corporation, or FDIC, contract, our Advanced Information Technology Services, or AITS, contract with the National Guard, and our United States Agency for International Development, or USAID, contract were significant drivers of our revenue growth, generating approximately \$79 million of additional revenue during fiscal 2006 compared to fiscal 2005.



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Our revenue increased 43.2% to \$881.8 million in fiscal 2005, from \$615.8 million in fiscal 2004. Organic revenue growth was 37.9% for the year, with the remainder of growth attributable to our acquisitions of Orion and Touchstone. Our USAID contract, Pentagon Wedge 2 subcontract with General Dynamics, AITS contract with the National Guard, and our FDIC contract were significant drivers of our fiscal 2005 revenue growth, generating approximately \$143 million in additional revenue during fiscal 2005 compared to fiscal 2004.

### ***Cost of Services***

Cost of services increased 34.9% to \$880.8 million in fiscal 2006, from \$653.1 million in fiscal 2005. This increase in cost of services was due primarily to the increased volume of services provided under our FDIC, AITS, and USAID contracts, and the volume of services attributable to Touchstone's and Galaxy's contracts. As a percentage of revenue, cost of services increased to 74.7% in fiscal 2006, from 74.1% in fiscal 2005. This increase as a percentage of revenue was attributable primarily to an increased amount of direct material purchases made by us and delivered to clients in connection with our services. Typically, direct material purchases generate lower profit, which increases the ratio of cost of services to revenue. While this higher direct material content can drive our operating margin down, it should have a positive impact on our earnings and return on invested capital.

Cost of services increased 47.5% to \$653.1 million in fiscal 2005, from \$442.8 million in fiscal 2004. This increase in cost of services was due primarily to the volume of services provided under the USAID, Pentagon Wedge 2, AITS, and FDIC contracts, and the increased cost of services attributable to Orion's and Touchstone's existing contracts. As a percentage of revenue, cost of services increased to 74.1% in fiscal 2005, from 71.9% in fiscal 2004. This increase as a percentage of revenue was attributable primarily to an increased amount of direct material purchases made by us and delivered to certain larger clients in connection with our services.

### ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses increased 45.0% to \$183.3 million in fiscal 2006, from \$126.4 million in fiscal 2005. As a percentage of revenue, selling, general and administrative expenses increased to 15.5% in fiscal 2006 from 14.3% in fiscal 2005. This increase as a percentage of revenue resulted primarily from the adoption of SFAS No. 123R on July 1, 2005. Under SFAS No. 123R, share-based payments not fully vested as of July 1, 2005 and those granted in the year ended June 30, 2006 and future periods will be measured at estimated fair value and included in selling, general and administrative expenses over the appropriate earning period. We recognized approximately \$12.8 million of compensation costs in accordance with SFAS No. 123R in fiscal 2006. Excluding the impact of SFAS No. 123R, selling, general and administrative expenses as a percentage of revenue was 14.5% and 14.3% for the years ended June 30, 2006 and 2005, respectively. This increase as a percentage of revenue resulted primarily from the double effect of increased costs associated with bid and proposal efforts and lower revenue due to the related transition of professional staff off of billable engagements to support the higher proposal activity.

Selling, general and administrative expenses increased 25.3% to \$126.4 million in fiscal 2005, from \$100.9 million in fiscal 2004. As a percentage of revenue, selling, general and administrative expenses decreased to 14.3% in fiscal 2005 from 16.4% in fiscal 2004. This decrease as a percentage of revenue resulted primarily from continued cost control measures taken by management to hold increases in these expenses to a rate below our revenue growth rate. We have been able to accomplish this by leveraging our central services model as we have won new contracts and integrated acquired companies into our systems and processes.

### ***Depreciation and Amortization***

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Depreciation and amortization increased 38.5% to \$18.2 million in fiscal 2006, from \$13.1 million in fiscal 2005. This increase in depreciation and amortization resulted primarily from the amortization associated with the identified intangibles recorded as a result of our acquisitions of Galaxy and Spectrum. As a percentage of revenue, depreciation and amortization was 1.5% in both fiscal 2006 and 2005.

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Depreciation and amortization increased 25.0% to \$13.1 million in fiscal 2005, from \$10.5 million in fiscal 2004. This increase in depreciation and amortization resulted primarily from the amortization associated with the identified intangibles recorded as a result of our acquisitions of Orion and Touchstone. As a percentage of revenue, depreciation and amortization decreased to 1.5% in fiscal 2005, from 1.7% in fiscal 2004.

### ***Interest Income, net***

Interest income, net increased to \$4.2 million in fiscal 2006, from \$3.4 million in fiscal 2005. This increase was due to a general rise in interest rates and one-time benefits from the interest earned on amended tax return refunds from previous years.

Interest income, net increased to \$3.4 million in fiscal 2005, from \$1.5 million in fiscal 2004. This increase reflected higher average cash and cash equivalents and investment balances and a general rise in interest rates.

### ***Income Taxes***

In fiscal 2006, our effective income tax rate increased to 38.2%, from 37.6% in fiscal year 2005. The increase was due primarily to additional services performed in higher taxing jurisdictions. The estimated effective tax rate is based on current tax law and current income and expense projections. The effective tax rate may be affected by future acquisitions, by changes in interest income from tax-advantaged municipal bond investments, or by the receipt of certain tax credits or refunds.

In fiscal 2005, our effective income tax rate decreased to 37.6%, from 38.4% in fiscal 2004. This decrease was due to one-time benefits from Virginia job creation tax credits from previous years and refund claims from prior federal and state income tax returns.

## **SEASONALITY**

Our quarterly operating margins are affected by, among other things, seasonality in our business model. We may experience a sequential decline in operating margins between our quarter ending June 30 and our quarter ending September 30. In the quarter ending September 30, we generally experience lower staff utilization rates. These lower utilization rates are attributable both to summer vacations and to increased proposal activity in connection with the end of the federal fiscal year. We typically transition a significant number of professional staff temporarily off of billable engagements to support this increased proposal activity. In addition, we tend to adopt budgets for selling, general and administrative expenses at the beginning of our fiscal year and allocate them roughly flat across the quarters. Our fourth quarter, which ends in June, is typically the strongest quarter as we benefit from the cumulative effect of hires during the year, growing revenue, and declining corporate selling, general and administrative expenses as a percentage of revenue.

## **LIQUIDITY AND CAPITAL RESOURCES**

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Our primary liquidity needs are to finance the costs of operations pending the billing and collection of accounts receivable, to acquire capital assets, to invest in research and development, and to make selective strategic acquisitions.

In June 2003, we completed a follow-on offering that resulted in net proceeds to us of approximately \$71 million. As of June 30, 2006, our total cash and investments balances were \$183.4 million. We used a total of approximately \$104.4 million of cash to purchase Galaxy Scientific Corporation and Spectrum Solutions Group, Inc. in fiscal year 2006.

Since our May 2002 initial public offering, we have been able to meet all of our liquidity requirements, including the completion of seven acquisitions, with cash generated from our operations. We expect the combination of cash flows from operations, our cash and cash equivalents, and our investments to meet our normal operating liquidity and capital expenditure requirements for at least the next twelve months. However, in the event of a large acquisition or a series of smaller acquisitions in a relatively short period of time, we will likely be required to enter into a credit facility or other financing arrangement.

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### ***Cash Flow***

Accounts receivable represent our largest working capital requirement. We bill most of our clients monthly after services are rendered. Our operating cash flow is primarily affected by the overall profitability of our contracts, our ability to invoice and collect from our clients in a timely manner, and our ability to manage our vendor payments. We continue to improve our invoicing and collections procedures to maximize cash flows from operations.

#### ***Fiscal 2006 Compared to Fiscal 2005***

Net cash provided by operating activities was \$86.8 million in fiscal 2006, compared to \$66.0 million in fiscal 2005, or 1.4 and 1.1 times net income for fiscal 2006 and 2005, respectively. The ratio of cash provided by operating activities to net income in fiscal 2006 was positively affected by the increase in our accounts payable and accrued expenses balance. Account payable and accrued expenses increased due to the timing of certain vendor payments. Net cash provided by operating activities in fiscal 2006 was also affected by the adoption of SFAS No. 123R, which resulted in the reclassification of excess tax benefits from operating cash flows to financing cash flows.

We used \$104.7 million in net cash for investing activities in fiscal 2006, compared to \$61.0 million in fiscal 2005. Three factors drive our investing cash outflows: capital expenditures, the purchase, sale or maturity of investments with maturities that exceed 90 days, and acquisitions. The higher amount of cash used was primarily the result of our acquisitions of Galaxy and Spectrum in July 2005 and November 2005, respectively. We spent approximately \$68.0 million more on acquisitions in fiscal 2006 than fiscal 2005.

Net cash provided by financing activities was \$28.5 million in fiscal 2006, compared to \$14.6 million in fiscal 2005. On a periodic basis, our employees exercise stock options which results in the issuance of common stock. The higher amount of cash provided by financing activities in fiscal 2006 was primarily the result of our adoption of SFAS No. 123R in July 2005. Under SFAS No. 123R, excess tax benefits from share-based payments are presented as sources of financing activity cash flows.

#### ***Fiscal 2005 Compared to Fiscal 2004***

Net cash provided by operating activities was \$66.0 million in fiscal 2005, compared to \$43.5 million in fiscal 2004, or 1.1 times net income for both periods. The ratio of cash provided by operating activities to net income in fiscal 2005 was positively affected by \$10.0 million of additional tax benefits of stock option exercises offset by higher net working capital requirements compared to fiscal 2004.

We used \$61.0 million in net cash for investing activities in fiscal 2005, compared to \$66.4 million in fiscal 2004. The lower amount of cash used for investing activities in fiscal 2005 was primarily attributable to lower net purchases of investments with maturities in excess of 90 days offset by higher capital expenditure requirements.

Net cash provided by financing activities was \$14.6 million in fiscal 2005, compared to \$8.0 million in fiscal 2004. On a periodic basis, our employees exercise stock options resulting in the issuance of common stock.

*Credit Facility and Borrowing Capacity*

We elected not to renew a \$40 million credit facility when it expired on February 29, 2004. We do not currently intend to replace the credit facility as we expect our cash and cash equivalents and investments, together with cash flow generated from operations, to meet our normal operating liquidity and capital expenditure requirements for at least the next twelve months. Based on our profitability and the cash flow generated from our operating activities, we believe we have significant borrowing capacity. We maintain relationships with a number of banks who have communicated a willingness to extend credit to us on reasonable terms if the need for credit arises. In particular, it is likely that we would be required to borrow in the event of a large acquisition or a series of smaller acquisitions in a relatively short period of time.

**Table of Contents****STOCK PURCHASE AGREEMENT**

On August 30, 2005, we and our chairman of the board of directors terminated a stock purchase agreement that required us to repurchase shares from the chairman's estate upon his death. We had purchased term life insurance policies on our chairman to meet these repurchase obligations. We have terminated all related term life insurance policies. Expenses recognized under these policies were \$49,000 and \$53,000 for the years ended June 30, 2005 and 2004, respectively.

**OFF-BALANCE SHEET ARRANGEMENTS**

We do not have any off-balance sheet arrangements.

**CONTRACTUAL OBLIGATIONS**

The following table summarizes our contractual obligations as of June 30, 2006 that require us to make future cash payments. For contractual obligations, we included payments that we have an unconditional obligation to make. We did not include amounts already recorded on our balance sheet as liabilities at June 30, 2006.

	Payments due by period				
	Total	Less than 1 Year	Years 2 and 3	Years 4 and 5	After 5 Years
<b>Contractual obligations:</b>					
	(in thousands)				
Operating lease obligations, net	\$ 187,024	\$ 27,942	\$ 48,783	\$ 37,739	\$ 72,560
Total contractual obligations	\$ 187,024	\$ 27,942	\$ 48,783	\$ 37,739	\$ 72,560

In the normal course of our business, we enter into agreements with subcontractors and vendors to provide products and services that we consume in our operations or that are delivered to our customers. These products and services are not considered unconditional obligations until the products and services are actually delivered, at which time we record a liability for our obligation.

**RELATED PARTY TRANSACTIONS**

In May 2001, Mantas, which was previously one of our service offerings, was contributed to a separate company, Mantas, Inc., or Mantas, which was formed with funding and other contributions received from unrelated third parties. Mantas is a provider of services to the financial services industry to address anti-money laundering and other data mining issues. As of June 30, 2006, we owned approximately eight million shares of

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Mantas class A common stock. We have no cost basis in this investment and do not fund, nor is there any obligation or expectation to fund, the on-going operations of Mantas.

In the years ended June 30, 2005 and 2004, Mantas leased space and received other services from the Company for which the Company was reimbursed. The Company is no longer providing services to Mantas.

### **DESCRIPTION OF CRITICAL ACCOUNTING POLICIES**

The preparation of our financial statements in accordance with accounting principles generally accepted in the United States of America requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, as well as the disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates including those related to revenue recognition, doubtful accounts receivable, goodwill and other intangible assets, and other contingent liabilities. We base our estimates on our historical experience and various other factors that we believe are reasonable at the time the estimates are made. Actual results may differ significantly from our estimates under different assumptions or conditions. We believe the critical accounting policies requiring us to make significant estimates and judgments are revenue recognition, contract cost accounting, and accounting for acquisitions, including the identification of intangible assets and the



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ongoing impairment assessments of the intangible assets. If any of these estimates or judgments proves to be incorrect, our reported results could be materially affected.

### ***Revenue Recognition***

We recognize revenue when persuasive evidence of an arrangement exists, services have been rendered or goods delivered, the contract price is fixed or determinable, and collectibility is reasonably assured. We have a standard management process that we use to determine whether all required criteria for revenue recognition have been met. This standard management process includes a regular review of our contract performance. This review covers, among other matters, outstanding action items, progress against schedule, effort and staffing, requirements stability, quality, risks and issues, subcontract management, cost, commitments, and client satisfaction. During this review we determine whether the overall progress on a contract is consistent with the effort expended.

Absent evidence to the contrary, we recognize revenue as follows. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. We consider fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on time-and-materials contracts is recognized based on the hours actually incurred at the negotiated contract billing rates, plus the cost of any allowable material costs and out-of-pocket expenses. Revenue on fixed-price contracts is generally recognized using the percentage-of-completion method of contract accounting. Unless it is determined as part of our regular contract performance review that overall progress on a contract is not consistent with costs expended to date, we determine the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected upon completion of the contract. Revenue on fixed-price contracts pursuant to which a client pays us a specified amount to provide only a particular service for a stated time period, a so-called fee-for-service arrangement, is generally recognized ratably over the contract period, assuming all other criteria for revenue recognition are met. We consider performance-based fees, including award fees, under any contract type to be earned when we can demonstrate satisfaction of performance goals, based upon historical experience, or we receive contractual notification from a client that the fee has been earned. Billings for hardware or software purchased by customers under one of our contracts where we act as an agent, rather than a principal, in the transaction are excluded from our revenue and cost of services, except to the extent of any fee or profit earned.

Contract revenue recognition inherently involves estimation. Examples of estimates include the contemplated level of effort to accomplish the tasks under contract, the cost of the effort, and an ongoing assessment of our progress toward completing the contract. From time to time, as part of our standard management processes, facts develop that require us to revise our estimated total costs or revenue. To the extent that a revised estimate affects contract profit or revenue previously recognized, we record the cumulative effect of the revision in the period in which the facts requiring the revision become known. The full amount of an anticipated loss on any type of contract is recognized in the period in which it becomes probable and can be reasonably estimated.

From time to time, we may proceed with work based on client direction prior to the completion and signing of formal contract documents. We have a formal review process for approving any such work. Revenue associated with such work is recognized only when it can be reliably estimated and realization is probable. We base our estimates on previous experiences with the client, communications with the client regarding funding status, and our knowledge of available funding for the contract or program.

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We maintain reserves for doubtful accounts receivable that may arise in the normal course of business. Historically, we have not had significant write-offs of doubtful accounts receivable related to work we perform for the federal government. However, we do perform work on contracts and task orders where, on occasion, issues arise that lead to accounts receivable not being fully collected.

### ***Contract Cost Accounting***

As a contractor providing services primarily to the federal government, we must categorize our costs as either direct or indirect and allowable or unallowable. Direct costs are those costs that are identified with specific contracts. These costs include labor, subcontractor and consultant services, third party materials we purchase under a contract, and other non-labor costs incurred in support of a contract. Indirect costs are those costs not identified with specific contracts. Rather, indirect costs are allocated to contracts in accordance with federal government rules and regulations. These costs typically include our selling, general and administrative expenses, fringe benefit expenses, and depreciation and amortization costs. Direct and indirect costs that are not allowable under the Federal Acquisition Regulation or specific contract provisions cannot be considered for reimbursement under our federal government contracts. We must specifically identify these costs to ensure we comply with these requirements. Our unallowable costs include a portion of our executive compensation, certain employee morale activities, certain types of legal and consulting costs, and the amortization of identified intangible assets, among others. A key element to our recent margin expansion has been our success at controlling indirect cost growth and unallowable costs. In addition, as we acquire and integrate new companies, we have been able to manage our indirect costs by realizing opportunities for cost synergies and integrating the indirect support function of acquired companies into our own.

### ***Accounting for Acquisitions and Asset Impairment***

The purchase price that we pay to acquire the stock or assets of an entity must be assigned to the net assets acquired based on the estimated fair market value of those net assets. The purchase price in excess of the estimated fair market value of the tangible net assets and separately identified intangible assets acquired represents goodwill. The purchase price allocation related to acquisitions involves significant estimates and management judgments that may be adjusted during the purchase price allocation period, but generally not beyond one year from the acquisition date.

We must evaluate goodwill for impairment on an annual basis, or during any interim period if we have an indication that goodwill may be impaired. We assess the potential impairment of goodwill by comparing the carrying value of the assets and liabilities of our reporting unit to which goodwill is assigned to the estimated fair value of the reporting unit using a discounted cash flow approach. We performed our annual goodwill impairment analysis as of January 1, 2006. There was no indication of goodwill impairment as a result of our impairment analysis. If we are required to record an impairment charge in the future, it could materially affect our results of operations.

The estimated fair market value of identified intangible assets is amortized over the estimated useful life of the related intangible asset. We have a process pursuant to which we typically retain third-party valuation experts to assist us in determining the fair market values and useful lives of identified intangible assets. We evaluate these assets for impairment when events occur that suggest a possible impairment. Such events could include, but are not limited to, the loss of a significant client or contract, decreases in federal government appropriations or funding for specific programs or contracts, or other similar events. None of these events have occurred for the periods presented. We determine impairment by comparing the net book value of the asset to its future undiscounted net cash flows. If an impairment occurs, we will record an impairment expense equal to the difference between the net book value of the asset and its estimated discounted cash flows using a discount rate based on our cost of capital and the related risks of recoverability.



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### **DESCRIPTION OF STATEMENT OF OPERATIONS ITEMS**

The following is a description of certain line items of our statements of operations.

#### ***Revenue***

Most of our revenue is generated on the basis of services provided to the federal government, either by our employees or by our subcontractors. To a lesser degree, the revenue we earn may include third-party hardware and software that we purchase and integrate when requested by the client as a part of the solutions that we provide to our clients.

*Contract Types.* When contracting with our government clients, we enter into one of three basic types of contracts: cost-plus-fee, time-and-materials, and fixed-price.

*Cost-plus-fee contracts.* Cost-plus-fee contracts provide for reimbursement of allowable costs and the payment of a fee, which is our profit. Cost-plus-fixed-fee contracts specify the contract fee in dollars. Cost-plus-award-fee contracts may provide for a base fee amount, plus an award fee that varies, within specified limits, based upon the client's assessment of our performance as compared to contractual targets for factors such as cost, quality, schedule, and performance.

*Time-and-materials contracts.* Under a time-and-materials contract, we are paid a fixed hourly rate for each direct labor hour expended and we are reimbursed for allowable material costs and out-of-pocket expenses. To the extent our actual direct labor and associated costs vary in relation to the fixed hourly billing rates provided in the contract, we will generate more or less profit, or could incur a loss.

*Fixed-price contracts.* Under a fixed-price contract, we agree to perform the specified work for a pre-determined price. To the extent our actual costs vary from the estimates upon which the price was negotiated, we will generate more or less than the anticipated amount of profit or could incur a loss. Some fixed-price contracts have a performance-based component, pursuant to which we can earn incentive payments or incur financial penalties based on our performance.

#### ***Cost of Services***

Cost of services includes the direct costs to provide our services and business solutions to clients. The most significant of these costs are the salaries and wages, plus associated fringe benefits, of our employees directly serving clients. Cost of services also includes the costs of subcontractors and outside consultants, third-party materials, such as hardware or software that we purchase and provide to the client as part of an integrated solution, and any other direct costs, such as travel expenses incurred to support contract efforts.

#### ***Selling, General and Administrative Expenses***

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Selling, general and administrative expenses include the salaries and wages, plus associated fringe benefits, of our employees not performing work directly for clients. Among the functions covered by these costs are asset and facilities management, business development, research and development, contracts and legal, finance and accounting, executive and senior management, human resources, and information system support. Facilities-related costs are also included in selling, general and administrative expenses.

### *Depreciation and Amortization*

Depreciation and amortization includes depreciation of computers and other equipment, the amortization of software we use internally, the amortization of leasehold improvements, and the amortization of identified intangible assets. The amortization of computer software developed for sale to clients is included in cost of services.

### *Other Income*

The Internal Revenue Service, or IRS, challenged our use of the cash receipts and disbursements method of accounting for income taxes during its audit of our fiscal 1996 tax return. While we disagreed with the IRS on

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this matter, in order to bring the matter to closure, we agreed in February 2002 to convert from the cash method to the accrual method effective July 1, 2000. We had previously established an allowance of approximately \$2.6 million relating to the estimated probable interest on the tax liability. The provision for this accrual was reflected in other expense in the statements of operations through June 30, 2001. Because this allowance exceeded the amount of the actual federal interest payments of approximately \$538,000 and our estimated state interest payments of approximately \$250,000, we reversed approximately \$1.8 million of the allowance in fiscal year 2002. During fiscal 2004, we made final payments to settle all remaining state tax liabilities with respect to this matter. As a result, we reversed the remaining \$153,000 allowance balance. These reversals are reflected as other income in the statements of operations for fiscal year 2002 and fiscal year 2004.

## **DEFINITION OF CERTAIN TERMS USED IN THIS MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following is our definition of certain terms we have used in our discussion and analysis.

### ***Backlog***

We define backlog to include funded and unfunded orders for services under existing signed contracts, assuming the exercise of all options relating to those contracts, less the amount of revenue we have previously recognized under those contracts. Backlog includes all contract options that have been priced but not yet funded. Backlog also includes the contract value under single award ID/IQ contracts against which we expect future task orders to be issued without competition. Backlog does not take contract ceiling value into consideration under multiple award contracts, nor does it include any estimate of future potential delivery orders that might be awarded under multiple award ID/IQ vehicles, GWAC contracts, or GSA schedules. We define funded backlog to be the portion of backlog for which funding currently is appropriated and obligated to us under a contract or other authorization for payment signed by an authorized purchasing authority.

Our backlog includes orders under contracts that in some cases extend for several years, with the latest expiring during calendar year 2016.

We cannot guarantee that we will recognize any revenue from our backlog. The federal government has the prerogative to cancel any contract or delivery order at any time. Most of our contracts and delivery orders have cancellation terms that would permit us to recover all or a portion of our incurred costs and potential fees in such cases. Backlog varies considerably from time to time as current contracts or delivery orders are executed and new contracts or delivery orders under existing contracts are won.

### ***Days Sales Outstanding***

We calculate days sales outstanding, or DSO, by dividing the average accounts receivable at the beginning and end of the period, net of average billings in excess of revenue, by revenue per day in the period. Revenue per day for a quarter is determined by dividing total revenue by 90 days. Revenue per day for a year is determined by dividing total revenue by 360 days.

### ***Direct Labor Utilization***

We define direct labor utilization as the ratio of labor dollars worked on customer engagements to total labor dollars worked. We include every working employee of the company in the computation. We exclude leave taken, such as vacation time or sick leave, so that we can understand how we are applying worked labor. Leave actually taken by our employees is largely beyond the control of management in the near term.

*Organic Growth*

We calculate organic growth by comparing our actual reported revenue in the current period, including revenue attributable to acquired companies, with adjusted revenue from the prior-year period. In arriving at prior-year revenue, we include the revenue of acquired companies for the prior-year periods comparable to the current-year periods for which the acquired companies are included in our actual reported revenue. The resulting growth

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rate is intended to represent our organic, or non-acquisitive, growth year-over-year, including comparable period growth attributable to acquired companies. For illustrative purposes, we compute our fiscal 2006 organic growth rate of 17.2% as follows:

	Year Ended June 30,		
	2006	2005	% Increase
Revenue, as reported	\$ 1,179,267	\$ 881,770	33.7%
Plus: Revenue from acquired companies for the comparable prior year period		124,643	
Organic Revenue	\$ 1,179,267	\$ 1,006,413	17.2%

**Recent Accounting Pronouncements**

In June 2006, the Emerging Issues Task Force, or EITF, reached a consensus on Issue No. 06-3, How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation). EITF Issue No. 06-3 requires that companies disclose their accounting policy regarding the gross or net presentation of certain taxes. Taxes within the scope of EITF Issue No. 06-3 are any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise taxes. EITF Issue No. 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. We do not expect the adoption of this new accounting guidance to have a material impact on our financial position, results of operations, or cash flows.

In July 2006, the FASB issued Interpretation No. 48 ( FIN 48 ), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes, and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating what effect, if any, the adoption of FIN 48 will have on our financial position, results of operations, or cash flows.

**Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Financial instruments that potentially subject us to credit risk consist primarily of cash equivalents, short- and long-term investments, and accounts receivable.

We believe that concentrations of credit risk with respect to cash equivalents and investments are limited due to the high credit quality of these investments. Our investment policy requires that investments be in direct obligations of the U.S. government, certain U.S. government sponsored entities, investments that are secured by direct or sponsored U.S. government obligations, or certain corporate or municipal debt obligations rated at least single-A or A-1/P-1, as applicable, by both Moody's Investor Service and Standard and Poor's. Our policy does not allow investment



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in any equity securities or the obligations of any entity under review for possible downgrade by a major rating service to a debt rating below single-A.

Investments in both fixed and floating rate interest earning instruments carry a degree of interest rate risk. Fixed securities may have their fair market value adversely affected because of a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations because of changes in interest rates or we may suffer losses in principal if forced to sell securities which have seen a decline in market value because of changes in interest rates. Investments are made in accordance with an investment policy approved by our board of directors.

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Under this policy, no investment securities may have maturities exceeding two years and the average duration of the portfolio cannot exceed nine months. A one percentage point change in the interest rate we earn between July 1, 2006 and December 31, 2006, could have approximately a \$1.0 million impact on our interest income for the period ending June 30, 2007.

We believe that concentrations of credit risk with respect to accounts receivable are limited as they are primarily federal government receivables.

As of June 30, 2006 and 2005, the carrying value of financial instruments approximated fair value. These investments consist of corporate and municipal bonds with maturities of 7 months or less that are classified as held-to-maturity.

## **Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The consolidated financial statements of SRA International, Inc. and subsidiaries are submitted on pages F-1 through F-26 of this report.

## **Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

Not Applicable

## **Item 9A. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2006. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2006, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

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No change in our internal control over financial reporting occurred during the fiscal quarter ended June 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of SRA International, Inc. and subsidiaries (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting, as that term is defined in Exchange Act Rule 13a-15(f), and for assessing the effectiveness of internal control over financial reporting. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability and fair presentation of published financial statements in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of management, including our chief executive officer and chief financial officer, management assessed the effectiveness of the Company's internal control over financial reporting as of June 30, 2006 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*. This assessment excluded the internal control over financial reporting at Spectrum Solutions Group, Inc., which was acquired on November 2, 2005 and whose financial statements reflect total assets and revenue both constituting 1 percent of the related consolidated financial statement amounts as of and for the year ended June 30, 2006. Based on this assessment, management determined that the Company's internal control over financial reporting was effective as of June 30, 2006.

Deloitte & Touche LLP (D&T), an independent registered public accounting firm, has issued an attestation report on management's assessment of the Company's internal control over financial reporting. The D&T report immediately follows this report.

/s/ RENATO A. DiPENTIMA

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**President and Chief Executive Officer**

/s/ STEPHEN C. HUGHES

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**Executive Vice President, Chief Financial Officer**

**and Chief of Finance and Administration**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING**

To the Board of Directors and Stockholders of

SRA International, Inc.

Fairfax, VA

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that SRA International, Inc. and subsidiaries (the Company) maintained effective internal control over financial reporting as of June 30, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. As described in Management's Report on Internal Control Over Financial Reporting, management excluded from their assessment the internal control over financial reporting at Spectrum Solutions Group, Inc., which was acquired on November 2, 2005 and whose financial statements reflect total assets and revenues both constituting 1 percent of the related consolidated financial statement amounts as of and for the year ended June 30, 2006. Accordingly, our audit did not include the internal control over financial reporting at Spectrum Solutions Group, Inc. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

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

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In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of June 30, 2006, is fairly stated, in all material respects, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2006, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended June 30, 2006 of the Company and our report dated August 22, 2006 expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ DELOITTE & TOUCHE LLP

McLean, Virginia

August 22, 2006

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**Item 9B. OTHER INFORMATION**

Not Applicable

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**PART III**

Certain information required by Part III is omitted from this Annual Report on Form 10-K and incorporated herein by reference to the definitive proxy statement with respect to our 2006 annual meeting of stockholders (the Proxy Statement), which we will file with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year covered by this report.

**Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Certain information required by this Item is contained under the heading Executive Officers of the Registrant in Part I of this report. Other information required by this Item will appear under the headings Proposal 1 Election of Directors and Corporate Governance in the Proxy Statement, which sections are incorporated herein by reference.

The disclosure required by Item 405 of Regulation S-K will appear under the heading Section 16(a) Beneficial Ownership Reporting Compliance in the Proxy Statement, which section is incorporated herein by reference.

We have adopted a written code of ethics that applies to our principal executive officer, principal financial officer, and principal accounting officer or controller, or persons performing similar functions. We have posted a current copy of the code on our website, which is located at [www.sra.com](http://www.sra.com). In addition, we intend to post on our website all disclosures that are required by law or NYSE stock market listing standards concerning any amendments to, or waivers from, any provision of the code.

**Item 11. EXECUTIVE COMPENSATION**

The information required by this Item will appear under the headings Director Compensation, Executive Compensation, Compensation Committee Report on Executive Compensation, Compensation Committee Interlocks and Insider Participation, and Comparative Stock Performance in the Proxy Statement, which sections are incorporated herein by reference.

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

The information required by this Item will appear under the headings Beneficial Ownership of Common Stock and Equity Compensation Plan Information in the Proxy Statement, which sections are incorporated herein by reference.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**



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The information required by this Item will appear under the heading Certain Relationships and Transactions in the Proxy Statement, which section is incorporated herein by reference.

### **Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this Item will appear under the heading Proposal 2 Ratification of Selection of Independent Auditors in the Proxy Statement, which section is incorporated herein by reference.

**Table of Contents****PART IV****Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) Documents filed as part of the report:

(1) Financial Statements

	<b>Page</b>
<u>Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements</u>	
	F-1
<u>Consolidated Balance Sheets</u>	F-2
<u>Consolidated Statements of Operations</u>	F-4
<u>Consolidated Statements of Changes in Stockholders' Equity</u>	F-5
<u>Consolidated Statements of Cash Flows</u>	F-6
<u>Notes to Consolidated Financial Statements</u>	F-7

(2) Financial Statement Schedule

<u>Schedule II Valuation and Qualifying Accounts</u>	F-26
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(3) Exhibits

<b>Exhibit Number</b>	<b>Description</b>
2.1	Agreement and Plan of Merger, by and among SRA International, Inc., Alex Acquisition Corporation, and Adroit Systems, Inc., dated January 3, 2003. Pursuant to Item 601(b)(2) of Regulation S-K, the exhibits and schedules of the Agreement and Plan of Merger are omitted.
3.1	Amended and Restated Certificate of Incorporation of the Registrant
3.2	Amended and Restated By-Laws of the Registrant
4.1	Specimen common stock certificate
4.2	See Exhibits 3.1 and 3.2 for provisions of the Certificate of Incorporation and By-Laws of the Registrant defining the rights of holders of common stock of the Registrant

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10.1	1994 Stock Option Plan, as amended*
10.2	1985 Key Employee Incentive Plan*
10.3	2002 Stock Incentive Plan*
10.4	Deferred Compensation Plan for Key Employees, as amended*
10.5	Office Lease Agreement, dated May 11, 1999, between the Registrant and Fair Lakes North and South L.P., as amended
10.6	Office Lease Agreement, dated May 11, 1999, between the Registrant and Fair Lakes North and South L.P., as amended
10.8	401(k) Savings Plan, as amended and restated effective January 1, 2001*
10.8a^	Amendment to 401(k) Savings Plan*
21.1	Subsidiaries of the Registrant
23.1	Consent of Independent Registered Public Accounting Firm

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Exhibit Number	Description
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Previously filed and incorporated by reference to the Registrant's Registration Statement on Form S-1 filed on May 21, 2002 (333-83780).

Incorporated by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended June 30, 2002 (File No. 001-31334).

Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the SEC on February 13, 2002 (File No. 001-31334).

^ Incorporated by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended June 30, 2003 (File No. 001-31334).

\* Management contract or compensatory plan, contract or arrangement.

(b) *Exhibits*. The exhibits required by this Item are listed under Item 15(a)(3).

(c) *Financial Statement Schedule*. The financial statement schedule required by this Item is listed under Item 15(a)(2). All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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, in the city of Fairfax, Virginia on the 24<sup>th</sup> day of August, 2006.

**SRA INTERNATIONAL, INC.**

By: /s/ RENATO A. DiPENTIMA  
**Renato A. DiPentima**

**President and Chief Executive Officer**

**(Principal Executive Officer)**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ Renato A. DiPentima <b>Renato A. DiPentima</b>	President and Chief Executive Officer (Principal Executive Officer)	August 24, 2006
/s/ STEPHEN C. HUGHES <b>Stephen C. Hughes</b>	Executive Vice President, Chief Financial Officer and Chief of Finance and Administration (Principal Financial and Accounting Officer)	August 24, 2006
/s/ ERNST VOLGENAU <b>Ernst Volgenau</b>	Chairman	August 24, 2006
/s/ JOHN W. BARTER <b>John W. Barter</b>	Director	August 24, 2006
/s/ WILLIAM K. BREHM <b>William K. Brehm</b>	Director	August 24, 2006
/s/ STEVEN A. DENNING <b>Steven A. Denning</b>	Director	August 24, 2006
/s/ MILES R. GILBURNE <b>Miles R. Gilburne</b>	Director	August 24, 2006
/s/ MICHAEL R. KLEIN <b>Michael R. Klein</b>	Director	August 24, 2006

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**Michael R. Klein**

/s/ DAVID H. LANGSTAFF

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**David H. Langstaff**

Director

August 24, 2006

/s/ EDWARD E. LEGASEY

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**Edward E. Legasey**

Director

August 24, 2006

/s/ DELBERT C. STALEY

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**Delbert C. Staley**

Director

August 24, 2006

/s/ GAIL R. WILENSKY

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**Gail R. Wilensky**

Director

August 24, 2006

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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON THE  
CONSOLIDATED FINANCIAL STATEMENTS**

To the Board of Directors and Stockholders of

SRA International, Inc.

Fairfax, VA

We have audited the accompanying consolidated balance sheets of SRA International, Inc. and subsidiaries (the Company) as of June 30, 2006 and 2005, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of SRA International, Inc. and subsidiaries as of June 30, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2006 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of June 30, 2006, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 22, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

McLean, Virginia

August 22, 2006

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## SRA INTERNATIONAL, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(in thousands)

## Assets

	June 30,	
	2006	2005
Current assets:		
Cash and cash equivalents	\$ 173,564	\$ 162,973
Short-term investments	9,834	20,156
Accounts receivable, net	266,160	206,995
Prepaid expenses and other	23,382	19,931
Deferred income taxes, current	4,839	6,506
Total current assets	477,779	416,561
Property and equipment, net	37,462	34,754
Other assets:		
Goodwill	169,334	89,214
Identified intangibles, net	26,169	17,661
Investments		5,172
Deferred income taxes, noncurrent	3,462	
Deferred compensation trust	7,768	5,755
Total other assets	206,733	117,802
Total assets	\$ 721,974	\$ 569,117

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

**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share amounts)****Liabilities and Stockholders' Equity**

	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Current liabilities:</b>		
Accounts payable and accrued expenses	\$ 115,545	\$ 74,970
Accrued payroll and employee benefits	59,463	49,486
Billings in excess of revenue recognized	3,204	6,616
<b>Total current liabilities</b>	<b>178,212</b>	<b>131,072</b>
<b>Long-term liabilities:</b>		
Deferred income taxes, noncurrent		106
Other long-term liabilities	10,465	8,847
<b>Total long-term liabilities</b>	<b>10,465</b>	<b>8,953</b>
<b>Total liabilities</b>	<b>188,677</b>	<b>140,025</b>
<b>Commitments and contingencies</b>		
<b>Stockholders' equity:</b>		
Preferred stock, par value \$0.20 per share; 5,000,000 shares authorized; none issued		
Class A common stock, par value \$0.004 per share; 180,000,000 shares authorized; 42,158,048 and 39,239,400 shares issued as of June 30, 2006 and 2005; 41,403,312 and 38,419,877 shares outstanding as of June 30, 2006 and 2005	169	157
Class B common stock, par value \$0.004 per share; 55,000,000 shares authorized; 14,459,828 and 15,627,466 shares issued and outstanding as of June 30, 2006 and 2005	58	63
Additional paid-in capital	275,440	231,754
Treasury stock, at cost	(6,302)	(4,839)
Deferred stock-based compensation	(888)	(343)
Retained earnings	264,820	202,300
<b>Total stockholders' equity</b>	<b>533,297</b>	<b>429,092</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 721,974</b>	<b>\$ 569,117</b>

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



**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except share and per share amounts)**

	Year Ended June 30,		
	2006	2005	2004
Revenue	\$ 1,179,267	\$ 881,770	\$ 615,802
Operating costs and expenses:			
Cost of services	880,802	653,115	442,771
Selling, general and administrative	183,297	126,404	100,919
Depreciation and amortization	18,201	13,141	10,511
Total operating costs and expenses	1,082,300	792,660	554,201
Operating income	96,967	89,110	61,601
Interest income, net	4,232	3,442	1,474
Other income			153
Income before taxes	101,199	92,552	63,228
Provision for income taxes	38,679	34,829	24,291
Net income	\$ 62,520	\$ 57,723	\$ 38,937
Earnings per share:			
Basic	\$ 1.14	\$ 1.09	\$ 0.76
Diluted	\$ 1.08	\$ 1.02	\$ 0.71
Weighted-average shares:			
Basic	55,064,138	52,965,623	51,008,978
Diluted	57,738,875	56,549,303	54,738,028

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

**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

(in thousands, except share amounts)

	Class A		Class B		Additional Paid-In Capital	Deferred		Total		
	Common Stock		Common Stock			Treasury Stock			Stock-Based Retained	
	Shares	Amount	Shares	Amount	Shares	Amount	Compensation Earnings			
Balance, July 1, 2003	45,156,014	\$ 186	20,905,506	\$ 80	\$ 224,675	(15,985,022)	\$ (47,057)	\$ (509)	\$ 105,640	\$ 283,015
Net income									38,937	38,937
Issuance of common stock	1,490,332	6			5,453					5,459
Reissuance of treasury stock					3,992	217,530	642			4,634
Purchase of treasury stock						(8,884)	(145)			(145)
Tax benefits of stock option exercises					7,109					7,109
Shares converted between classes	531,096	2	(531,096)	(2)						
Issuance of restricted stock					466				(466)	
Amortization of deferred stock-based compensation									259	259
Balance, June 30, 2004	47,177,442	194	20,374,410	78	241,695	(15,776,376)	(46,560)	(716)	144,577	339,268
Net income									57,723	57,723
Issuance of common stock	2,131,283	9			10,016					10,025
Reissuance of treasury stock					4,030	122,530	405			4,435
Adjustment due to stock split	(10,937,171)	(49)	(3,882,352)	(12)	(41,255)	14,834,323	41,316			
Tax benefits of stock option exercises					17,156					17,156
Shares converted between classes	864,592	3	(864,592)	(3)						
Issuance of common stock for ESPP	5,626				168					168
Issuance of restricted stock	(2,372)				(56)				56	
Compensatory stock options issued or modified									240	240
Amortization of deferred stock-based compensation									77	77
Balance, June 30, 2005	39,239,400	157	15,627,466	63	231,754	(819,523)	(4,839)	(343)	202,300	429,092
Net income									62,520	62,520
Issuance of common stock	1,680,503	7			11,746					11,753
Reissuance of treasury stock					3,198	134,162	799			3,997
Purchase of treasury stock						(69,375)	(2,262)			(2,262)
Tax benefits of stock option exercises					13,774					13,774
Shares converted between classes	1,167,638	5	(1,167,638)	(5)						
Issuance of common stock for ESPP	36,179				1,246					1,246
Issuance of restricted stock	34,328				919				(919)	
FAS 123R stock based compensation					12,803					12,803
Amortization of deferred stock-based compensation									374	374
Balance, June 30, 2006	42,158,048	\$ 169	14,459,828	\$ 58	\$ 275,440	(754,736)	\$ (6,302)	\$ (888)	\$ 264,820	\$ 533,297

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



**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)**

	<b>Year Ended June 30,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Cash flows from operating activities:</b>			
Net income	\$ 62,520	\$ 57,723	\$ 38,937
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Depreciation and amortization	18,201	13,141	10,511
Stock-based compensation	13,177	317	259
Tax benefits of stock option exercises		17,156	7,109
Deferred income taxes	(1,901)	(3,570)	1,982
<b>Changes in assets and liabilities, net of the effect of acquisitions:</b>			
Accounts receivable	(39,074)	(35,890)	(39,051)
Prepaid expenses and other	2,250	2,941	(10,466)
Accounts payable and accrued expenses	32,609	7,704	23,573
Accrued payroll and employee benefits	2,534	8,226	7,164
Billings in excess of revenue recognized	(3,412)	(1,660)	3,152
Other	(73)	(100)	281
<b>Net cash provided by operating activities</b>	<b>86,831</b>	<b>65,988</b>	<b>43,451</b>
<b>Cash flows from investing activities:</b>			
Capital expenditures	(15,639)	(21,353)	(11,760)
Purchases of investments	(9,748)	(18,516)	(22,792)
Sales and maturities of investments	25,723	15,983	1,083
Acquisition of ORION Scientific Systems, net of cash acquired			(32,927)
Acquisition of Touchstone Consulting Group, net of cash acquired		(37,124)	
Acquisition of Galaxy Scientific Corporation, net of cash acquired	(95,645)		
Acquisition of Spectrum Solutions Group, net of cash acquired	(8,802)		
Acquisition of Mercomms Unlimited, net of cash acquired	(637)		
<b>Net cash used in investing activities</b>	<b>(104,748)</b>	<b>(61,010)</b>	<b>(66,396)</b>
<b>Cash flows from financing activities:</b>			
Issuance of common stock	12,999	10,193	5,459
Tax benefits of stock option exercises	13,774		
Reissuance of treasury stock	3,997	4,435	3,134
Purchase of treasury stock	(2,262)		(145)
Repayment of term loan			(400)
<b>Net cash provided by financing activities</b>	<b>28,508</b>	<b>14,628</b>	<b>8,048</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>10,591</b>	<b>19,606</b>	<b>(14,897)</b>
Cash and cash equivalents, beginning of period	162,973	143,367	158,264

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Cash and cash equivalents, end of period	\$ 173,564	\$ 162,973	\$ 143,367
Supplemental disclosures of cash flow information:			
Cash paid during the period:			
Income taxes	\$ 26,377	\$ 21,211	\$ 11,249
Cash received during the period:			
Interest	\$ 4,219	\$ 3,897	\$ 1,524
Income taxes	\$ 1,038	\$ 652	\$ 767

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



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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Years Ended June 30, 2006, 2005, and 2004**

**1. Summary of Significant Accounting Policies:**

**Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of SRA International, Inc. (a Delaware corporation), and its wholly-owned subsidiaries (SRA or the Company). All significant intercompany transactions and balances have been eliminated. Investments in other companies in which the Company exerts significant influence but does not have a controlling interest are accounted for using the equity method of accounting.

**Nature of Business**

SRA provides technology and strategic consulting services and solutions primarily to clients in national security, civil government, and health care and public health. Since SRA's founding in 1978, the Company has derived substantially all of its revenue from services provided to federal government clients. SRA expects that services provided to federal government clients will continue to account for substantially all of its revenue for the foreseeable future.

Revenue from contracts with federal government agencies was 99 percent of total revenue for all periods presented herein. The National Guard, as a client group, accounted for approximately 10 percent, 11 percent, and 13 percent of revenue for the years ended June 30, 2006, 2005, and 2004, respectively. The United States Agency for International Development, as a client, accounted for approximately 10 percent, 12 percent, and 10 percent of revenue for the years ended June 30, 2006, 2005, and 2004, respectively. No other client or client group accounted for more than 10 percent of revenue in the periods presented herein.

**Accounting Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and judgments in determining the reported amounts of assets, liabilities, revenue and expenses, as well as the disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to revenue recognition, doubtful accounts receivable, goodwill and other intangible assets, and other contingent liabilities. The Company bases its estimates on historical experience and various other factors that are deemed reasonable at the time the estimates are made. Actual results may differ from estimates under different assumptions or conditions. See the Revenue Recognition section of this Note and Notes 2, 5, 6, 8, 10, 11 and 16 for additional information on certain estimates included in the Company's consolidated financial statements.

**Revenue Recognition**

*Contract Accounting*

The Company recognizes revenue when persuasive evidence of an arrangement exists, services have been rendered or goods delivered, the contract price is fixed or determinable, and collectibility is reasonably assured. The Company has a standard management process that we use to determine whether all required criteria for revenue recognition have been met. This standard management process includes a regular review of the Company's contract performance. This review covers, among other matters, outstanding action items, progress against schedule, effort and staffing, requirements stability, quality, risks and issues, subcontract management, cost, commitments, and client satisfaction. During this review, the Company determines whether the overall progress on a contract is consistent with the effort expended.

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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended June 30, 2006, 2005, and 2004**

Absent evidence to the contrary, the Company recognizes revenue as follows. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. The Company considers fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on time-and-materials contracts is recognized based on the hours actually incurred at the negotiated contract billing rates, plus the cost of any allowable material costs and out-of-pocket expenses. Revenue on fixed-price contracts is generally recognized using the percentage-of-completion method of contract accounting. Unless it is determined as part of the Company's regular contract performance review that overall progress on a contract is not consistent with costs expended to date, the Company determines the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected upon completion of the contract. Revenue on fixed-price contracts pursuant to which a client pays us a specified amount to provide only a particular service for a stated time period, a so-called fee-for-service arrangement, is generally recognized ratably over the contract period, assuming all other criteria for revenue recognition are met. Performance-based fees, including award fees, under any contract type are considered earned when the Company can demonstrate satisfaction of performance goals, based upon historical experience, or has received contractual notification from a client that the fee has been earned. Billings for hardware or software purchased by customers under one of SRA's contracts where SRA acts as an agent, rather than a principal, in the transaction are excluded from the Company's revenue and cost of services, except to the extent of any fee or profit earned.

Contract revenue recognition inherently involves estimation. Examples of estimates include the contemplated level of effort to accomplish the tasks under contract, the cost of the effort, and an ongoing assessment of the Company's progress toward completing the contract. From time to time, as part of the Company's standard management processes, facts develop that require the Company to revise its estimated total costs or revenue. To the extent that a revised estimate affects contract profit or revenue previously recognized, the Company records the cumulative effect of the revision in the period in which the facts requiring the revision become known. The full amount of an anticipated loss on any type of contract is recognized in the period in which it becomes probable and can be reasonably estimated.

From time to time, the Company may proceed with work based on client direction prior to the completion and signing of formal contract documents. The Company has a formal review process for approving any such work. Revenue associated with such work is recognized only when it can be reliably estimated and realization is probable. The Company bases its estimates on previous experiences with the client, communications with the client regarding funding status, and its knowledge of available funding for the contract or program.

Disputes occasionally arise in the normal course of the Company's business due to events such as delays, changes in contract specifications, and questions of cost allowability or collectibility. Such matters, whether claims or unapproved change orders in the process of negotiation, are recorded at the lesser of their estimated net realizable value or actual costs incurred, and only when realization is probable and can be reliably estimated. Claims against the Company are recognized where a loss is considered probable and can be reasonably estimated in amount.

Unbilled accounts receivable are stated at the lower of actual cost incurred plus accrued profits or net estimated realizable value of incurred costs, reduced by billings to date. The Company maintains reserves for doubtful accounts receivable that may arise in the normal course of business. Historically, the Company has not had significant write-offs of doubtful accounts receivable related to work performed for the federal government. However, the Company performs work on contracts and task orders where, on occasion, issues arise that lead to accounts receivable not being fully collected. It is the Company's policy to provide reserves for the collectibility

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of accounts receivable when it is determined that it is probable that the Company will not collect all amounts due and the amount of the reserve requirements can be reasonably estimated.

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**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended June 30, 2006, 2005, and 2004**

Revenue for the years ended June 30, 2006, 2005, and 2004 was earned from the following contract types:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cost-plus-fee	45%	46%	44%
Time-and-materials	40	34	38
Fixed-price	15	20	18

***Software Licensing and Related Activities***

The Company enters into arrangements, which may include the sale of licenses of the Company's proprietary software, consulting services and maintenance, or various combinations of each element. The Company recognizes revenue based on Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended, and modified by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. SOP 98-9 modified SOP 97-2 by requiring revenue to be recognized using the residual method if certain conditions are met. Revenue is recognized based on the residual method when an agreement has been signed by both parties, the fees are fixed or determinable, collection of the fees is probable, delivery of the product has occurred, and no other significant obligations remain. In the limited cases where return or refund rights have been offered, the Company defers all revenue recognition until the end of the return or refund period. Total software licensing and related activities revenue was \$3,961,000, \$4,148,000, and \$2,318,000 for the years ended June 30, 2006, 2005, and 2004, respectively. Software licensing of the Company's proprietary software and related activities revenue was less than one percent of consolidated revenue for all periods presented.

**Research and Development Costs**

Research and development costs are expensed as incurred. Total research and development costs, which are included in selling, general and administrative expenses, were \$1,290,000, \$1,638,000, and \$1,708,000 for the years ended June 30, 2006, 2005, and 2004, respectively.

**Internal-Use Computer Software**

The Company capitalizes costs incurred to license and implement software for internal-use in accordance with SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal-Use. Such costs are amortized over periods ranging from three to seven years. Internal-use software costs capitalized were \$638,000, \$2,813,000, and \$610,000 for the years ended June 30, 2006, 2005, and 2004, respectively.

### **Impairment of Long-Lived Assets**

Whenever events or changes in circumstances indicate that the carrying amount of long-lived assets and other intangibles may not be fully recoverable, the Company evaluates the probability that future undiscounted net cash flows, without interest charges, will be less than the carrying amount of the assets. If an impairment is indicated as a result of this review, the Company recognizes a loss based on the amount by which the carrying amount exceeds the estimated discounted future cash flows.

### **Income Taxes**

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recognized for the tax consequences of temporary differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities less valuation allowances, if required. Enacted statutory tax rates are used to compute the tax consequences of these temporary differences.

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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended June 30, 2006, 2005, and 2004**

**Deferred Compensation Plan**

Certain key employees of the Company are eligible to defer a specified percentage of their cash compensation by having it contributed to a nonqualified deferred compensation plan. Eligible employees may elect to defer up to 50 percent of their base salary and up to 100 percent of performance bonuses, reduced by any amounts withheld for the payment of taxes or other deductions required by law. The Company funds its deferred compensation liabilities by making cash contributions to a Rabbi Trust at the time the salary or bonus being deferred would otherwise be payable to the employee. Gains or losses on amounts held in the Rabbi Trust are fully allocable to plan participants. As a result, there is no net impact on the Company's results of operations, and the liability to plan participants is fully funded at all times.

**Cash and Cash Equivalents**

The Company considers all highly liquid investments with a current maturity of 90 days or less to be cash equivalents.

**Investments in Debt Securities**

The Company considers all investments with current maturity dates of one year or less that do not qualify as cash equivalents to be short-term investments. The Company does not purchase investments with original maturity dates that exceed two years. The Company classifies all investments in debt securities as held-to-maturity and accounts for these investments at amortized cost.

**Property and Equipment**

Property and equipment, including major additions or improvements thereto, are recorded at cost and depreciated over their estimated useful lives ranging from three to seven years using the straight-line method. Leasehold improvements are amortized over the lesser of the lease term or the asset's estimated useful life, but typically not exceeding seven years, using the straight-line method. Depreciation and amortization expense related to property and equipment, including capitalized internal-use computer software, was \$13,205,000, \$11,150,000, and \$9,142,000 for the years ended June 30, 2006, 2005, and 2004, respectively.

**Goodwill and Intangible Assets**

Goodwill, which represents the excess of the cost of an acquired entity over the net amounts assigned to assets acquired and liabilities assumed, is assessed for impairment under Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" (Note 5). Intangible assets with finite lives are amortized on a straight-line basis over their useful lives, typically determined with the assistance of an outside valuation firm, of 5 to 12 years. Intangible assets are evaluated for impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable in accordance with SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets."

#### **Concentration of Credit Risk and Fair Value of Financial Instruments**

Financial instruments that potentially subject the Company to credit risk consist primarily of cash equivalents, short- and long-term investments, and accounts receivable. The Company believes that concentrations of credit risk with respect to cash equivalents and investments are limited due to the high credit quality of these investments. The Company's investment policy requires that investments be in direct obligations of the U.S. government, certain U.S. government sponsored entities, investments that are secured by direct or sponsored U.S. government obligations, or certain corporate or municipal debt obligations rated at least single-A or A-1/P-1, as applicable, by both Moody's Investor Service and Standard and Poor's. The Company's policy



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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended June 30, 2006, 2005, and 2004**

does not allow investment in any equity securities or the obligations of any entity under review for possible downgrade by a major rating service to a debt rating below single-A.

Investments in both fixed and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely affected because of a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations because of changes in interest rates or the Company may suffer losses in principal if forced to sell securities which have seen a decline in market value because of changes in interest rates. Investments are made in accordance with an investment policy approved by the Company's board of directors. Under this policy, no investment securities may have original maturities exceeding two years and the average duration of the portfolio cannot exceed nine months.

The Company believes that concentrations of credit risk with respect to accounts receivable are limited as they are primarily federal government receivables.

As of June 30, 2006 and 2005, the carrying value of financial instruments approximated fair value. These investments consist of corporate and municipal bonds with maturities of 7 months or less that are classified as held-to-maturity.

**Stock Split**

On May 2, 2005, the Company's board of directors declared a two-for-one split of the Company's outstanding common stock in the form of a 100 percent stock dividend. The stock dividend was distributed on May 27, 2005 to stockholders of record on May 13, 2005.

The par value of the Company's common stock was not adjusted with the stock split and remains at \$0.004 per share. As a result, the Company reclassified amounts from additional paid-in capital to class A and class B par value of common stock based on the total shares of common stock issued. The Company used treasury shares to satisfy a portion of the stock dividend. The issuance of treasury shares was accounted for by transferring the book value of those shares from treasury stock to additional paid-in capital.

All per share amounts, outstanding shares of common stock, and common stock equivalents reported in the accompanying consolidated financial statements and notes thereto have been adjusted to retroactively reflect the stock split.

**Earnings Per Share**

Basic earnings per share (EPS) is computed by dividing reported net income by the weighted-average number of common shares outstanding. Diluted EPS considers the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The difference between basic and diluted weighted-average common equivalent shares with respect to the Company's EPS calculation is due entirely to the assumed exercise of stock options. The dilutive effect of stock options for each period reported is summarized below:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Basic weighted-average common shares outstanding	55,064,138	52,965,623	51,008,978
Effect of potential exercise of stock options	2,674,737	3,583,680	3,729,050
Diluted weighted-average common shares outstanding	<u>57,738,875</u>	<u>56,549,303</u>	<u>54,738,028</u>

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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended June 30, 2006, 2005, and 2004**

Stock options that could potentially dilute basic EPS in the future that were not included in the computation of diluted EPS, because to do so would have been antidilutive, were 1,490,708, 375,000, and 46,000 for the years ended June 30, 2006, 2005, and 2004, respectively.

**Recent Accounting Pronouncements**

In June 2006, the Emerging Issues Task Force, or EITF, reached a consensus on Issue No. 06-3, How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation). EITF Issue No. 06-3 requires that companies disclose their accounting policy regarding the gross or net presentation of certain taxes. Taxes within the scope of EITF Issue No. 06-3 are any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise taxes. EITF Issue No. 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. The Company does not expect the adoption of this new accounting guidance to have a material impact on its financial position, results of operations, or cash flows.

In July 2006, the FASB issued Interpretation No. 48 ( FIN 48 ), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes, and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating what effect, if any, the adoption of FIN 48 will have on its financial position, results of operations, or cash flows.

**Reclassifications**

Certain reclassifications have been made to prior-period balances to conform to the current-period presentation.

**2. Accounts Receivable:**

Accounts receivable, net as of June 30, 2006 and 2005 consisted of the following (in thousands):

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	<u>2006</u>	<u>2005</u>
Billed and billable, net of allowance of \$1,614 and \$1,159 as of June 30, 2006 and 2005, respectively	\$ 242,259	\$ 195,140
Unbilled:		
Retainages	5,347	4,444
Revenue recorded in excess of milestone billings on fixed-price contracts	7,210	3,783
Revenue recorded in excess of contractual authorization, billable upon receipt of contractual amendments/documents	13,079	5,480
Allowance for unbillable amounts	(1,735)	(1,852)
<b>Total unbilled</b>	<u>23,901</u>	<u>11,855</u>
<b>Total accounts receivable</b>	<u>\$ 266,160</u>	<u>\$ 206,995</u>

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**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended June 30, 2006, 2005, and 2004**

The billable receivables included in the billed and billable line item above represent primarily revenue earned in the final month of the reporting period and were billable as of the balance sheet date. These billable receivables are typically billed and collected within 90 days of the balance sheet date.

Consistent with industry practice, certain receivables related to long-term contracts are classified as current, although a portion of these amounts is not expected to be billed and collected within one year. Unbilled accounts receivable at June 30, 2006 are expected to be billed and collected within one year except for approximately \$1.6 million related to a portion of retainages.

**3. Prepaid Expenses and Other:**

Prepaid expenses and other as of June 30, 2006 and 2005 consisted of the following (in thousands):

	<u>2006</u>	<u>2005</u>
Hardware and equipment purchased on behalf of customers	\$ 10,468	\$ 2,914
Prepaid maintenance and software	7,385	8,765
Other	5,529	8,252
	<u>          </u>	<u>          </u>
Total prepaid expenses and other	\$ 23,382	\$ 19,931
	<u>          </u>	<u>          </u>

**4. Property and Equipment:**

The components of property and equipment as of June 30, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Leasehold improvements	\$ 24,653	\$ 21,617
Furniture, equipment, and software	59,387	47,465
	<u>          </u>	<u>          </u>

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Subtotal	84,040	69,082
Less: Accumulated depreciation and amortization	(46,578)	(34,328)
	<u>          </u>	<u>          </u>
Total property and equipment, net	\$ 37,462	\$ 34,754
	<u>          </u>	<u>          </u>

**5. Goodwill and Identified Intangibles:**

The components of goodwill and identified intangible assets as of June 30, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Goodwill	\$ 169,334	\$ 89,214
Identified intangibles	35,265	21,761
	<u>          </u>	<u>          </u>
Subtotal	204,599	110,975
Less: Accumulated amortization	(9,096)	(4,100)
	<u>          </u>	<u>          </u>
Total goodwill and identified intangibles	\$ 195,503	\$ 106,875
	<u>          </u>	<u>          </u>

Goodwill must be reviewed annually for impairment. The Company performs this review at the beginning of each calendar year. The Company performed the annual goodwill impairment analysis as of January 1, 2006 and concluded that there was no impairment of goodwill. The identified intangibles as of June 30, 2006 were all

**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended June 30, 2006, 2005, and 2004**

assigned to contract rights. Amortization expense of identified intangibles was \$4,996,000, \$1,991,000, and \$1,369,000 for the years ended June 30, 2006, 2005, and 2004, respectively. Identified intangibles are being amortized on a straight-line basis over a period of 5 to 12 years.

Estimated amortization expense is as follows for the periods indicated (in thousands):

Years ending June 30,	
2007	\$ 5,153
2008	5,153
2009	4,747
2010	3,970
2011	2,609
Thereafter	4,537
	Total
	\$ 26,169

**6. Accounts Payable and Accrued Expenses:**

Accounts payable and accrued expenses as of June 30, 2006 and 2005 consisted of the following (in thousands):

	2006	2005
Vendor obligations	\$ 108,803	\$ 69,581
Current taxes payable and other	6,742	5,389
	Total accounts payable and accrued expenses	\$ 74,970

**7. Debt:**

The Company had a term loan that matured on July 1, 2003. The term loan interest rate was fixed at 6.89 percent and the term loan principal balance was payable in quarterly installments of \$400,000.

The Company maintained a \$40 million credit facility that the Company elected not to renew when it expired on February 29, 2004. The Company does not currently intend to replace the credit facility as the Company expects its cash and cash equivalents and investments, together with cash flow generated from operations, to meet its normal operating liquidity and capital expenditure requirements for at least the next twelve months. However, in the event of a large acquisition or a series of smaller acquisitions in a relatively short period of time, the Company will likely be required to enter into a credit facility. The average revolving line of credit interest rate was 2.2 percent on balances outstanding for the year ended June 30, 2004. Total interest expense under the revolving credit facility and term loan was \$6,000 for the year ended June 30, 2004. The maximum revolving line of credit balance was \$2,258,000 for the year ended June 30, 2004. The average monthly revolving line of credit balance outstanding was \$50,000 for the months during which there was a balance outstanding for the year ended June 30, 2004.



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Other long-term liabilities as of June 30, 2006 and 2005, consisted of the following (in thousands):

	<u>2006</u>	<u>2005</u>
Liability to deferred compensation plan participants	\$ 7,768	\$ 5,755
Incentives for tenant improvements and other	2,697	3,092
<b>Total other long-term liabilities</b>	<b>\$ 10,465</b>	<b>\$ 8,847</b>

**9. Benefit Plan:**

The Company maintains a defined contribution plan, the SRA International, Inc. 401(k) Savings Plan (Plan). All regular and full-time employees are generally eligible to participate in the Plan. The board of directors of SRA may elect to make matching or other discretionary contributions to the Plan. The Company's matching contribution expense was \$10,026,000, \$7,477,000, and \$5,985,000 for the years ended June 30, 2006, 2005, and 2004, respectively, including the value of the stock described in the next paragraph.

Plan participants may elect to receive matching contributions in cash, company stock, or a combination of the two. Matching contributions are earned by participants on the basis of their calendar year contributions to the Plan. The Company makes the matching contributions, including the transfer of class A common stock, each January for participant contributions made during the previous calendar year. The Company contributed 56,142, 107,730, and 145,106 shares of class A common stock to the Plan during the years ended June 30, 2006, 2005, and 2004, respectively.

**10. Stockholders' Equity and Stock Options:****Preferred Stock**

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The Company is authorized to issue 5,000,000 shares of preferred stock, \$0.20 par value per share, the terms and conditions of which are determined by the board of directors at each issuance. No preferred stock has been issued.

### **Common Stock**

Holders of class A common stock are entitled to dividends per share in an amount equal to dividends per share declared and paid on class B common stock. Holders of both classes of common stock vote as a single class, with each share of class A common stock having one vote per share and each share of class B common stock having ten votes per share. Holders of both classes of common stock would share ratably in the net assets of the Company upon its liquidation or dissolution.

### **Treasury Stock**

The treasury stock transactions that occurred before the Company's May 2002 initial public offering, reflected the Company's historical practice of purchasing up to a specified number of shares approved by the board of directors at the then fair market value. Prior to becoming publicly-traded, the Company retained an independent valuation firm to assist the board of directors in assessing the fair value of the stock. Only shares held by stockholders for more than six months were eligible to be purchased by the Company under this limited stock repurchase plan. The limited stock repurchase plan was discontinued when the Company became publicly-traded. Additionally, the Company historically purchased common stock from the SRA International Inc. 401(k) Savings Plan from terminated employees. This practice was discontinued in August 2003. In limited circumstances, the Company may elect to repurchase shares of outstanding common stock from employees upon the exercise of stock options for the purpose of satisfying the minimum required tax withholding.

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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended June 30, 2006, 2005, and 2004**

**Public Offerings**

In June 2002, the Company completed its initial public offering, issuing 11,500,000 shares of class A common stock, all of which were issued and sold by the Company, at a price of \$9.00 per share before expenses. Net proceeds to the Company were approximately \$94.2 million, after deducting expenses related to the offering and the portion of the underwriting discount payable by the Company.

In June 2003, the Company completed a follow-on offering of 6,957,500 shares of class A common stock, of which 5,053,756 were issued and sold by the Company and 1,903,744 were sold by selling stockholders, at a price of \$15.00 per share before expenses. Net proceeds to the Company were approximately \$71.1 million, after deducting expenses related to the offering and the portion of the underwriting discount payable by the Company. The Company did not receive any proceeds from the sale of stock by selling stockholders.

**Stock Options**

**Accounting for Stock-Based Compensation:**

***Stock-Based Benefit Plans***

The Company maintained a key employee incentive plan that was approved by the Company's stockholders in November 1994. All options granted by the Company from November 1994 until January 2002 were granted under this 1994 plan. Following completion of the Company's initial public offering of stock, no additional options may be granted under this plan. Under the terms of the plan, options to purchase class A common stock or class B common stock were granted by the board of directors to key employees. The option price per share was determined by the board of directors and generally was no less than the fair value of the stock on the date of grant of the option. Prior to becoming publicly traded, the Company retained an independent valuation firm to assist the board of directors in assessing the fair value of the stock. Each option is exercisable within periods and in increments determined by the board of directors.

In March 2002, the Company adopted the SRA International, Inc. 2002 Stock Incentive Plan. Upon adoption, up to 7,058,822 shares of class A common stock were reserved for issuance under the 2002 plan. Pursuant to the terms of the 2002 plan, the number of shares authorized for issuance automatically increases at the beginning of each fiscal year, beginning with the fiscal year ended June 30, 2004. An additional 6,353,463 shares of class A common stock were reserved for issuance pursuant to the automatic increase feature of the 2002 plan through July 1, 2006. The 2002 plan provides for the grant of incentive stock options, non-statutory stock options, restricted stock, and other stock-based awards. The 2002 plan is administered by the compensation committee of the board of directors, which shall determine the number of shares

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covered by options, and the exercise price, vesting period, and duration of option grants. The board of directors also has the authority under the 2002 plan to determine the number of shares of common stock subject to any restricted stock or other stock-based awards and the terms and conditions of such awards. The 2002 plan expires in March 2012.

### *Adoption of SFAS No. 123R*

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), Share-Based Payment, which requires that compensation costs related to share-based payment transactions be recognized in financial statements. SFAS No. 123R eliminates the alternative to use the intrinsic method of accounting provided for in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, which generally resulted in no compensation expense recorded in the financial statements related to the grant of stock options to employees if certain conditions were met.

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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended June 30, 2006, 2005, and 2004**

Effective July 1, 2005, the Company adopted SFAS No. 123R using the modified prospective method. Under this method, compensation costs for all awards granted after the date of adoption and the unvested portion of previously granted awards outstanding at the date of adoption will be measured at estimated fair value and included in operating expenses over the vesting period during which an employee provides service in exchange for the award. Accordingly, prior period amounts presented herein have not been restated to reflect the adoption of SFAS No. 123R.

Prior to the adoption of SFAS No. 123R, the Company reported all tax benefits resulting from the exercise of stock options as operating cash flows in the consolidated statements of cash flows. In accordance with SFAS No. 123R, for the period beginning July 1, 2005, excess tax benefits from the exercise of stock options are presented as financing cash flows. The excess tax benefits totaled \$13.8 million for the year ended June 30, 2006. Such benefits were \$17.2 million and \$7.1 million for the years ended June 30, 2005 and 2004, respectively, and are presented as a component of operating cash flows.

As a result of adopting SFAS No. 123R, the Company recorded an additional \$12.8 million of stock-based compensation, or \$7.8 million after-tax, in its statement of operations for the year ended June 30, 2006. This stock-based compensation expense reduced both basic and diluted earnings per share by \$0.14 for the year ended June 30, 2006.

***Fair Value Determination***

The fair value concepts were not changed significantly in SFAS No. 123R; however, in adopting this Standard, companies must choose among alternative valuation models and amortization assumptions. The Company has elected to continue to use both the Black-Scholes-Merton option pricing model and straight-line amortization of compensation expense over the requisite service period of the grant. The Company will reconsider use of the Black-Scholes-Merton model if additional information becomes available in the future that indicates another model would be more appropriate, or if grants issued in future periods have characteristics that cannot be reasonably estimated using this model.

The Company has 10-year and 15-year options. The following weighted-average assumptions were used for option grants during the years ended June 30, 2006, 2005 and 2004:

*Expected Volatility.* The expected volatility of the Company's shares was estimated based upon the historical volatility of the Company's share price. The expected volatility factor used in valuing options granted during the years ended June 30, 2006, 2005, and 2004 was 32 percent, 31 percent and 47 percent, respectively.

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*Expected Term.* The expected term was estimated based upon exercise experience of option grants made in the past to Company employees. Historical experience shows that employees typically exercise options prior to the end of the contractual term. The expected term used in valuing options granted for all periods presented was 5 years.

*Risk-free Interest Rate.* The Company bases the risk-free interest rate used in the Black-Scholes-Merton valuation method on the implied yield available on a U.S. Treasury note with a term equal to the expected term of the underlying grants. The weighted-average risk-free interest rate used in valuing options granted during the years ended June 30, 2006, 2005, and 2004 was 4.2 percent, 3.6 percent, and 3.2 percent, respectively.

*Dividend Yield.* The Black-Scholes-Merton valuation model calls for single expected dividend yield as an input. The Company has not paid dividends in the past nor does it expect to pay dividends in the future. As such, the Company used a dividend yield percentage of zero for all periods presented.

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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended June 30, 2006, 2005, and 2004**

***Stock Compensation Expense***

The Company recognized compensatory stock option expense on stock options issued below fair market value or upon modification of option terms of \$88,000, \$211,000, and \$211,000 for each of the years ended June 30, 2006, 2005, and 2004 respectively.

The Company recorded \$12.8 million of stock-based compensation expense related to stock options and \$0.3 million related to restricted stock for the year ended June 30, 2006 in addition to the stock compensation expense recorded above.

In prior years, while accounting for stock options under APB No. 25 and disclosing a pro forma expense calculation under SFAS No. 123, the Company did not include a forfeiture rate when calculating pro forma expense related to the options. In accordance with SFAS No. 123R, the Company estimated forfeitures and is recognizing compensation expense only for those share-based awards that are expected to vest.

As of June 30, 2006, there was \$26.3 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements. This cost is expected to be fully amortized in four years, with half of the total amortization cost being recognized within the next 15 months.

***Stock Option Activity***

During the year ended June 30, 2006, the Company granted stock options to purchase 1,625,760 shares of class A common stock at a weighted-average exercise price of \$34.62 per share based on the fair value of class A common stock on the date of grant. The Black-Scholes-Merton weighted-average value of options granted for the years ended June 30, 2006, 2005, and 2004, was \$12.32, \$7.80, and \$7.63, respectively. Using the Black-Scholes-Merton model, the total value of the options granted for the years ended June 30, 2006, 2005, and 2004, was \$18,126,922, \$16,266,000, and \$10,875,000, respectively. The options vest at the rate of 25 percent per year over four years, beginning on the date of grant and expire ten years from the grant date.

During the year ended June 30, 2006, the Company also granted 35,450 shares of restricted stock at an average price of \$30.06 per share that will vest at the rate of 25 percent per year over four years.

The following table summarizes stock option activity for the year ended June 30, 2006:

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	<b>Number of Shares</b>	<b>Weighted-Average Exercise Price</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Shares under option, July 1, 2005	8,028,226	\$ 12.54	\$ 178,040
Options granted	1,625,760	34.62	\$
Options exercised	(1,680,503)	6.98	\$ 43,974
Options cancelled and expired	(306,699)	23.58	\$ 3,030
	<hr/>		
Shares under option, June 30, 2006	7,666,784	\$ 18.00	\$ 80,365
	<hr/>		
Options exercisable at June 30, 2006	3,663,790	\$ 10.09	\$ 61,459
	<hr/>		
Shares reserved for equity awards at June 30, 2006	4,959,467		
	<hr/>		

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**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended June 30, 2006, 2005, and 2004**

Information with respect to stock options outstanding and stock options exercisable at June 30, 2006 was as follows:

Range of Exercise Price	Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
\$0.20 - \$0.30	271,596	0.9 years	\$ 0.29
\$2.58 - \$5.07	1,638,243	7.5	\$ 4.06
\$10.85 - \$16.80	2,177,043	9.4	\$ 14.29
\$19.39 - \$35.40	3,579,902	8.6	\$ 27.99
	7,666,784		
Range of Exercise Price	Options Exercisable	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
\$0.20 - \$0.30	271,596	0.9 years	\$ 0.29
\$2.58 - \$5.07	1,638,243	7.5	\$ 4.06
\$10.85 - \$16.80	1,173,529	9.8	\$ 13.86
\$19.39 - \$35.40	580,422	8.2	\$ 24.11
	3,663,790		

**Pro Forma Disclosures**

Under the modified prospective method, results for the years ended June 30, 2005 and 2004 were not restated to include stock option expense. The previously disclosed pro forma effects of recognizing the estimated fair value of stock-based employee compensation for the years ended June 30, 2005 and 2004 (in thousands, except per share amounts) are presented below.

	2005	2004
Net income, as reported	\$ 57,723	\$ 38,937
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	317	259
	(5,845)	(3,554)

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Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects			
Pro forma net income	\$ 52,195	\$ 35,642	
Earnings per share:			
Basic as reported	\$ 1.09	\$ 0.76	
Basic pro forma	\$ 0.99	\$ 0.70	
Diluted as reported	\$ 1.02	\$ 0.71	
Diluted pro forma	\$ 0.92	\$ 0.65	

### Employee Stock Purchase Plan

The Company maintains the SRA International, Inc. 2004 Employee Stock Purchase Plan (ESPP) and has reserved 500,000 shares for issuance thereunder. The ESPP was available to all eligible employees beginning on January 1, 2005. The ESPP permits eligible employees to purchase class A common stock, through payroll deductions of up to 15% of the employee's compensation, at a price equal to 100% of the average of the high and

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## SRA INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Years Ended June 30, 2006, 2005, and 2004

low price of the common stock on the last day of each offering period. Employees purchased 36,179 and 5,626 shares for the years ended June 30, 2006 and 2005, respectively, under the ESPP.

**11. Income Taxes:**

The provision for federal and state income taxes for the years ended June 30, 2006, 2005, and 2004, included the following (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Current provision:			
Federal	\$ 28,344	\$ 27,416	\$ 18,363
State	5,802	4,660	3,512
Deferred provision:			
Federal	3,836	1,644	2,130
State	697	1,109	286
<b>Total income tax provision</b>	<b>\$ 38,679</b>	<b>\$ 34,829</b>	<b>\$ 24,291</b>

The Company's effective income tax rate varied from the statutory federal income tax rate for the years ended June 30, 2006, 2005, and 2004 as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal income tax benefit	4.2	4.2	3.9
Stock-based compensation	0.1	0.1	0.1
Municipal bond interest	(0.5)	(0.9)	(0.4)
Refunds and credits	(0.8)	(1.0)	(0.5)
Nondeductible expenses and other	0.2	0.2	0.3
<b>Effective tax rate</b>	<b>38.2%</b>	<b>37.6%</b>	<b>38.4%</b>



**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended June 30, 2006, 2005, and 2004**

The components of the net deferred tax asset as of June 30, 2006 and 2005 were as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Deferred tax assets:		
Compensated absences and other accruals not yet deductible for tax purposes	\$ 14,762	\$ 13,047
Financial statement depreciation in excess of tax depreciation	3,464	3,486
Deferred compensation	1,987	2,098
Nonqualified stock awards	4,927	
State job creation credits	399	438
	<u>25,539</u>	<u>19,069</u>
Deferred tax liabilities:		
Identified intangibles	(5,809)	(4,549)
Prepaid expenses	(2,804)	(2,872)
Unbilled contract revenue	(7,228)	(3,784)
Capitalized software	(1,397)	(1,370)
Other		(94)
	<u>(17,238)</u>	<u>(12,669)</u>
Net deferred tax asset	<u>\$ 8,301</u>	<u>\$ 6,400</u>

**12. Commitments and Contingencies:****Government Contracting**

Payments to the Company on cost-plus-fee contracts are provisional and are subject to adjustment upon audit by the Defense Contract Audit Agency. Audits through June 30, 2004 have been completed. In the opinion of management, audit adjustments that may result from audits for periods after June 30, 2004 are not expected to have a material effect on the Company's financial position, results of operations, or cash flows.

Additionally, federal government contracts, by their terms, generally can be terminated at any time by the federal government, without cause, for the convenience of the federal government. If a federal government contract is so terminated, the Company would be entitled to receive

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compensation for the services provided and costs incurred through the time of termination, plus a negotiated amount of profit. Federal government contractors who fail to comply with applicable government procurement-related statutes and regulations may be subject to potential contract termination, suspension and debarment from contracting with the government, or other remedies. Management believes the Company has complied with all applicable procurement-related statutes and regulations.

### Leases

Net rent expense for the years ended June 30, 2006, 2005, and 2004 was as follows (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Office space	\$ 27,649	\$ 23,726	\$ 18,114
Sublease income	(1,085)	(936)	(964)
<b>Subtotal</b>	<u>26,564</u>	<u>22,790</u>	<u>17,150</u>
Furniture and equipment	881	737	628
<b>Total</b>	<u>\$ 27,445</u>	<u>\$ 23,527</u>	<u>\$ 17,778</u>

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**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended June 30, 2006, 2005, and 2004**

The following table summarizes our future minimum rental commitments under noncancellable operating leases, primarily for office space, as of June 30, 2006 (in thousands). We did not include amounts already recorded on our balance sheet as liabilities at June 30, 2006.

	<b>Rental Commitments</b>	<b>Sublease Income</b>	<b>Net Commitments</b>
	<u>          </u>	<u>          </u>	<u>          </u>
Years ending June 30,			
2007	\$ 28,015	\$ 73	\$ 27,942
2008	25,333	75	25,258
2009	23,596	71	23,525
2010	20,863		20,863
2011	16,876		16,876
Thereafter	72,560		72,560
	<u>          </u>	<u>          </u>	<u>          </u>
Total minimum lease payments	\$ 187,243	\$ 219	\$ 187,024
	<u>          </u>	<u>          </u>	<u>          </u>

The Company leases all of its office facilities. Leases for certain office space may include incentives for tenant improvements, rent holidays, or rent escalation clauses. Certain lease commitments are subject to adjustment based on changes in the Consumer Price Index. Incentives for tenant improvements are recorded as liabilities and amortized as reductions in rent expense over the term of the respective leases. The Company recognizes rent expense, including escalated rent and rent holidays, on a straight-line basis over the term of the lease.

Capitalized lease obligations included in accounts payable and accrued expenses were \$146,000 and \$93,000 as of June 30, 2006 and 2005, respectively, and represent the current portion of amounts due under leases for the use of computers and other equipment. The long-term portion of the capital lease obligations was approximately \$46,000 and \$132,000 at June 30, 2006 and 2005, respectively, and is included in other long-term liabilities. Included in property and equipment are related assets of \$1,362,000 and \$1,312,000 less accumulated amortization of \$1,187,000 and \$1,104,000 as of June 30, 2006 and 2005, respectively.

**13. Litigation**

The Company is involved in various legal proceedings concerning matters arising in the ordinary course of business. The Company currently believes that any ultimate liability arising out of these proceedings will not have a material adverse effect on the Company's financial position, results of operations, or cash flows.

**14. Related Party Transactions:**

In May 2001, Mantas, which was previously one of the Company's service offerings, was contributed to a separate company, Mantas, Inc., or Mantas, which was formed with funding and other contributions received from unrelated third parties. Mantas is a provider of services to the financial services industry to address anti-money laundering and other data mining issues. As of June 30, 2006, the Company owned approximately eight million shares of Mantas class A common stock. The Company has no cost basis in Mantas, nor is there any obligation or expectation to fund, the ongoing operations of Mantas.

In the years ended June 30, 2005 and 2004, Mantas had utilized certain services provided by the Company for which the Company was reimbursed. Mantas leased space from the Company and received other support services related to its occupancy. Sublease income and amounts due for other support services provided were

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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended June 30, 2006, 2005, and 2004**

approximately \$707,000 for the year ended June 30, 2004. The Company also allowed Mantas to obtain certain travel and insurance-related services utilizing the Company's existing relationships with vendors. The total of such services received by Mantas were approximately \$183,000 and \$2.5 million for the years ended June 30, 2005 and 2004, respectively. Additionally, the Company provided labor services when requested by Mantas to support its administrative and client support activities. Approximately \$304,000 and \$368,000 of such labor services were provided for the years ended June 30, 2005 and 2004, respectively. All amounts were subsequently paid by Mantas to the Company. The Company is no longer providing services to Mantas.

**15. Segment Reporting:**

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. Although the Company is organized by strategic business unit, the Company considers each of its government contracting units to have similar economic characteristics, provide similar types of services, and have a similar customer base. Accordingly, the Company reports one operating segment for financial reporting purposes, the Consulting & System Integration (C&SI) business which aggregates all of its current operations.

The C&SI segment represents the Company's core business and includes high-end technology and strategic consulting services and solutions primarily for federal government clients. Since October 2002, the C&SI segment has represented all of the Company's ongoing operations.

**16. Acquisitions:**

**ORION Scientific Systems**

In January 2004, the Company completed its acquisition of ORION Scientific Systems, or Orion, a privately-held company focused on national security and homeland defense. Orion provides analytical support, training, system development, and proprietary knowledge management applications to its customers in the intelligence agencies, Department of Defense, and law enforcement community. The Company acquired Orion for approximately \$34.5 million net of acquisition costs, consisting of approximately \$33.0 million of cash on hand and \$1.5 million of class A common stock. Approximately \$8.4 million of the purchase price was allocated to identified intangibles and approximately \$26.6 million to goodwill. Pursuant to the requirements of SFAS No. 141 Business Combinations, the effect of the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these consolidated financial statements.

**Touchstone Consulting Group, Inc.**

In April 2005, the Company completed its acquisition of Touchstone Consulting Group, Inc., or Touchstone, a privately-held management consultancy with an established track record of serving senior executives in the federal government. Touchstone provides strategic consulting services to its customers throughout the federal government, including the Department of Homeland Security, Department of Defense, intelligence agencies, and the Office of Management and Budget. The Company acquired Touchstone for approximately \$37.0 million net of acquisition costs, from cash on hand. Approximately \$6.5 million of the purchase price was allocated to identified intangibles and approximately \$26.5 million to goodwill. Pursuant to the requirements of SFAS No. 141 Business Combinations, the effect of the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these consolidated financial statements.

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**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended June 30, 2006, 2005, and 2004**

**Galaxy Scientific Corporation**

In July 2005, the Company completed its acquisition of Galaxy Scientific Corporation, or Galaxy, a privately-held provider of systems engineering, information technology, and tactical communication services and solutions to the federal government. Galaxy specializes in command and control, communications, computers and intelligence (C4I) tactical systems; information assurance; information technology; training systems; engineering support; and safety and security technologies. The Company acquired Galaxy for approximately \$98.7 million, net of acquisition costs, from cash on hand. Approximately \$12.0 million of the purchase price was allocated to identified intangibles and approximately \$73.4 million to goodwill. Pursuant to the requirements of SFAS No. 141, Business Combinations, the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these consolidated financial statements.

**Spectrum Solutions Group, Inc.**

In November 2005, the Company acquired Spectrum Solutions Group, Inc., or Spectrum, a privately-held provider of enterprise solutions such as Oracle, SAP, PeopleSoft, and Seibel applications and technologies to the federal government. The Company acquired Spectrum for approximately \$9.7 million, net of acquisition costs, from cash on hand. Approximately \$0.9 million of the purchase price was allocated to identified intangibles and approximately \$6.7 million to goodwill. Pursuant to the requirements of SFAS No. 141, Business Combinations, the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these consolidated financial statements.

**Mercomms Unlimited, Inc.**

In April 2006, the Company acquired Mercomms Unlimited, Inc., or Mercomms, which specializes in advanced maritime and defense communications technologies for the federal government. Mercomms was acquired for approximately \$637,000, substantially all of which was assigned to identified intangibles. Pursuant to the requirements of SFAS No. 141, Business Combinations, the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these consolidated financial statements.

**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended June 30, 2006, 2005, and 2004****17. Quarterly Financial Data (Unaudited) (in thousands, except per share amounts):**

	Revenue	Operating Income	Income Before Taxes	Net Income	Earnings	
					Per Share (a)	
					Basic	Diluted
<b>Year Ended June 30, 2006</b>						
1 <sup>st</sup> Quarter	\$ 280,695	\$ 22,788	\$ 23,521	\$ 14,390	\$ 0.27	\$ 0.25
2 <sup>nd</sup> Quarter	305,313	24,220	25,257	15,903	0.29	0.28
3 <sup>rd</sup> Quarter	296,098	23,019	23,845	14,783	0.27	0.26
4 <sup>th</sup> Quarter	297,161	26,940	28,576	17,444	0.31	0.30
<b>Year Ended June 30, 2005</b>						
1 <sup>st</sup> Quarter	\$ 203,474	\$ 19,770	\$ 20,293	\$ 12,440	\$ 0.24	\$ 0.22
2 <sup>nd</sup> Quarter	211,212	22,269	23,023	14,723	0.28	0.26
3 <sup>rd</sup> Quarter	226,018	22,752	23,722	14,694	0.28	0.26
4 <sup>th</sup> Quarter	241,066	24,319	25,514	15,866	0.29	0.28

- (a) The sum of earnings per share for the four quarters may differ from the annual earnings per share due to the required method of computing the weighted-average number of shares in the interim period.

**18. Subsequent Event:**

On August 14, 2006, i-flex solutions, a leading IT provider to the global financial services industry, announced that it entered into a definitive agreement to acquire Mantas, Inc. for approximately \$122.6 million. The transaction is subject to customary conditions, including expiration of the Hart-Scott-Rodino antitrust waiting period. Upon the completion of the sale of Mantas and subsequent release of funds pursuant to the terms of the indemnification escrow agreements, the Company will recognize a total pre-tax gain of approximately \$4.4 million.

**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****Years Ended June 30, 2006, 2005 and 2004****Schedule II Valuation and Qualifying Accounts**

Activity in the Company's allowance accounts for the years ended June 30, 2006, 2005, and 2004, was as follows (in thousands):

**Allowance for Doubtful Accounts**

<u>Period</u>	<u>Balance at Beginning of Period</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Other</u>	<u>Balance at End of Period</u>
2006	\$ 1,159	\$ 75	\$ 49	\$ 429*	\$ 1,614
2005	1,425	74	380	40*	1,159
2004	1,378	75	68	40*	1,425

**Allowance for Unbillable Amounts**

<u>Period</u>	<u>Balance at Beginning of Period</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Other</u>	<u>Balance at End of Period</u>
2006	\$ 1,852	\$ 21	\$ 138	\$	\$ 1,735
2005	1,861	51	60		1,852
2004	2,175	(150)	224	60*	1,861

**Allowance for Interest on Tax Exposure**

<u>Period</u>	<u>Balance at Beginning of Period</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Other</u>	<u>Balance at End of Period</u>
2006	\$	\$	\$	\$	\$
2005					
2004	155	(153)	2		

\* Represents allowances assumed in connection with acquisitions.