Large and Diversified Client Base

Major Market Share Positions

Strong Financial Position

Highest Quality Service Levels

Large and Growing Salesforce

Strong Service Offerings

Long-term Clients

Record Levels of Productivity

42,000 Committed and Engaged Associates

# WELL POSITIONED

2004 ANNUAL REPORT

Contents



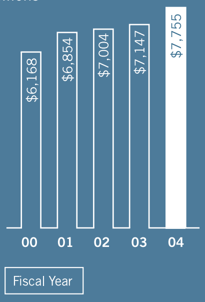
## OUR MISSION

**To add value to our clients by making available a broad range of premier, mission-critical, cost-effective transaction processing and information-based business solutions in selected markets on a global basis.**

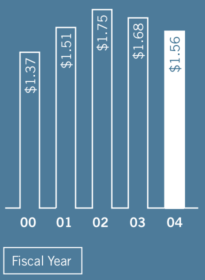
## FINANCIAL HIGHLIGHTS

| (In thousands, except per share amounts) Years ended June 30, | 2004 | 2003 | Change |
|---|---|---|---|
| Total revenues | **$ 7,754,942** | $ 7,147,017 | 9% |
| Net earnings | **$ 935,570** | $ 1,018,150 | (8%) |
| Basic earnings per share | **$ 1.58** | $ 1.70 | (7%) |
| Diluted earnings per share | **$ 1.56** | $ 1.68 | (7%) |
| Cash dividends | **$ 319,515** | $ 284,605 | 12% |
| Cash dividends per share | **$ .5400** | $ .4750 | 14% |
| Basic average shares outstanding | **591,697** | 600,071 | |
| Diluted average shares outstanding | **598,749** | 605,917 | |
| Return on equity | **17.3%** | 19.4% | |
| At year end: | | | |
| Cash, cash equivalents and marketable securities | **$ 2,092,576** | $ 2,344,343 | |
| Working capital | **$ 993,165** | $ 1,676,718 | |
| Total assets before funds held for clients | **$ 8,217,027** | $ 8,025,922 | |
| Long-term debt | **$ 76,200** | $ 84,674 | |
| Stockholders' equity | **$ 5,417,670** | $ 5,371,473 | |
| Number of employees | **42,000** | 41,000 | |

**TOTAL REVENUES**
In millions

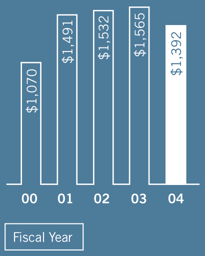


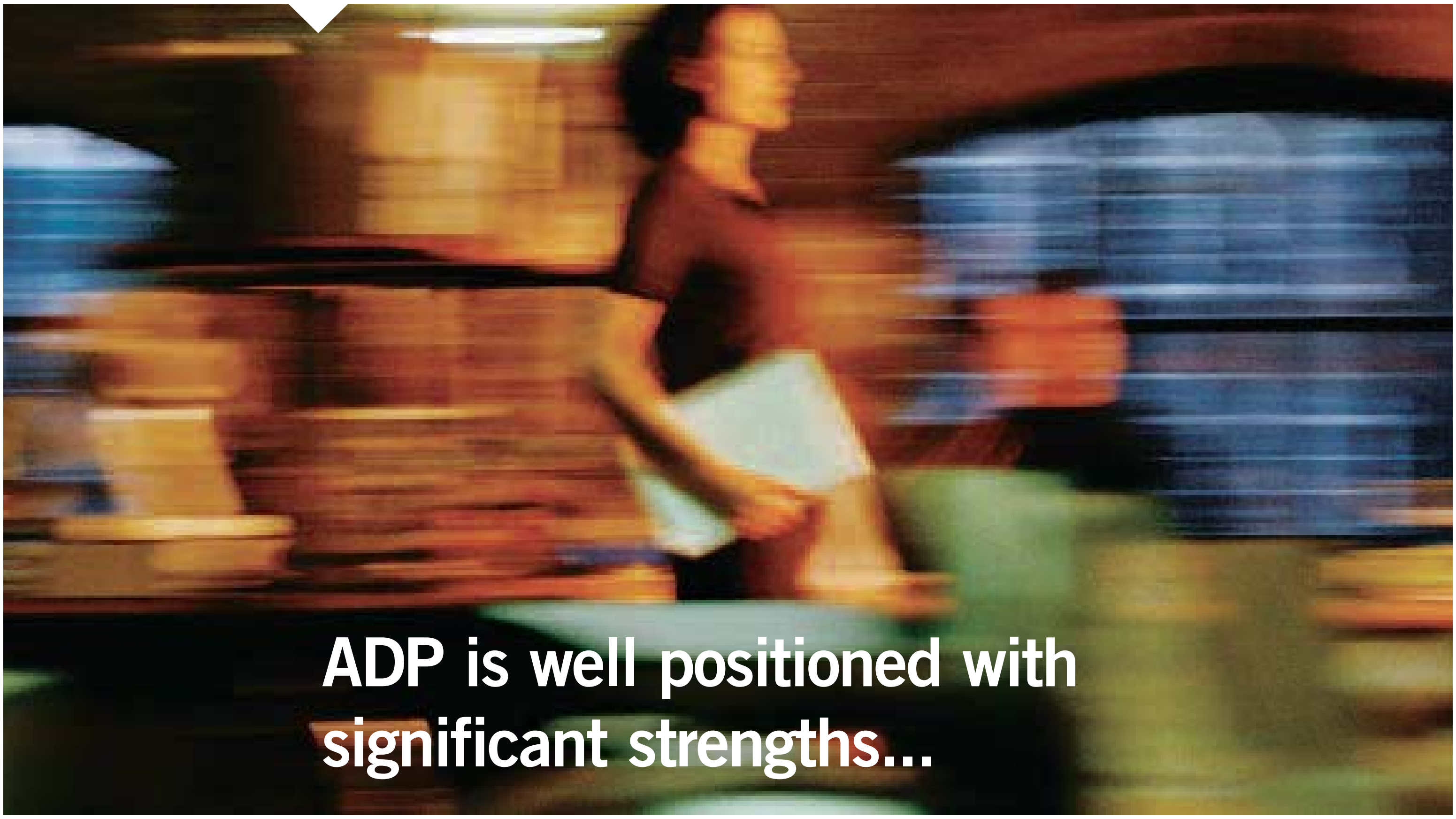

**DILUTED EARNINGS PER SHARE**
In dollars




*The 2001 and 2000 data reflects the pro forma impact relating to the July 1, 2001 adoption of Statement of Financial Accounting Standards No. 142, which eliminated goodwill amortization.*

**OPERATING CASH FLOW**
In millions





# ADP is well positioned with significant strengths...

> a very strong financial position

> 42,000 committed and engaged associates worldwide

> market-leading products and service offerings

> the highest levels of service quality ever

> long-term client relationships in all of our businesses

**Together, these strengths prepare us to thrive in an economy that is steadily improving.**

# We are positioned to take ADP to new levels of growth, expanded markets, and enhanced shareholder value.

*Left: Gary C. Butler   Right: Arthur F. Weinbach*

TRANSITION YEAR

Fiscal 2004 was an important transition year for ADP. Although we reported lower earnings than in the prior year, we took the steps necessary to position ourselves for the future. We had over $7.7 billion of revenues, over $900 million of net income, and maintained our relatively rare position as a AAA-rated company by the major rating agencies. So, even in transition, it was a good year by most companies' standards.

**The good news...is that the cyclical contraction has reversed and we are on, what we believe to be, a sustainable growth path.**

RECURRING REVENUE MODEL

One of ADP's greatest strengths is its recurring revenue model. We have long-term relationships with most of our clients and receive revenue each month for the high-quality, value-added services we provide. Our growth is primarily driven by adding more new clients and services (sales) than we lose (client retention), and by the organic growth of our clients (for example, the number of employees on our clients' payrolls (pays per control) or the number of trades processed by our Brokerage clients). For many years, we benefited from the consistent growth created by this model. Over the last three years, however, we learned the difficulties when the momentum goes the wrong way. The good news (and why fiscal 2004 was such an important transition year) is that the cyclical contraction has reversed and we are on, what we believe to be, a sustainable growth path.

WHAT HAPPENED IN FISCAL 2004?

We should never feel good about a year like fiscal 2004 where we had an earnings decline. We assure you we are not satisfied. However, we understand the factors that caused the decline. As we entered the fiscal year, we had three major economic trends going against us and, with full understanding, we added a fourth item that also negatively impacted earnings:

1. Early in the year, the residual impact of the weak economy affected our sales, pays per control, and the client fund balances on which we earn interest;

2. Weak brokerage markets resulted in (i) fewer trades processed, (ii) reduced retail trading activity, (iii) continued consolidation of financial institutions within the brokerage industry and (iv) fewer shareholder communications;

3. Interest rates were at forty-year lows. Since our average daily balances of the combined corporate and client funds exceeded $14 billion in fiscal 2004, the continued low rates had a big impact; and

4. We decided to increase our investment in the face of these negatives. During fiscal 2004, we spent $170 million on future growth opportunities and employer of choice initiatives.

**Our new products, larger salesforce and energized associates are here now, in today's strengthening economic environment.**

As we ended the year, the improvement in the economy became apparent in our leading indicators and our results:

1. Our Employer Services' sales growth improved in the second half of our fiscal year, client retention reached record highs for the year, and pays per control and client investable funds also showed improving growth rates in the second half of our fiscal year;

2. Brokerage markets rebounded and generated higher transaction volume, more retail trades, and, in the latter months of our fiscal year, increased investor communications mailings;

3. Interest rates started to rebound in reaction to the stronger economy and the Federal Reserve increased the target Fed funds rate by 25 basis points (the first increase in four years) on July 1, 2004 and by 25 basis points again on August 10, 2004; and

4. The timing of our investments in growth opportunities (primarily product development and salesforce growth) and employer of choice initiatives (including restoring full bonuses and increased focus on training) has worked out particularly well. Our new products, larger salesforce and energized associates are here now, in today's strengthening economic environment.

WHERE ARE WE HEADED?

We face the future well positioned for the challenges and uncertainties of fiscal 2005 and beyond. We are forecasting mid-single digit revenue growth and double-digit earnings per share growth for fiscal 2005 while we continue to invest for future growth. We also are very positive about the longer term. Here are just a few of our significant strengths:

> a large and diversified client base;

> a very strong financial position;

> major market share positions;

> our highest quality service levels ever;

> excellent direct sales capabilities with a large and growing salesforce;

> strong product and service offerings in virtually every market in which we compete;

> long-term client relationships with client retention rates at record levels;

> record levels of productivity; and

> our most important asset – 42,000 trained, client service-oriented, committed and engaged associates.

## We face the future well positioned for the challenges and uncertainties of fiscal 2005 and beyond.

Our confidence in ADP's future is reflected in our acquisition of nearly 16 million shares of ADP common stock for about $650 million, and in our Board's November 2003 decision to increase our dividend for the 30th consecutive year, by 17%.

### ACQUISITIONS AND DISPOSITIONS

Our growth objectives include supplementing internal growth with strategic acquisitions that extend our markets (i) geographically, (ii) by broadening our market potential, (iii) by adding applications or services to our product set, or (iv) by adding clients in our existing markets. In fiscal 2004, we acquired six businesses with annualized revenues of about $130 million for an aggregate purchase price of approximately $270 million.

The largest transactions were the acquisitions of ABZ, a Netherlands-based provider of insurance distribution services by our Claims Services division, and EDS's Automotive Retail Group by Dealer Services.

In June, we announced the acquisition of Bank of America's third-party clearing operations. We expect this transaction to close before the end of calendar 2004.

In addition, each year we review our business and product lines and dispose of or close businesses that are no longer strategically relevant. In fiscal 2004, we disposed of five businesses or product lines with aggregate revenues of approximately $80 million.

### PROMOTIONS AND APPOINTMENT

We recently announced the following senior executive promotions: Mike Martone to Group President, Employer Services; Steve Anenen to President, Dealer Services; and Vince Coppola to President, Employer Services' Major Accounts division.

During the year we also announced the promotions of Marianne Brown (Brokerage Services) and Vincent De Palma (Employer Services) to Corporate Vice President in recognition of their significant contributions to ADP's success.

We were also very pleased that Glenn Hubbard joined our Board of Directors. Glenn is now the Dean of The Graduate School of Business at Columbia University following his role as chair of the U.S. Council of Economic Advisors.

### LARRY TISCH

We lost a legend with the death of Larry Tisch. Larry was a Director of ADP from 1972 until his retirement at last November's Annual Meeting of Shareholders. His wisdom and contributions to ADP's success were significant. We will miss him.

### IN CLOSING

We have been humbled by the last few years, but are proud of the leadership of our senior executive team and the commitment, dedication and contributions of all of our associates. We are positioned to look forward to the future with increasing optimism. Many thanks for your support and encouragement.

Arthur F. Weinbach
Chairman and Chief Executive Officer

Gary C. Butler
President and Chief Operating Officer

# Our story,

At ADP, we measure success by how well we serve our clients. In fact, world class service is one of several enterprise-wide strengths that have helped to make us a market leader.

On the following pages, we are pleased to present some of the highlights of the current year, made possible by the many accomplishments of our dedicated associates worldwide.

# their words.

It is an honor for us to welcome the perspective of ADP clients in this year's Annual Report. We hope their insightful observations about the quality and breadth of our products and our commitment to their needs will add a valuable new dimension to your understanding of ADP.

# How are over 350,000 small business employers able to devote more time to their business goals and spend less time worrying about administrative issues?

**Small businesses** have many of the same employer-related obligations as larger firms, only on a different scale. Processing payroll, filing taxes, managing time and attendance, administering benefits and securing workers' compensation insurance coverage are among the requirements that many employers share, regardless of the size of their employee population. In fact, an increasing number of small businesses, acting on the guidance of their accountant, banker or other trusted adviser, are choosing to outsource these administrative tasks that would otherwise divert their focus and resources from the core needs of their business.

In fiscal 2004, **ADP's Small Business Services (SBS) division** provided more than 350,000 small employers with reliable and accurate solutions that relieved them of time-consuming processing requirements and compliance worries. Client retention improved as client satisfaction reached record levels.

This year, two-thirds of all new SBS clients were referred to us by their accountant, banker or another satisfied ADP client — a double-digit increase in such referrals over the prior year. We will continue to focus on and strengthen these important small business referral channels by offering market-leading products and services. Recent enhancements to existing Web-based payroll services enable clients and their accountants to securely access payroll data more effectively. Also, with our fiscal 2003 acquisition of eLabor®, we now provide small and medium-sized employers with the vital capability of managing their labor costs — often, their largest single expense — with hosted and Web-based, fully integrated time and labor management solutions.

Ask Andrew Thompson,
Financial Analyst, Gleason,
Hill & Ambrette, LLC:

"We use ADP's payroll, payroll tax filing and workers' compensation products…I trust ADP because I'm 100% confident in the accuracy and timeliness of the products they provide to us."

**Medium-sized employers** (those with 50 to 999 employees) face enormous challenges. Chief among them are how to manage the burden of increased regulatory compliance, control labor costs, enhance employee communication, improve employee retention, and increase productivity by remaining current with advances in technology. Rather than increase non-core staffing, many firms are now opting to engage the expertise and assistance of outsourcing.

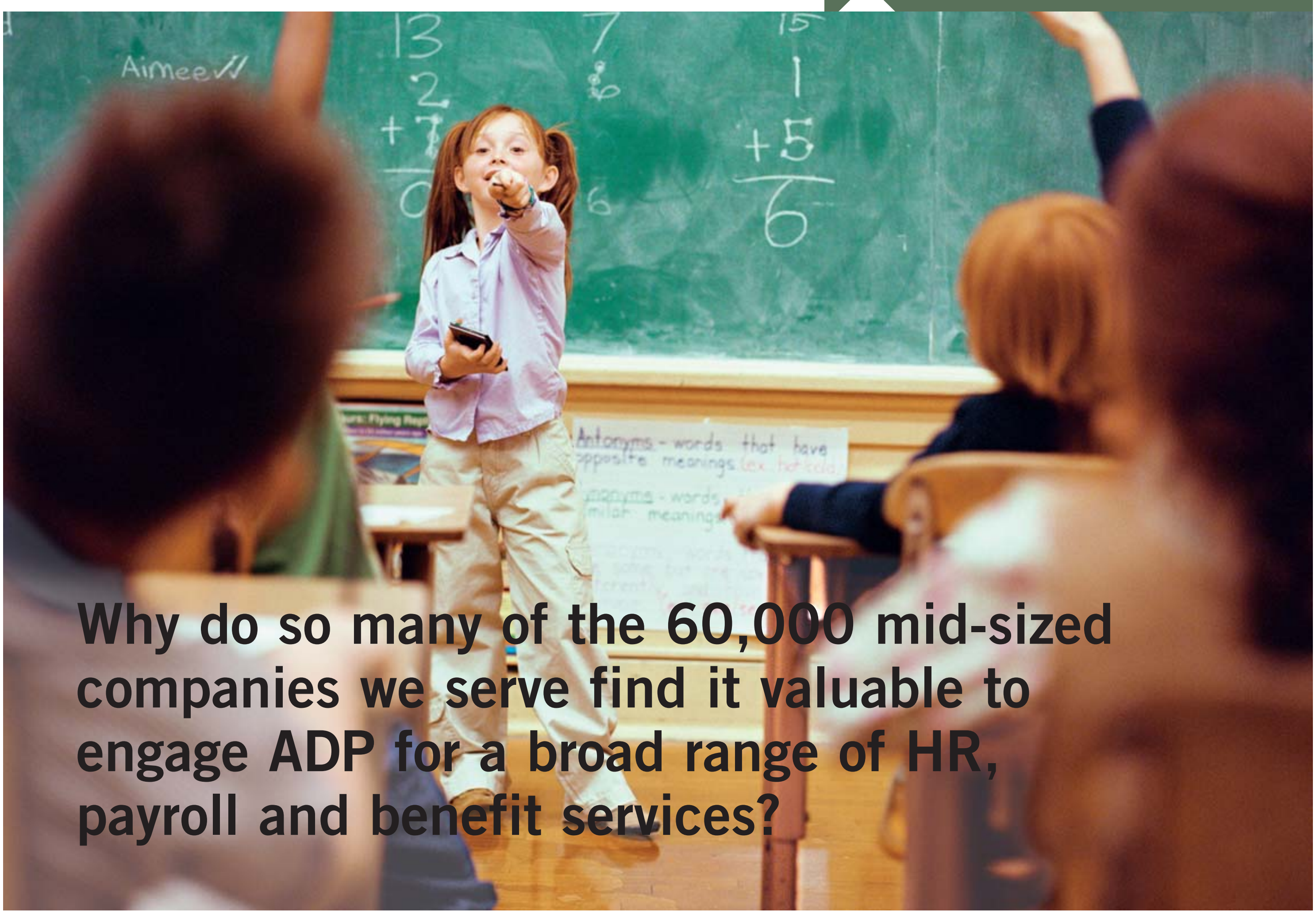
As wage growth and employment rates continued on a slow but steady trend upward, ADP's Major Accounts Services division was already in the marketplace with comprehensive, flexible and efficient end-to-end solutions featuring Web technology and employee self service. This year, 60,000 medium-sized companies utilized ADP's high-value solutions to fulfill critical business applications encompassing HRIS, payroll and benefit administration.

In addition, **ADP Benefit Services** enhances the value of our client relationships in both our **Major Accounts and National Account Services divisions**, with Health and Welfare, COBRA, Flexible Spending Accounts and other services that enable us to be a single-source provider to many employers. Sales of ADP's Web-based payroll service, Pay eXpert®, continued to grow at a robust rate. Our eXpert Services℠ suite, which includes Pay eXpert, enables users to access ADP offerings, such as human resource management, benefit administration and employee self-service solutions.

ADP also expanded the use of the TotalPay® Card, a new pay instrument introduced last year. This VISA®-branded, stored value payroll card electronically stores an employee's net pay for each pay period, providing convenient access to funds at ATMs and retailers. Employers benefit from more control and the elimination of printing, distribution and reconciliation of paper payroll checks.

Ask Martin Nock, President, Communities in Schools of Philadelphia, Inc.:

"We chose ADP to provide us with payroll, HR and benefit solutions because ADP is a name brand. They're the leader in the market and they offer the range of flexible services that our organization needs."




**Why do so many of the 60,000 mid-sized companies we serve find it valuable to engage ADP for a broad range of HR, payroll and benefit services?**

As **large employers**, including those with multinational operations, continue to recognize outsourcing as an attractive and efficient method for business processing, the concept of outsourcing itself is being adapted to satisfy new market trends. For example, there is a growing preference for system hosting — which relieves companies of maintenance and upgrade burdens — as well as single-source relationships with providers such as **ADP's National Account Services division** and **ES International Services**, that can deliver multiple services on a global basis. We successfully integrated ProBusiness Services, Inc. in fiscal 2004, broadening our offerings to the largest clients in the marketplace, while achieving almost 95% client retention.

We also augmented our existing capabilities to serve the largest employers by entering the business process outsourcing (BPO) market with the launch of our comprehensive outsourcing services (COS) business solution. COS provides clients with a new single-source solution that delivers full-service outsourcing: back-office processing and system support, in addition to front-office payroll and benefit administration services that interface with our clients' employees. The market for BPO services is growing and expected to reach $15 billion by 2007.

ADP also enhanced its product offerings to large clients that utilize our traditional outsourcing services for HR, payroll and benefit administration. We expanded the "paperless payroll" features of our comprehensive Web-based payroll solution for large employers, enabling clients to increase cost savings by replacing payroll checks and paper-based reports with electronic transfer of funds, pay card technology and on-demand access to information that streamlines payroll administration. Thirty years ago, our average client solely utilized our payroll services; today most of our new clients with employee populations of 1,000 or more begin their relationship with an average of four ADP services, including payroll tax filing.

Ask Chris Paull, Vice President,
Global Hire to Retire,
Central Shared Services
InterContinental Hotels Group:

"For comprehensive outsourced payroll and HR administration solutions, we found that ADP has the best value. We are confident that our five-year deal with ADP will bring significant cost savings across these processes."

# Why are over 4,000 small business owners leveraging the expertise and resources of our Professional Employer Organization to focus on growth and to compete more effectively in the marketplace?

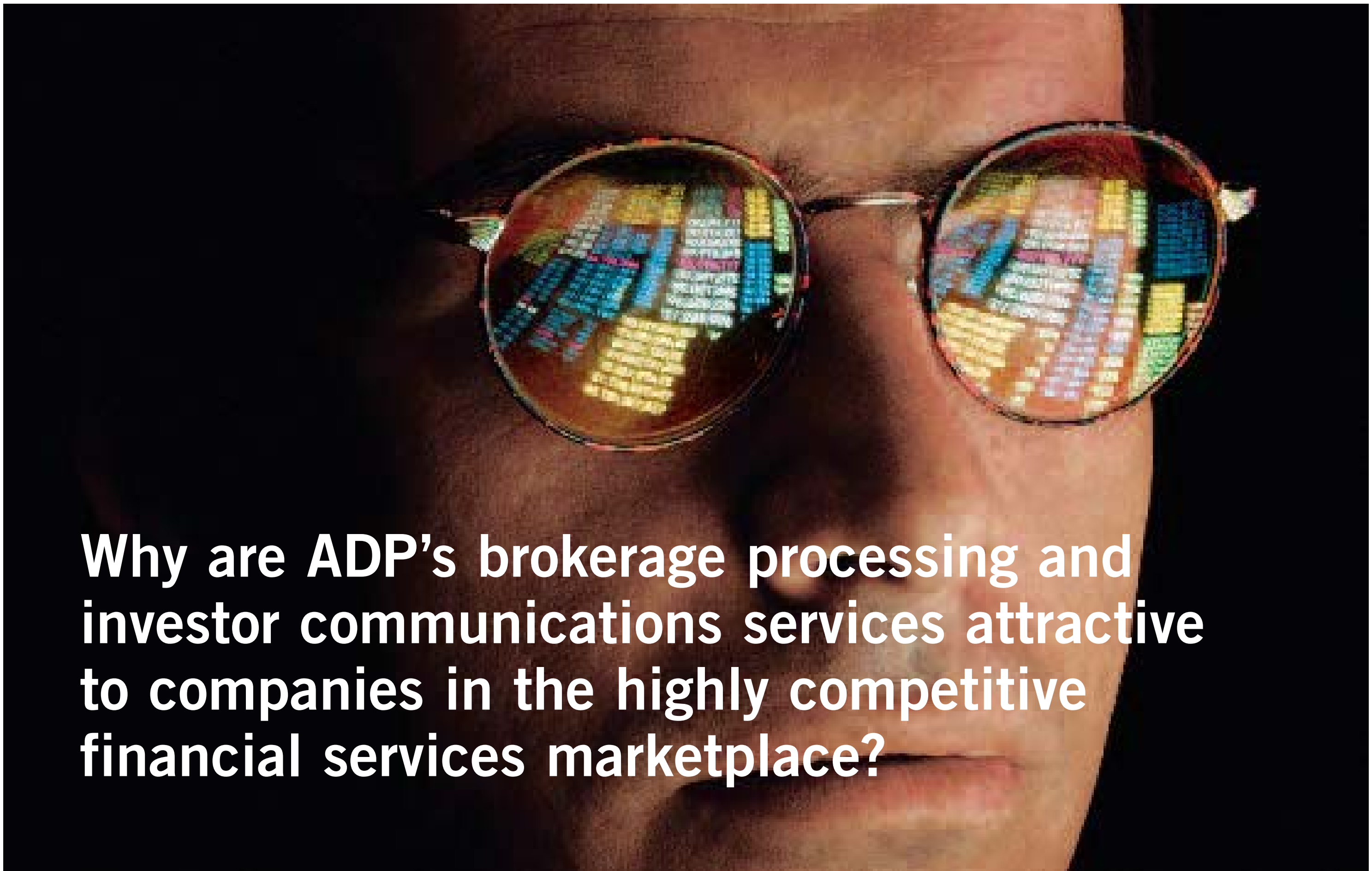
Rapidly rising employment costs and an increasingly complex regulatory environment in the United States are causing many small and medium-sized employers to consider a special brand of outsourcing — a co-employment arrangement with a **Professional Employer Organization (PEO)**. Our PEO helps smaller businesses compete more effectively for talent and benefit from our scale and resources for employment-related administrative tasks, such as HR, payroll and benefit administration. PEO clients enjoy cost savings and can offer their employees benefits and services that were once economically viable only for the largest employers.

Through **ADP TotalSource®**, our PEO business, we provide over 4,200 clients — representing 94,000 worksite employees — with an integrated and comprehensive employment administration outsourcing solution that includes payroll and payroll tax filing, employee background checks, 401(k) plan administration, benefit administration, regulatory compliance services, workers' compensation and healthcare insurance, risk management and voluntary benefits, such as long-term care and additional life and disability coverage.

Small and medium-sized businesses recognize the importance of financially strong and well-capitalized companies like ADP that have the resources to efficiently deploy new products, expand into new geographical markets and introduce clients and their employees to helpful new technology. As an example, ADP's introduction this year of the *My TotalSource*SM secure Web site enables PEO clients to manage payroll and benefit information and utilize recruiting and screening tools online. It concurrently allows worksite employees to make benefit elections and access training. ADP's PEO client satisfaction and retention rates continued to improve in fiscal 2004, reflecting our investment in people, processes and technology.

Ask Albert Santalo, President and Chief Executive Officer, Avisena:

"We entered into a PEO arrangement with ADP…As an outsourcing company ourselves, we believe there are some things you just shouldn't build inside. So for HR, payroll and benefits administration, we decided from the very beginning to work with the biggest and the best — ADP."



# Why are ADP's brokerage processing and investor communications services attractive to companies in the highly competitive financial services marketplace?

The securities industry is on a path to recovery, providing new opportunities for **ADP Brokerage Services**. Industry consolidation, competition among financial services firms and an increasingly complex regulatory environment are creating a stronger demand for end-to-end outsourced services.

In fiscal 2004, we expanded our position as the premier outsourcing provider for **trade processing and investor communications services** in core North American markets by increasing client satisfaction to record levels and continuing to invest in products that differentiate us from our competitors. We furthered our business process outsourcing strategy with the addition of third-party clearing operations by signing a definitive agreement to acquire the U.S. Clearing and BrokerDealer Services divisions of Bank of America Corporation. When completed, this acquisition will enable us to provide both retail and institutional broker clients with an integrated solution that encompasses our Brokerage Processing Services (Service Bureau), Operations Outsourcing and Clearing Services.

Our investor communications business experienced moderate growth this year, distributing more than 850 million pieces of investor communications materials as well as proxy ballots covering more than 470 billion shares. As compliance issues — driven by the USA Patriot Act, Sarbanes-Oxley and other laws — gained a high level of importance throughout the financial services industry, ADP responded with solutions to alleviate some of the compliance burden. *ProxyDisclosure*SM, for example, provides investment companies with an outsourced solution that helps them comply with the U.S. Securities and Exchange Commission's proxy voting disclosure regulations.

Ask Norman Eaker,
Principal, Edward Jones:

"ADP is cost-effective for us in the long run. Their solutions add scale and value. Our relationship with ADP enables us to focus our resources where they matter most — on our clients, our investment representatives and our business."

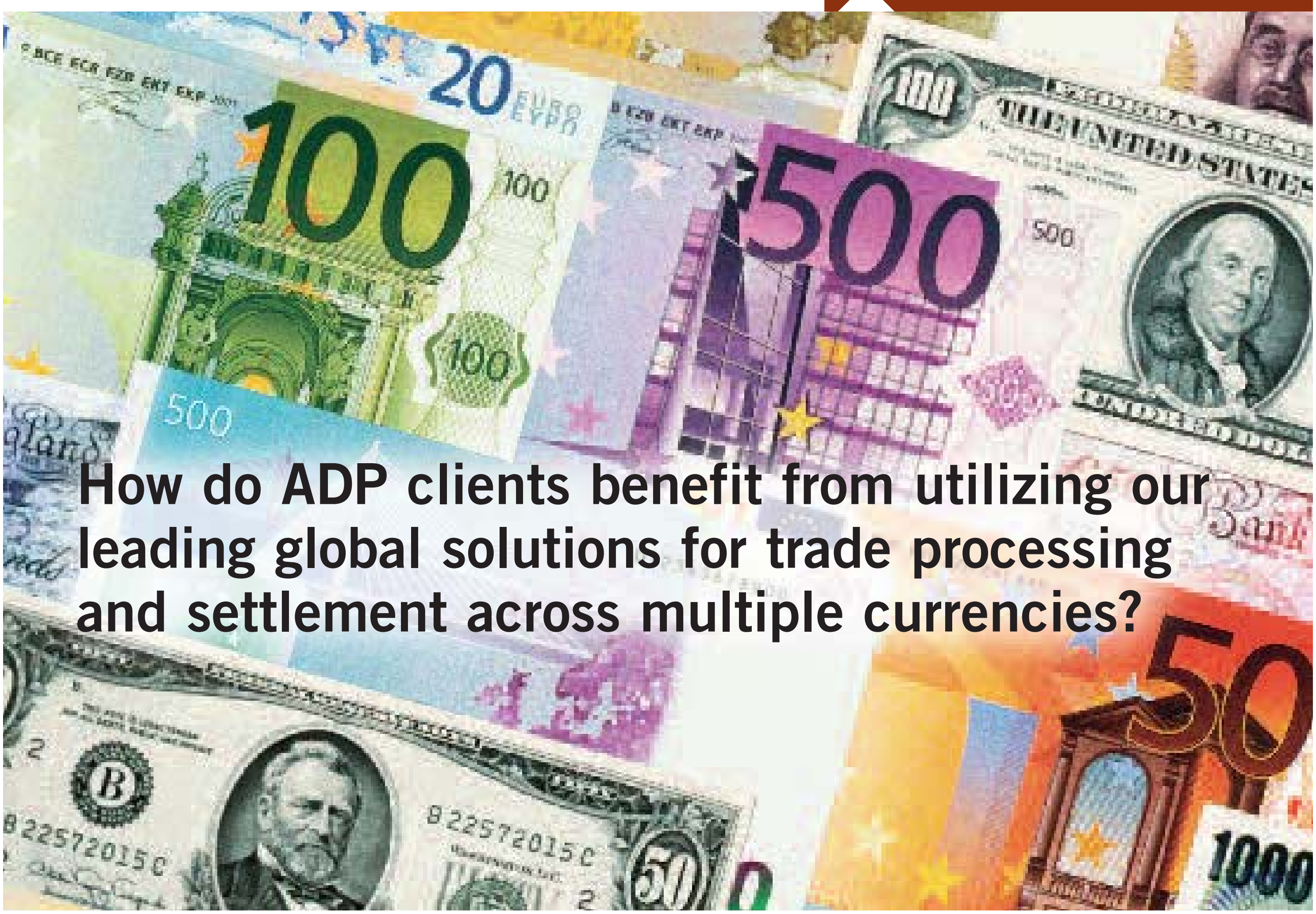
No industry is more inherently global than financial services. Today, with the aid of advanced technology, millions of securities are being traded all the time, everywhere, and irrespective of time zones, geographies and currencies. This year, ADP supported retail and institutional trade processing in major markets worldwide, and the scale of our international operations is growing to meet the heightened global demands of our clients and prospective clients.

In addition to IT outsourcing for **international securities processing** through the traditional service bureau of our **international brokerage business**, we also extended the range of our business process outsourcing services. This capability enables clients to outsource to ADP, on a 24/7 basis, many of the day-to-day tasks typically performed by their back-office staff, such as end-of-day reconciliation and the management of securities data. Additionally, we have extended our global processing capability within our outsourced data center operations. Clients may process trades in many markets and across the three key processing hubs of the United States, Europe and Asia.

We also expanded our footprint in the **global proxy services** market through a joint venture with the Tokyo Stock Exchange and Japan Securities Dealers Association to provide an electronic voting platform in the Japanese market. Users will be able to view meeting materials and receive ballots over the Web, in Japanese or English, and return their votes electronically.

Ask John Kenny,
Senior Vice President,
Director of Operations,
Jefferies & Company, Inc.:

"With ADP, we've automated many of our operation processes, including international trade processing. This enables us to handle higher trade volume, decrease our settlement fail rates, and reduce our technology costs."



One way **automotive retailers and their manufacturers** strive to maintain healthy margins and a favorable position is through the use of technology. In fiscal 2004, ADP provided thousands of dealerships in North America and Europe with technology-enhanced core dealer management systems (DMS) that promote end-to-end solutions designed to help clients sell vehicles, parts and service more profitably than ever before. **Dealer Services'** double-digit sales growth, continued strong client retention rate and best-ever client service quality rating demonstrate that clients have been responding positively to these solutions.

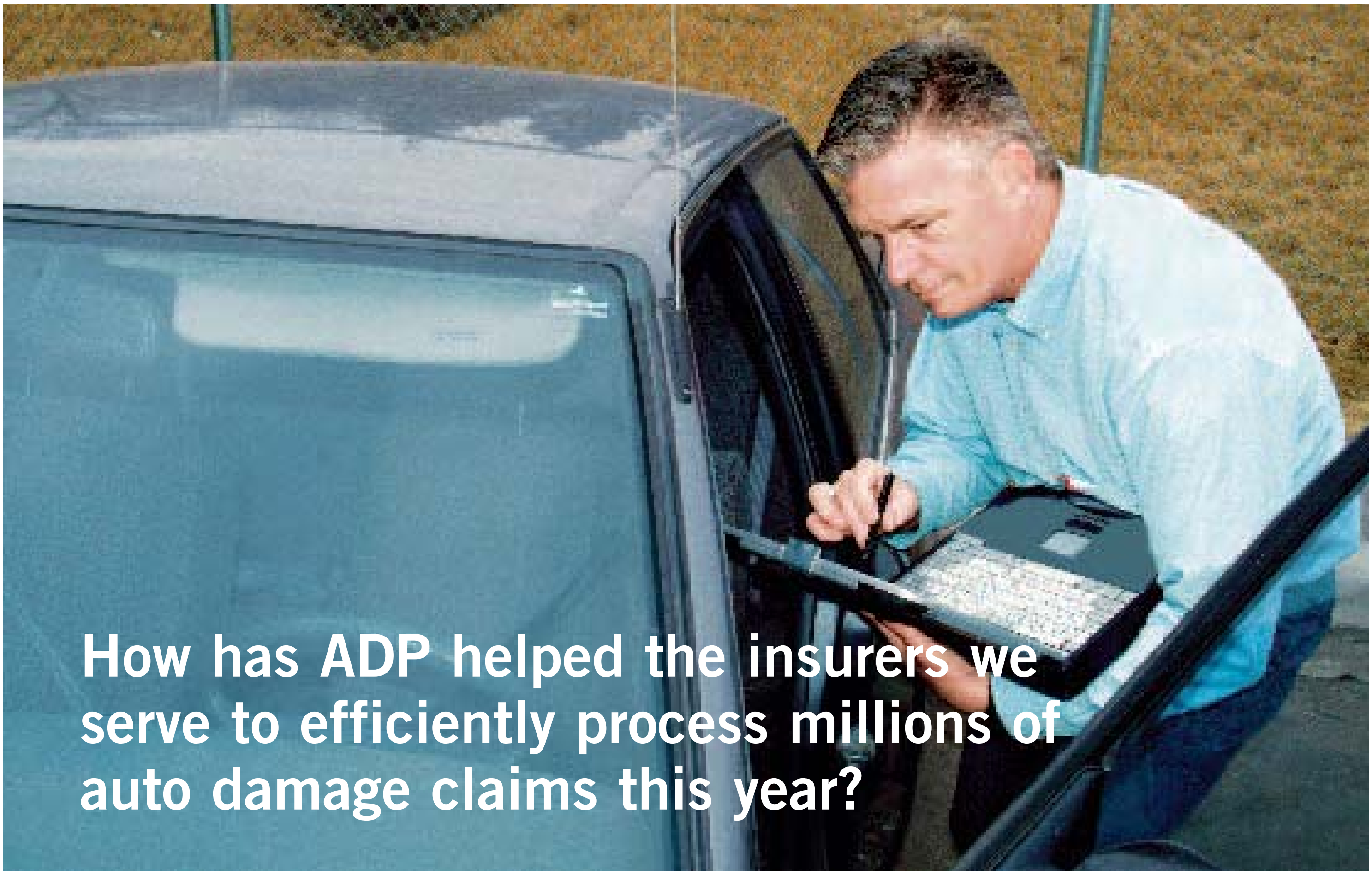
Our ASP (Application Service Provider), Web-enabled business and CRM (Customer Relationship Management) solutions continued to grow. Automotive retailers of all sizes turned to ADP to host their DMS off-site, relieving clients of IT infrastructure burdens such as upgrading to new software releases, network management, system maintenance and technology obsolescence. We also launched several new features to our next-generation, Web-enabled business solutions, as well as expanded our CRM applications to continue to offer dealers a choice of customized front-end management tools. Concurrently this year, ADP introduced the Payroll Tax Service solution, the first of a suite of tax and financial services designed to help dealerships improve tax filing accuracy and manage compliance risk.

We are also enhancing growth through key acquisitions. In March, ADP acquired the EDS Automotive Retail Group, which supports nearly 1,000 automotive retailers, most of which are General Motors and Saturn retailers. All Saturn dealerships will be exclusively supported by ADP. This year, we also entered the growing **powersports market** segment, which serves motorcycle, marine and recreational vehicle dealerships, with the acquisition of ProQuest Business Solutions' Lightspeed® DMS business.

Ask Sid DeBoer,
Chief Executive Officer,
Lithia Motors, Inc.:

"ADP invests a lot of resources in their products and services. They understand our industry and they spend a lot of time with us. As we've grown and changed through the years, ADP has been there for us with the support services we need."


## What puts the 17,000 vehicle retailers that use ADP in the fast lane to sell vehicles, parts and service more profitably?



# How has ADP helped the insurers we serve to efficiently process millions of auto damage claims this year?

The number of automotive vehicles is increasing worldwide, and so is the need to repair them when they are damaged by collision or severe weather forces. The **auto collision and damage claims market** is already large. Currently, over $70 billion in auto damage claims are filed in the countries where ADP provides claims processing services. In addition, insurance companies and repair facilities are increasingly utilizing automation and real-time electronic information exchange to improve workflow and make the claims settlement process more efficient.

Already serving many of the property and casualty insurance companies in North America and Europe, **ADP Claims Services** is well positioned to provide the auto damage claims market with an end-to-end claims solution that is designed to decrease the processing costs and the length of the claims cycle. This year, Web-based ADP Estimating was launched in the North American market. This completely Web-based collision estimating system permits both insurance companies and collision repair facilities to view and work from a single claims file.

To further serve our clients, we are adding products and services that support the end-to-end claims management process — from notification of a loss through estimatics, repair, claim settlement and closing. In fiscal 2004, Claims Services entered an important adjacent market — **insurance distribution and risk management services** — by acquiring ABZ Group B.V., a leading provider of Web-based services to the insurance and financial industries in the Netherlands. These services, which consist of applications, databases and networks, link insurers and insurance brokers to facilitate the efficient delivery of insurance and financial products. They complement ADP's existing claims-based service offerings by enabling seamless integration of data files from underwriting through claims settlement. We also acquired majority ownership of a joint venture that serves Mexico and neighboring markets in Central America. In addition, we are actively engaged in expansion activities in several other countries.

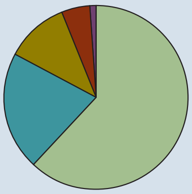
Ask Thomas J. Willson,
Sr. Vice President and
General Claims Manager —
Personal Lines, Liberty Mutual:

"ADP's automobile appraisal product is accurate, reliable and easy-to-use. We also appreciate ADP's flexible, customer-focused approach during a period of rapid growth for our company…They are a valued, long-term partner."

# ADP AT A GLANCE

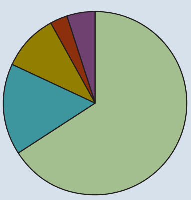
## ADP OVERVIEW

### Percentage of Revenues



**62%** Employer Services
**21%** Brokerage Services
**11%** Dealer Services
**5%** Claims Services
**1%** Other

### Percentage of Earnings



**66%** Employer Services
**16%** Brokerage Services
**10%** Dealer Services
**3%** Claims Services
**5%** Other

**Key Data:**

> ***One of the largest independent computing services firms in the world***

> ***Approaching $8 billion in revenue***

> ***Approximately 550,000 clients served worldwide***

> ***Strong leadership position in every core business segment***

> ***One of seven U.S. industrial companies rated AAA by Standard & Poor's and Moody's***

## EMPLOYER SERVICES OVERVIEW


*The leading provider of HR, payroll and benefit services helping employers increase productivity, ensure regulatory compliance, improve employee retention and control costs.*

**MAJOR MARKETS**

North America, Europe, Australia, Asia and Brazil.

**FY04 HIGHLIGHTS**

> Earned the highest client satisfaction scores in our history

> Increased client retention nearly a full percentage point from last year, establishing a new record

> Paid 1-in-6 private sector workers in the U.S. and approximately 31 million worldwide

> Served nearly 50 million employees with payroll, benefits and other standalone services

> Grew our TotalPay® direct deposit and payroll check product revenues 17%, the 8th consecutive year of growth

> Prepared 44 million Form W-2s — up 11% over last year

> Grew our time and labor management sales 50%, year-to-year

> Expanded our "beyond payroll" revenues to 36% of total North American revenues

> Grew average client fund balances 24%, with half contributed by ProBusiness

## ES BUSINESSES

**SMALL BUSINESS SERVICES (SBS)**

Serves businesses with fewer than 50 employees

**MAJOR ACCOUNTS SERVICES (MA)**

Serves businesses with 50-999 employees

**NATIONAL ACCOUNT SERVICES (NAS)**

Serves businesses with 1,000 or more employees

**FINANCIAL AND COMPLIANCE SERVICES**

Provides employer-related tax services and electronic money movement services to all Employer Services business segments including SBS, MA and NAS

**BENEFIT SERVICES**

Provides Health and Welfare, COBRA, FSA, 401(k) plan and other benefit administration solutions to all Employer Services business segments including SBS, MA and NAS

**ADP TOTALSOURCE**
**Professional Employer Organization Services**

Assists small and medium-sized businesses, through co-employment, with a suite of comprehensive employment administration outsourcing solutions, such as payroll and benefit administration

**ES INTERNATIONAL SERVICES**

Serves multinational and other clients outside the U.S. with payroll processing and HR administration services

| ES SERVICE OFFERINGS | FY04 ES HIGHLIGHTS |
| --- | --- |
| > Payroll Processing Management, Payroll Tax Deposit and Filing Services, Online Reports and Pay Statements, General Ledger Interface, Time and Labor Management, Workers' Compensation Premium Management, HRIS, Employee/Manager Self Service, Government Compliance Reporting | > Increased client satisfaction and retention<br>> Realized double-digit unit growth from accountant referrals<br>> Achieved over 7% growth in salesforce unit productivity<br>> Doubled to 25,000 the number of clients using our EasyPayNet℠ Web-based small business payroll solution |
| > Payroll Processing Management, Payroll Tax Deposit and Filing Services, Online Reports and Pay Statements, General Ledger Interface, Direct Deposit, Payroll Card, Check Reconciliation, Time and Labor Management, HRIS, Employee/Manager Self Service, Government Compliance Reporting, Expense Management Solutions | > Increased client satisfaction to record levels<br>> Grew client retention to record levels<br>> Increased Pay eXpert® and Benefits eXpert® sales 35% and 23%, respectively<br>> Increased sales to new clients to 45% of total sales |
| > Comprehensive Outsourcing Services (COS), Payroll Processing Management, Payroll Tax Deposit and Filing Services, Online Reports and Pay Statements, General Ledger Interface, Time and Labor Management, HRIS, Employee/Manager Self Service, Government Compliance Reporting, Expense Management Solutions | > Posted record sales results<br>> Increased client satisfaction and retention — both are at all-time highs<br>> Completed the 1,000th installation of our ADP Enterprise HR system<br>> Successfully integrated ProBusiness Services, Inc.<br>> Signed more than 10 new COS clients with over $50 million of anticipated recurring revenue |
| > Unemployment Claims Services, Wage Garnishment Processing Services, Job Tax Credit Service (including WOTC and federal and state empowerment zones), Full Service Direct Deposit, ADPCheck™, Check Reconciliation, TotalPay® Card (payroll card) | > Achieved 30% revenue growth in our standalone tax services business<br>> Realized early success with TotalPay® Card enrollment<br>> Moved approximately $800 billion in tax, direct deposit and related funds for our clients |
| > COBRA Administration Services, Health and Welfare Program Administration, Flexible Spending Account (FSA) Administration, Pre-employment Screening and Selection Services, Pretax Insurance Premium Payment Administration, Retirement Services, 529 College Plan Administration | > Increased sales over 20%, led by strong sales in COBRA, FSA and Health and Welfare<br>> Launched ADP's FSA Card, a stored value card for FSA use — we are one of the largest issuers of such cards in the U.S.<br>> Grew sales over 20% in Retirement Services<br>> Acquired ClinNet Solutions, LLC, enabling us to add drug testing services to our suite of product offerings |
| > Payroll, Payroll Tax Filing, HR Guidance, Employee Background Checks, Benefit Administration, 401(k) plan Administration, Regulatory Compliance Services, Workers' Compensation and Healthcare Insurance Coverage | > Grew revenues 28% over last year — our 4th consecutive year of double-digit revenue growth<br>> Increased both the number of clients and worksite employees we serve by nearly 10%<br>> Achieved the highest client satisfaction scores in our history |
| > Payroll and HR Services, Global and Regional Client Relationship Management, Payroll Interface with Top ERPs, Business Consulting Services/Professional Services | > Provided payroll and HR solutions to clients in 26 countries<br>> Expanded an alliance with SAP AG to offer the first truly global BPO offering for HR and payroll<br>> Improved client retention in the Asia-Pacific market to over 90% |

# ADP AT A GLANCE

| BUSINESS UNIT OVERVIEW | MAJOR MARKETS |
|---|---|
|  **BROKERAGE SERVICES** *A leading provider of securities transaction processing services, desktop productivity tools, and investor communications services to the financial services industry worldwide.* | Any firm that requires securities transaction processing of equities, fixed-income and mutual funds; processing, printing, distribution and archiving of investor communications; proxy voting and related services. Geographical markets: North America, Europe, Australia, Hong Kong and Tokyo. |
|  **DEALER SERVICES** *A leading provider of integrated dealer management systems (DMS) and business solutions for automotive, heavy truck, and powersports vehicle retailers and their manufacturers.* | Automotive (including dealership consolidators) and powersports (motorcycle, marine and recreational) vehicle franchise retailers, heavy truck retailers and service centers and their manufacturers. Geographical markets: North America and Europe. |
|  **CLAIMS SERVICES** *A leading international provider of integrated business solutions for companies in the property and casualty insurance, auto collision repair and auto recycling industries.* | Auto insurance claims divisions, auto collision repair centers, auto recyclers and other claims-related businesses. Geographical markets: North America, Europe, South America and South Africa. |

| SERVICE OFFERINGS | FY04 HIGHLIGHTS |
|---|---|
| > Integrated order entry, processing and settlement systems for trading virtually any type of security in any market, at any time; worldwide transaction processing over one technology platform<br>> Browser-based desktop productivity solutions that enable brokers and their representatives to gain more clients and serve existing ones better<br>> Investor communications services that help public companies and mutual funds communicate proxy information to their shareholders (including electronic delivery and Web solutions): proxy distribution and vote processing; mailing and fulfillment; householding; on-demand printing; and other shareholder services<br>> End-to-end management of international back-office trading and settlement operations; automated new accounts processing; and document archiving to satisfy compliance rules for third-party records retention | > Processed for major equity markets 1.4 million trades per day on average, a measure of volume-driven revenue<br>> Provided investor communications services to approximately 13,000 publicly traded U.S. corporations and 450 mutual funds and annuity companies, on behalf of more than 850 brokerage firms and banks<br>> Electronically delivered approximately 23 million investor communications via the Internet, 30% more than last year<br>> Consolidated or electronically delivered 33% of all proxies, saving clients about $310 million in print and postage<br>> Introduced Workflow Solution, a comprehensive, browser-based exceptions-handling tool that enables trade processing clients to significantly reduce the costs and risks associated with manual event exception handling<br>> Launched Intelligent Print Solution, a new method to produce annuity compliance communications that can significantly reduce clients' print and postage costs |
| > Application Service Provider (ASP) managed services hosted by ADP<br>> Hardware and software solutions that help automotive, heavy truck and powersports vehicle retailers sell vehicles, parts and service more profitably, including Customer Relationship Management (CRM) solutions that enable retailers to find and retain their customers, increasing sales and service revenues while decreasing advertising costs, as well as Computerized Vehicle Registration (CVR) systems that transmit electronic documentation between vehicle dealers and government agencies<br>> Networking and telecommunications systems that link and improve communications between automotive retailers and their manufacturers, business partners and consumers<br>> Information systems that help dealerships and manufacturers collect, manage and use customer, vehicle and third-party data to make well-informed decisions<br>> Training and consulting services that help retailers and manufacturers improve employee productivity and maximize the return on technology investments | > Delivered record-high client service, with improvement in each of the last five years<br>> Increased the number of clients utilizing w.e.b.Suite™ *1000* and w.e.b.Suite *2000* next generation DMS solutions to a base of 9,000 users at 1,020 sites, and 53,500 users at 935 sites, respectively<br>> Increased the size of our ASP managed network in excess of 100% with about 70,000 user connections installed at over 1,700 dealer sites<br>> Nearly doubled our Right Relationship 360 CRM system client base<br>> More than doubled sales of our ADP Network Phone IP (Internet Telephony) offering |
| > Claims management applications that streamline the end-to-end claims process, including: first notice of loss, dispatch and assignment, automated collision repair estimating, alternative parts locating, claims audit, claims payment and total loss vehicle valuation<br>> Body shop and auto recycler management systems, and auto recycler alternative parts locating solutions<br>> Other applications, databases, management information tools and services that enhance and optimize the claims process<br>> Insurance broker risk management and insurance distribution services that help clients create, update and manage insurance policies | > Processed over 16 million auto damage estimates for more than one-third of all major property and casualty insurance companies in North America and Europe<br>> Achieved a client retention rate of 92% in North America, and 98% in the international markets we serve<br>> Launched Claims Services' Web-based ADP Estimating product (integrated with Autosource®, our total loss valuation product) in the North American market. The product provides a Web-based collision estimating and total loss valuation system that allows insurers and collision repair facilities to work from a single electronic claims file |

# Selected Financial Data

(In thousands, except per share amounts)

| Years ended June 30, | **2004** | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Total revenues | **$ 7,754,942** | $ 7,147,017 | $ 7,004,263 | $ 6,853,652 | $ 6,168,432 |
| Earnings before income taxes | **$ 1,494,530** | $ 1,645,200 | $ 1,786,970 | $ 1,525,010 | $ 1,289,600 |
| Net earnings | **$ 935,570** | $ 1,018,150 | $ 1,100,770 | $ 924,720 | $ 840,800 |
| Pro forma net earnings* | | | | $ 971,680 | $ 881,890 |
| Basic earnings per share | **$ 1.58** | $ 1.70 | $ 1.78 | $ 1.47 | $ 1.34 |
| Diluted earnings per share | **$ 1.56** | $ 1.68 | $ 1.75 | $ 1.44 | $ 1.31 |
| Pro forma basic earnings per share* | | | | $ 1.54 | $ 1.41 |
| Pro forma diluted earnings per share* | | | | $ 1.51 | $ 1.37 |
| Basic average shares outstanding | **591,697** | 600,071 | 618,857 | 629,035 | 626,766 |
| Diluted average shares outstanding | **598,749** | 605,917 | 630,579 | 645,989 | 646,098 |
| Cash dividends per share | **$ .5400** | $ .4750 | $ .4475 | $ .3950 | $ .3388 |
| Return on equity | **17.3%** | 19.4% | 22.4% | 19.9% | 19.7% |
| At year end: | | | | | |
| Cash, cash equivalents and marketable securities | **$ 2,092,576** | $ 2,344,343 | $ 2,749,583 | $ 2,596,964 | $ 2,452,549 |
| Working capital | **$ 993,165** | $ 1,676,718 | $ 1,406,155 | $ 1,747,187 | $ 1,767,784 |
| Total assets before funds held for clients | **$ 8,217,027** | $ 8,025,922 | $ 7,051,251 | $ 6,549,980 | $ 6,429,927 |
| Total assets | **$21,120,559** | $19,833,671 | $18,276,522 | $17,889,090 | $16,850,816 |
| Long-term debt | **$ 76,200** | $ 84,674 | $ 90,648 | $ 110,227 | $ 132,017 |
| Stockholders' equity | **$ 5,417,670** | $ 5,371,473 | $ 5,114,205 | $ 4,700,997 | $ 4,582,818 |

*Pro forma net earnings and earnings per share reflect the impact relating to the July 1, 2001 adoption of Statement of Financial Accounting Standards No. 142, which eliminated goodwill amortization.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

**Description of the Company and Business Segments**

Automatic Data Processing, Inc. ("ADP" or the "Company") provides technology-based outsourcing solutions to employers, the brokerage and financial services community and vehicle retailers and their manufacturers. The Company's major business segments are: Employer Services, Brokerage Services and Dealer Services. A brief description of each segment's operations is provided below.

**Employer Services**

Employer Services offers a comprehensive range of payroll processing, human resource ("HR") and benefit administration products and services, including traditional and Web-based outsourcing solutions, that assist over 478,000 employers in the United States, Canada, Europe, South America (primarily Brazil), Australia and Asia to staff, manage, pay and retain their employees. Employer Services categorizes its services between traditional payroll and payroll tax, and "beyond payroll." The traditional payroll and payroll tax business represents the Company's core payroll processing and payroll tax filing business. The "beyond payroll" business represents the products that extend beyond the traditional payroll and payroll tax filing services, such as the Professional Employer Organization (PEO) business, TotalPay®, Time and Labor Management, and benefit and retirement administration. Within Employer Services, the Company collects client funds and remits such funds to tax authorities for payroll tax filing and payment services and to employees of payroll services clients.

**Brokerage Services**

Brokerage Services provides transaction processing services, desktop productivity applications and investor communications services to the financial services industry worldwide. Brokerage Services' products and services include: (i) global order entry, trade processing and settlement systems that enable firms to trade virtually any financial instrument, in any market, at any time; (ii) full-service investor communications services including: electronic delivery and Web solutions; workflow services; financial, offset, and on-demand printing; proxy distribution and vote processing; householding; regulatory mailings; fulfillment; and customized communications; (iii) automated, browser-based desktop productivity tools for financial consultants and back-office personnel; and (iv) integrated delivery of multiple products and services through ADP's Global Processing Solution.

**Dealer Services**

Dealer Services provides integrated dealer management computer systems (such a system is also known in the industry as a "DMS") and other business performance solutions to automotive retailers and their manufacturers throughout North America and Europe. More than 17,000 automobile, heavy truck and powersports (*i.e.,* motorcycle, marine and recreational) vehicle retailers use our DMS, networking solutions, data integration, consulting and/or marketing services.

**Executive Overview**

Consolidated revenues in fiscal 2004 grew 9% to $7.8 billion, compared to $7.1 billion in fiscal 2003. Earnings before income taxes and net earnings declined 9% and 8%, respectively. Diluted earnings per share of $1.56 declined 7% from $1.68 per share in fiscal 2003 on fewer shares outstanding. During fiscal 2004, we acquired approximately 15.8 million of our shares for treasury for approximately $649 million. Operating cash flows were $1.4 billion for the year as compared to $1.6 billion in fiscal 2003, and cash and marketable securities were $2.1 billion at June 30, 2004.

We concluded fiscal 2004 in line with our expectations. Employer Services' revenues grew 10% for the full year. There was positive momentum in new business sales during the second half of fiscal 2004 which resulted in 6% sales growth for the full year. The number of employees on our clients' payrolls in our Majors Market in the United States, "pays per control," grew 0.4% for the full year. Average client fund balances were strong with 24% growth for the year, half of which was contributed by last year's acquisition of ProBusiness Services, Inc. Brokerage Services' revenues grew 3% for the year. Our full year results in Brokerage Services were helped by 15% growth in investor communications pieces delivered, reflecting more holders of equities and incremental activity from the recent mutual fund regulatory activity. Dealer Services' revenues grew 9% for the full year supported by strong sales growth of 13% for the year.

In fiscal 2004, we spent about $170 million on what we have described as "incremental investments." This incremental spending was targeted at revenue growth opportunities as well as costs to scale back or exit lower growth areas. These expenses consisted primarily of $45 million of employer of choice initiatives (mostly associate compensation), $35 million of expenses relating to our salesforce (mostly additional salesforce, training, sales meetings and marketing expenses), $30 million of severance and facility exit costs, and expenses relating to maintaining our products and services. On an ongoing basis we expect that these expenses will continue at $180 million on a full year basis.

Our outlook for fiscal 2005 is positive. We are beginning to see the benefit of our investments in our associates, products and services and our salesforce. Our associate retention is good at almost 90% retention worldwide. Client retention is excellent across all businesses and especially in Dealer Services and Employer Services. In Employer Services, we improved retention almost one percentage point in fiscal 2004 compared to record levels a year ago. We are gaining momentum in sales, particularly in Employer Services and Dealer Services where, in both businesses, we finished fiscal 2004 strong and have double-digit sales growth expectations for fiscal 2005.

Our fiscal 2005 guidance is for mid-single digit revenue growth and double-digit earnings per share growth. The forecast is based on current economic conditions. We are assuming no further improvement in "pays per control," and a 3% increase in investor communications pieces delivered with lower mutual fund mailings related to regulatory activity. At the end of fiscal 2004, we reached an agreement to acquire the U.S. Clearing and BrokerDealer Services divisions of Bank of America Corporation, which provide third-party clearing operations. We anticipate closing this acquisition before the end of the calendar year with about $.01 dilution in fiscal 2005.

Although we are forecasting double-digit earnings per share growth for fiscal 2005, we expect to start the year slower with lower growth early in the year. We expect earnings growth to accelerate throughout the year as we anticipate more favorable interest rate comparisons and we anniversary investment spending levels that increased throughout fiscal 2004.

### Results of Operations
### Analysis of Consolidated Operations

(In millions, except per share amounts)

| | Years ended June 30, | | | Change | | |
|---|---|---|---|---|---|---|
| | **2004** | 2003 | 2002 | **2004** | 2003 | 2002 |
| Total revenues | **$7,755** | $7,147 | $7,004 | **9%** | 2% | 2% |
| Total expenses | **$6,260** | $5,502 | $5,217 | **14%** | 5% | (2)% |
| Earnings before income taxes | **$1,495** | $1,645 | $1,787 | **(9)%** | (8)% | 17% |
| Margin | **19.3%** | 23.0% | 25.5% | | | |
| Provision for income taxes | **$ 559** | $ 627 | $ 686 | **(11)%** | (9)% | 14% |
| Effective tax rate | **37.4%** | 38.1% | 38.4% | | | |
| Net earnings | **$ 936** | $1,018 | $1,101 | **(8)%** | (8)% | 19% |
| Diluted earnings per share | **$ 1.56** | $ 1.68 | $ 1.75 | **(7)%** | (4)% | 22% |

### Fiscal 2004 Compared to Fiscal 2003
### Revenues

Our consolidated revenues for the year ended June 30, 2004 grew 9% to $7.8 billion primarily due to increases in Employer Services of 10% to $4.8 billion, Dealer Services of 9% to $890 million and Brokerage Services of 3% to $1.7 billion. Our consolidated revenues, excluding the impact of acquisitions and divestitures, grew 6% in the fiscal year ending June 30, 2004 as compared with the prior year. Revenue growth for the fiscal year was also favorably impacted by $144 million, or 2%, due to fluctuations in foreign currency exchange rates.

Our fiscal 2004 consolidated revenues include interest on funds held for clients of $355 million, as compared to $369 million in fiscal 2003. The decrease in the consolidated interest earned on funds held for clients resulted from the decrease in interest rates in the current year, offset by the increase of 24% in our average client fund balances to $11.1 billion. The difference between the 4.5% standard rate allocation in Employer Services and the actual interest earned is a reconciling item that eliminates in consolidation and reduces revenues by $140 million in fiscal 2004 and $41 million in fiscal 2003.

### Expenses

Our consolidated expenses for fiscal 2004 increased by $759 million, from $5.5 billion to $6.3 billion. The increase in our consolidated expenses is primarily due to our increase in revenues, including the additional expenses related to acquisitions, and expenses relating to our incremental investments of $170 million. The incremental investments were targeted at revenue growth opportunities as well as costs to scale back or exit lower growth areas. These expenses consisted primarily of $45 million of employer of choice initiatives (mostly associate compensation), $35 million of expenses relating to our salesforce (mostly additional salesforce, training, sales meetings and marketing expenses), $30 million of severance and facility exit costs, and expenses relating to maintaining our products and services. In addition, consolidated expenses increased by $115 million, or 2%, due to fluctuations in foreign currency exchange rates. Operating expenses increased by $429 million, or 14%, primarily due to the increase in consolidated revenues. Selling, general and administrative expenses increased by $145 million to $1.9 billion primarily due to the additional compensation expenses incurred relating to our employer of choice initiatives and the additional salesforce added during fiscal 2004. Systems development and programming costs increased by $82 million to $581 million due to continued investments in sustaining our products, primarily in our Employer Services business, and the maintenance of our existing technology throughout all of our businesses. Depreciation and amortization expenses increased by $32 million to $307 million due to an increase in amortization of intangible assets primarily from the increase in software licenses acquired with our fiscal 2004 and fiscal 2003 acquisitions. In addition, other income, net, decreased $71 million due to a decline in interest income on corporate funds of $39 million resulting from lower investment yields and the net realized losses of $8 million in fiscal 2004 as compared to the net realized gains of $30 million in fiscal 2003 on our available-for-sale securities.

**Earnings Before Income Taxes**

Earnings before income taxes decreased by $151 million, or 9%, to $1.5 billion for the fiscal year primarily due to the investment spending relating to our employer of choice initiatives, investments in our salesforce and costs to maintain our products and services, which impacted all of our business segments, the integration of certain fiscal 2003 acquisitions, and a decrease in investment income on client fund balances and corporate funds of $90 million, primarily due to the lower interest rates during fiscal 2004.

**Provision for Income Taxes**

Our effective tax rate for fiscal 2004 was 37.4% as compared to 38.1% for fiscal 2003. The decrease is attributable to a favorable mix in income among tax jurisdictions and favorable settlements of state income tax examinations.

**Net Earnings**

Fiscal 2004 net earnings decreased 8% to $936 million from $1.0 billion and the related diluted earnings per share decreased 7% to $1.56. The decrease in net earnings reflects the decrease in earnings before income taxes, slightly offset by a lower effective tax rate. The decrease in diluted earnings per share reflects the decrease in net earnings, partially offset by fewer shares outstanding due to the repurchase of approximately 15.8 million shares for approximately $649 million in fiscal 2004, and approximately 27.4 million shares for approximately $939 million in fiscal 2003.

**Fiscal 2003 Compared to Fiscal 2002**

**Revenues**

Our consolidated revenues grew 2% to $7.1 billion in fiscal 2003, primarily due to an increase in Employer Services of 5% to $4.4 billion and an increase in Dealer Services of 11% to $813 million. These increases were offset by a decrease in our Brokerage Services business of 9%, or $167 million. Our revenue growth was impacted primarily by continued weak economic conditions impacting our Employer Services and Brokerage Services businesses and our interest income. Revenue growth for the fiscal year was also favorably impacted by $111 million, or 2%, due to fluctuations in foreign currency exchange rates.

Our fiscal 2003 consolidated revenues include interest on funds held for clients of $369 million, as compared to $431 million in fiscal 2002. The decrease in the consolidated interest earned on funds held for clients resulted from the decrease in interest rates in fiscal 2003, offset by the increase of 7% in our average client fund balances to $8.9 billion. The difference between the 4.5% standard rate allocation in Employer Services and the actual interest earned is a reconciling item that eliminates in consolidation and reduces revenues by $41 million in fiscal 2003 and increases revenues by $50 million in fiscal 2002.

**Expenses**

Selling, general and administrative expenses grew 9% to $1.8 billion and include approximately $60 million of restructuring charges relating to exiting of certain businesses and cost reduction efforts in certain slow growth businesses, most of which occurred in the fourth quarter of fiscal 2003. The restructuring was primarily severance costs, including charges to exit our medical claims business within Claims Services and a small payroll business servicing primarily government agencies, separate from our core payroll business, in the United Kingdom. Operating expenses increased 4% to $3.1 billion, primarily driven by revenue growth in Employer Services and Dealer Services. Systems development and programming costs increased 5% to $499 million due to continued investment in sustaining our products, primarily in our Employer Services business, and the maintenance of our existing technology throughout all of our businesses. Depreciation and amortization expense decreased 2% to $275 million due to a decrease in capital expenditures of approximately $12 million in fiscal 2003 and $40 million in fiscal 2002. Other income for the year increased to $127 million, or 12%, from the prior year due to an increase in our net realized gains associated with our investment portfolio of $13.1 million. In addition, consolidated expenses increased by $97 million, or 2%, due to fluctuations in foreign currency exchange rates.

**Earnings Before Incomes Taxes**

Earnings before income taxes in fiscal 2003 decreased 8% to $1.6 billion as total expenses grew at a faster rate than revenues. This decrease primarily reflects the 35% decrease in earnings before income taxes in Brokerage Services. While we focused on cost containment initiatives throughout the fiscal years ended June 30, 2002 and 2003 to bring our expense structure in line with our slower revenue growth, our Brokerage Services' cost reductions did not offset the 9% decline in revenues in this business.

**Provision for Income Taxes**

Our effective tax rate for fiscal 2003 was 38.1%, a decrease of 0.3% from fiscal 2002. The decrease is attributable to a favorable mix in income among tax jurisdictions.

**Net Earnings**

Fiscal 2003 net earnings decreased 8% to $1.0 billion and the related diluted earnings per share decreased 4% to $1.68. The decrease in net earnings primarily reflects the decrease in earnings before income taxes, slightly offset by a lower effective tax rate. The decrease in diluted earnings per share reflects the decrease in net earnings, partially offset by fewer shares outstanding due to the repurchase of approximately 27.4 million shares for approximately $939 million during fiscal 2003 and approximately 17.4 million shares for approximately $875 million during fiscal 2002 and the lower impact of stock options on dilution during fiscal 2003.

**Analysis of Business Segments**

**Revenues**

| (In millions) | Years ended June 30, | | | Change | | |
|---|---|---|---|---|---|---|
| | **2004** | 2003 | 2002 | **2004** | 2003 | 2002 |
| Employer Services | **$4,809** | $4,390 | $4,176 | **10%** | 5% | 6% |
| Brokerage Services | **1,665** | 1,610 | 1,777 | **3** | (9) | 1 |
| Dealer Services | **890** | 813 | 732 | **9** | 11 | 3 |
| Other | **476** | 462 | 464 | **3** | — | 5 |
| Reconciling items: | | | | | | |
| Foreign exchange | **55** | (87) | (195) | **—** | — | — |
| Client fund interest | **(140)** | (41) | 50 | **—** | — | — |
| Total revenues | **$7,755** | $7,147 | $7,004 | **9%** | 2% | 2% |

**Earnings Before Income Taxes**

| (In millions) | Years ended June 30, | | | Change | | |
|---|---|---|---|---|---|---|
| | **2004** | 2003 | 2002 | **2004** | 2003 | 2002 |
| Employer Services | **$ 993** | $1,070 | $ 995 | **(7)%** | 8% | 21% |
| Brokerage Services | **245** | 232 | 358 | **5** | (35) | 6 |
| Dealer Services | **144** | 137 | 120 | **6** | 14 | 15 |
| Other | **112** | 153 | 169 | **(27)** | (11) | 145 |
| Reconciling items: | | | | | | |
| Foreign exchange | **7** | (15) | (27) | **—** | — | — |
| Client fund interest | **(140)** | (41) | 50 | **—** | — | — |
| Cost of capital charge | **134** | 109 | 122 | **—** | — | — |
| Total earnings before income taxes | **$1,495** | $1,645 | $1,787 | **(9)%** | (8)% | 17% |

**Major Business Units**

Certain revenues and expenses are charged to the business units at a standard rate for management reasons. Other costs are recorded based on management responsibility. As a result, various income and expense items, including certain non-recurring gains and losses, are recorded at the corporate level.

The fiscal 2003 and 2002 business unit revenues and earnings before income taxes have been adjusted to reflect updated fiscal year 2004 budgeted foreign exchange rates. This adjustment is made for management purposes so that the business unit revenues are presented on a consistent basis without the impact of fluctuations in foreign currency exchange rates. This adjustment is eliminated in consolidation and as such represents a reconciling item to revenues and earnings before income taxes.

In addition, Employer Services' fiscal 2003 and 2002 revenues and earnings before income taxes were adjusted to include interest income earned on funds held for clients at a standard rate of 4.5%. Prior to fiscal 2004, Employer Services was credited with interest earned on client funds at 6.0%. Given the decline in interest rates over recent years, the standard rate has been changed to 4.5%. This adjustment is made for management reasons so that the interest earned on client funds at Employer Services is presented on a consistent basis without the impact of fluctuations in interest rates. This adjustment is eliminated in consolidation and as such represents a reconciling item to revenues and earnings before income taxes.

The business unit results also include a cost of capital charge related to the funding of acquisitions and other investments. This charge is eliminated in consolidation and as such represents a reconciling item to earnings before income taxes.

***Employer Services***

**Fiscal 2004 Compared to Fiscal 2003**

**Revenues**

Employer Services' revenues increased 10% in fiscal 2004 primarily due to revenues from fiscal 2003 acquisitions, strong client retention, new business sales, price increases and interest earned on client fund balances. Internal revenue growth, which represents revenue growth excluding the impact of acquisitions and divestitures, was approximately 5% for the fiscal year. Our client retention in the United States continues to be excellent, improving almost one percentage point from record retention levels in fiscal 2003. New business sales, which represent the annualized recurring revenues anticipated from sales orders to new and existing clients, increased 6% to approximately $750 million in fiscal 2004. Interest income is credited to Employer Services at a standard rate of 4.5%. The average client funds balance was $11.1 billion during fiscal 2004, representing an increase of 24%, of which about one-half was related to the June 2003 acquisition of ProBusiness Services, Inc. Revenues from our "beyond payroll" products continued to grow at a faster rate than the traditional payroll and payroll tax revenues. Our Professional Employer Organization (PEO) revenues grew 28% to $467 million primarily due to 10% growth in the number of PEO worksite employees and additional pass-through benefit and workers' compensation costs. In addition, "beyond payroll" revenues increased due to increased number of clients utilizing services, such as Time and Labor Management and TotalPay Services.

**Earnings Before Income Taxes**

Earnings before income taxes in Employer Services decreased 7% for the fiscal year due primarily to our investment spending relating to our employer of choice initiatives, investments in our salesforce and costs to maintain our products and services totaling approximately $138 million. In addition, earnings before income taxes declined approximately 3% as a result of the integration of certain fiscal 2003 acquisitions. These decreases were offset by the increase in earnings before income taxes of approximately 9% as a result of revenue growth and operating efficiencies.

**Fiscal 2003 Compared to Fiscal 2002**

**Revenues**

Employer Services' revenues grew 5% in fiscal 2003 when compared to fiscal 2002. Despite the negative impacts of the weak economy in fiscal 2003, Employer Services grew primarily due to the increases in our U.S. payroll and payroll tax businesses, as well as strong growth in our "beyond payroll" products, including our PEO business. Internal revenue growth was approximately 5% for the fiscal year. Client retention improved 1% from the prior year; however, pays per control decreased 1% for the year. New business sales, which represent the annualized recurring revenues anticipated from sales orders to new and existing clients, decreased 2% to approximately $710 million in fiscal 2003. Interest income is credited to Employer Services at a standard rate of 4.5%. The average client funds balance was $8.9 billion during fiscal 2003, representing an increase of 7%. Our "beyond payroll" revenues increased due to the growth in our PEO revenues of 37% to $366 million primarily due to the 13% growth in the number of PEO worksite employees and additional pass-through benefit and workers' compensation costs.

**Earnings Before Income Taxes**

Earnings before income taxes grew 8% as a result of the 5% increase in revenues and our cost containment efforts of reducing headcount to properly align our cost structure with our existing businesses, which contributed approximately 3% to the increase.

On June 20, 2003, we acquired all of the outstanding shares of ProBusiness Services, Inc. for cash of approximately $517 million, net of cash acquired.

***Brokerage Services***

**Fiscal 2004 Compared to Fiscal 2003**

**Revenues**

Brokerage Services' revenues increased 3% for fiscal 2004 when compared to fiscal 2003 primarily due to an increase in certain investor communications activity offset by continued industry consolidations which reduced our trade processing revenues. Revenues from investor communications increased by $83 million, or 7%, to $1.2 billion primarily due to increases in the volume of our proxy and interim communications services, as well as our distribution services for confirmations, statements, and pre- and post-sale mutual fund documents. Our proxy and interim communication pieces delivered increased 15%, from 755 million to 865 million, stemming from more holders of equities and incremental activity from recent mutual fund industry regulatory activity. Stock record growth, which is a measure of how many stockholders own a security compared with the prior year and a key factor in the number of pieces delivered, increased 4% in fiscal 2004 as compared to a 1% decline in fiscal 2003. Our distribution services' revenue increased $35 million primarily due to the increase in the amount of pre- and post-sale mutual fund pieces delivered. Our back-office trade processing revenues declined by $12 million to $343 million primarily due to an 11% decline in the average revenue per trade. The average revenue per trade was primarily impacted by industry consolidations, our client mix, and volume processed under tier pricing agreements. The decline in the average revenue per trade was partially offset by an increase in average trades per day of 6%, from 1.32 million to 1.39 million, primarily due to net new business sales and internal growth.

**Earnings Before Income Taxes**
Earnings before income taxes increased 5% primarily due to our cost containment efforts in our underperforming businesses and increased revenues in our investor communications activities. Our ability to eliminate unprofitable business lines and properly align our cost structure with the slower growth levels of our underperforming businesses contributed approximately $19 million to earnings before income taxes. These increases were offset by the decline in earnings before income taxes from our trade processing services, primarily due to industry consolidations. In addition, our earnings before income taxes were negatively impacted by our incremental investments in our products and services and employer of choice initiatives that totaled approximately $14 million during the fiscal year.

**Fiscal 2003 Compared to Fiscal 2002**
**Revenues**
Brokerage Services' revenues declined 9% in fiscal 2003 when compared to fiscal 2002 primarily due to continued industry consolidations that reduced our trade processing revenues and a decrease in certain investor communications activity. Trade processing revenues declined by $93 million to $356 million due to a 13% decline in trades per day from 1.51 million in fiscal 2002 to 1.32 million in fiscal 2003. Revenues per trade also declined by 12% due primarily to the change in the mix of retail vs. institutional trades, industry consolidations and pricing pressures. Revenues from our investor communications decreased by $55 million to $1.1 billion, primarily due to a 6% decline in pieces delivered from 806 million in fiscal 2002 to 754 million in fiscal 2003. Stock record growth decreased 1% in fiscal 2003.

**Earnings Before Income Taxes**
Earnings before income taxes declined 35% primarily due to the decline in revenues and an increase in selling, general and administrative expenses of approximately $15 million relating to severance costs and expenses relating to potential acquisitions. During fiscal 2003, we focused on cost reductions in our underperforming businesses in order to properly align our cost structure with the slower growth levels expected in fiscal 2004.

***Dealer Services***
**Fiscal 2004 Compared to Fiscal 2003**
**Revenues**
Dealer Services' revenues increased 9% in fiscal 2004 when compared to fiscal 2003. Internal revenue growth was approximately 8% for the fiscal year. Revenues increased for our dealer business systems in North America by $62 million to $730 million due to new product growth in our traditional core businesses. The new product growth accounted for approximately 60% of the increase in revenue for the fiscal year and is primarily driven by increased users for Application Service Provider (ASP) managed services, new network installations, and strong market acceptance of our Customer Relationship Management (CRM) product.

**Earnings Before Income Taxes**
Earnings before income taxes grew 6% primarily due to the increase in revenues of our traditional core business which contributed approximately 15% to earnings before income taxes. These increases were partially offset by our incremental investments in our products and services and employer of choice initiatives which totaled approximately $10 million during the fiscal year.

**Fiscal 2003 Compared to Fiscal 2002**
**Revenues**
Dealer Services' revenues increased 11% in fiscal 2003 when compared to fiscal 2002 due to the increase in revenue of $79 million, to $665 million, for our dealer business systems in North America. Internal revenue growth was approximately 8% for the fiscal year. Revenue growth was generated by strong client retention as well as growth from new services, primarily ASP managed services, Networking and Computer Vehicle Registration. Further, sales of our CRM products were strong.

**Earnings Before Income Taxes**
Earnings before income taxes grew 14% as a result of increased revenues and continued cost containment efforts which reduced certain selling, general and administrative expenses by approximately $6 million.

***Other***
The primary components of "Other" are Claims Services, miscellaneous processing services, and corporate allocations and expenses.

**Financial Condition, Liquidity and Capital Resources**
Our financial condition and balance sheet remain exceptionally strong. At June 30, 2004, cash and marketable securities approximated $2.1 billion. Stockholders' equity was approximately $5.4 billion and return on average equity for the year was over 17%. The ratio of long-term debt-to-equity at June 30, 2004 was 1.4%.

At June 30, 2004, working capital was $1.0 billion compared to $1.7 billion at June 30, 2003. The decrease in the Company's working capital arose primarily from the movement of cash, cash equivalents and short-term marketable securities to long-term marketable securities to obtain more favorable interest yields. We also used cash and cash equivalents for such matters as treasury share repurchases and acquisitions during the fiscal year.

Our principal sources of liquidity are derived from cash generated through operations and our cash and marketable securities on hand. We also have the ability to generate cash through our financing arrangements under our U.S. short-term commercial paper program and our U.S. and Canadian short-term repurchase agreements. In addition, we have two unsecured revolving credit agreements that allow us to borrow $4.5 billion, in the aggregate. Our short-term commercial paper program and repurchase agreements are utilized as the primary instruments to meet short-term funding requirements related to client funds obligations. Our revolving credit agreements, totaling $4.5 billion, are in place to provide additional liquidity, if needed. We have never had borrowings under the current or previous revolving credit agreements. The Company believes that the internally generated cash flows and financing arrangements are adequate to support business operations and capital expenditures.

Cash flows generated from operations were approximately $1.4 billion for the year ended June 30, 2004. This amount compares to cash flows from operations of $1.6 billion in fiscal 2003. The decrease in cash flow from operations was primarily due to the decline in net earnings of $83 million, an increase in receivables and other assets of $139 million due to acquisitions and the increase in consolidated revenue, and the fluctuation in accounts payable and accrued expenses of $152 million due to the timing of payments. The decline in cash generated from operations was offset by the change in deferred income taxes of $125 million, the increase in amortization of premiums and discounts on our available-for-sale securities of $52 million and the increase in depreciation and amortization of $32 million.

Cash flows used in investing activities in fiscal 2004 totaled $1.3 billion compared to cash flows provided by investing activities in fiscal 2003 of approximately $0.2 billion. The fluctuation between periods was primarily due to the timing of purchases and proceeds of marketable securities and client fund money market securities, offset by the fluctuation in the net change in client funds obligations in fiscal 2004 and the reduction in cash used for acquisitions of businesses during fiscal 2004 due primarily to the fact that ProBusiness Services, Inc. was acquired in fiscal 2003.

Cash flows used in financing activities in fiscal 2004 totaled $0.8 billion compared to $1.1 billion in fiscal 2003. The decrease in cash used in financing was primarily due to lower repurchases of common stock of approximately $309 million and an increase in the amount of proceeds from stock purchase plans and exercises of stock options of approximately $76 million. We purchased approximately 15.8 million shares of common stock at an average price per share of $41.09 during fiscal 2004. As of June 30, 2004, we had remaining Board of Directors' authorization to purchase up to 27.7 million additional shares.

In June 2004, the Company entered into two new unsecured revolving credit agreements, each for $2.25 billion, with certain financial institutions, replacing an existing $4.5 billion credit agreement which was due to expire in September 2004. The interest rate applicable to the borrowings is tied to LIBOR or prime rate depending on the notification provided by the Company to the syndicated financial institutions prior to borrowing. The Company is also required to pay facility fees on the credit agreements. The primary uses of the credit facilities are to provide liquidity to the unsecured commercial paper program and to provide funding for general corporate purposes, if necessary. The Company had no borrowings through June 30, 2004 under the new credit agreements or the credit agreement that was replaced. The two new unsecured revolving credit agreements expire in June 2005 and June 2009, respectively.

In April 2002, we initiated a U.S. short-term commercial paper program providing for the issuance of up to $4.0 billion in aggregate maturity value of commercial paper at our discretion. In November 2003, the Company increased the aggregate maturity value of commercial paper available under the program to $4.5 billion. Our commercial paper program is rated A-1+ by Standard & Poor's and Prime 1 by Moody's. These ratings denote the highest quality commercial paper securities. Maturities of commercial paper can range from overnight to 270 days. We use the commercial paper issuances as a primary instrument to meet short-term funding requirements related to client funds obligations that occur as a result of our decision to extend maturities of our client fund marketable securities. We also use commercial paper issuances to fund general corporate purposes, if needed. This commercial paper program allows us to take advantage of higher extended term yields, rather than liquidating portions of our marketable securities, in order to provide more cost effective liquidity to the Company. At June 30, 2004 and 2003, there was no commercial paper outstanding. For fiscal 2004 and 2003, the Company's average borrowings were $1.0 billion and $0.9 billion, respectively, at a weighted average interest rate of 1.0% and 1.5%, respectively. The weighted average maturity of the Company's commercial paper during fiscal 2004 and 2003 was less than two days for both periods.

The Company's U.S. and Canadian short-term funding requirements related to client funds obligations are sometimes obtained on a secured basis through the use of repurchase agreements, which are collateralized principally by government and government agency securities. These agreements generally have terms ranging from overnight up to five business days. At June 30, 2004 and 2003, there were no outstanding repurchase agreements. For fiscal 2004 and 2003, the Company had an average outstanding balance of $32.0 million and $6.1 million, respectively, at a weighted average interest rate of 1.8% and 3.0%, respectively.

Capital expenditures during 2004 were $204 million, as compared to $134 million in 2003 and $146 million in 2002. The capital expenditures in fiscal 2004 related primarily to technology assets, buildings, furniture and equipment and leasehold improvements to support our operations. Capital expenditures in fiscal 2005 should be approximately $225 to $245 million.

The following table provides a summary of our contractual obligations as of June 30, 2004:

(In thousands) Payments due by period

| Contractual Obligations | Less than 1 year | 1-3 years | 3-5 years | More than 5 years | Total |
|---|---|---|---|---|---|
| Debt Obligations [(1)] | $ 515 | $ 746 | $ 16,535 | $ 58,919 | $ 76,715 |
| Operating Lease and Software License Obligations [(2)] | 290,901 | 364,018 | 158,229 | 117,617 | 930,765 |
| Purchase Obligations [(3)] | 46,121 | 31,976 | 10,581 | — | 88,678 |
| Other long-term liabilities reflected on our Consolidated Balance Sheets: Compensation and Benefits [(4)] | 13,262 | 82,238 | 39,379 | 74,957 | 209,836 |
| Total | $350,799 | $478,978 | $224,724 | $251,493 | $1,305,994 |

(1) These amounts represent the principal repayments of our debt and are included in our Consolidated Balance Sheets. See Note 8 to the Consolidated Financial Statements for additional information about our debt and related matters.

(2) Included in these amounts are various facilities and equipment leases, and software license agreements. We enter into operating leases in the normal course of business relating to facilities and equipment as well as the licensing of software. The majority of our lease agreements have fixed payment terms based on the passage of time. Certain facility and equipment leases require payment of maintenance and real estate taxes and contain escalation provisions based on future adjustments in price indices. Our future operating lease obligations could change if we exit certain contracts and if we enter into additional operating lease agreements.

(3) Purchase obligations primarily relate to maintenance agreements on our software, equipment and other assets.

(4) Compensation and benefits primarily relates to amounts associated with our employee benefit plans and other compensation arrangements.

In addition to the obligations quantified in the table above, we have obligations for the remittance of funds relating to our payroll and payroll tax filing services. As of June 30, 2004, the obligations relating to these matters, which are expected to be paid in fiscal 2005, total $12.8 billion and are recorded in client fund obligations on our Consolidated Balance Sheets. We have $12.9 billion of funds recorded in funds held for clients on our Consolidated Balance Sheets that have been impounded from our clients to satisfy such obligations.

On June 22, 2004, our Brokerage Services Group announced plans to implement a new business process outsourcing (BPO) strategy that is intended to strengthen its service offerings to meet the needs of a broader array of firms in the financial services marketplace. As part of this BPO strategy, we have reached an agreement to acquire the U.S. Clearing and BrokerDealer Services divisions of Bank of America Corporation, which provide third-party clearing operations. The transaction is subject to regulatory review and is expected to close before the end of the calendar year. On July 21, 2004, the Federal Trade Commission granted early termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, with respect to the transaction. When the acquisition of U.S. Clearing and BrokerDealer Services is completed, we will offer a traditional clearing service to retail and institutional broker/dealers in the United States that want to outsource their entire back-office function.

In June 2003, we formed a new wholly-owned subsidiary, ADP Indemnity, Inc. The primary purpose of this subsidiary is to provide workers' compensation insurance coverage, as well as coverage for occupational disease or employer liability, for our PEO worksite employees. This insurance was previously provided by a third-party insurance company. The Company has specific reinsurance with a third-party insurance company for aggregate losses between $75 million and $85 million in a policy year and also has stop loss insurance at $120 million of aggregated losses in a policy year. The Company utilizes historical loss experience and actuarial judgment to determine the estimated insurance liability for these services. The Company reviews the assumptions and obtains valuations provided by an independent third-party actuary to determine the adequacy of the workers' compensation liabilities. During the fiscal year ending June 30, 2004, we received premiums of $57 million and paid claims of $7 million. At June 30, 2004, our cash balance is approximately $64 million to cover potential future workers' compensation claims for the policy year that the PEO worksite employees were covered. We believe that the level of funding is adequate to cover the future workers' compensation claims for the PEO worksite employees covered.

It is not our business practice to enter into off-balance sheet arrangements. However, in the normal course of business, we do enter into contracts in which we make certain representations and warranties that guarantee the performance of our products and services. There have historically been no material losses related to such guarantees and we do not expect there to be any in the future. The Company also has provisions within certain contracts that require the Company to make future payments if specific conditions occur. The maximum potential payments under these contracts is not material to the consolidated financial statements.

**Quantitative and Qualitative Disclosures About Market Risk**

During fiscal 2004, approximately twenty-five percent of our overall investment portfolio was invested in cash and cash equivalents, which were therefore impacted almost immediately by changes in short-term interest rates. The other seventy-five percent of our investment portfolio was invested in fixed-income securities, with varying maturities of less than ten years, which were also subject to interest rate risk including reinvestment risk. We have historically had the ability to hold these investments until maturity.

Details regarding our corporate investments and funds held for clients are as follows:

(In millions)

| Years ended June 30: | 2004 | 2003 | 2002 |
|---|---|---|---|
| Average investment balances at cost: | | | |
| Corporate investments | **$ 3,218.3** | $ 3,374.4 | $ 2,752.3 |
| Funds held for clients | **11,060.0** | 8,936.8 | 8,376.6 |
| Total | **$14,278.3** | $12,311.2 | $11,128.9 |
| Average interest rates earned exclusive of realized gains/(losses) on corporate investments and funds held for clients | **3.1%** | 3.9% | 4.9% |
| Realized gains on available-for-sale securities | **$ 9.7** | $ 34.5 | $ 22.7 |
| Realized losses on available-for-sale securities | **$ (17.3)** | $ (4.9) | $ (6.2) |
| As of June 30: | | | |
| Unrealized pre-tax gains on available-for-sale securities | **$ 59.9** | $ 375.9 | $ 208.8 |
| Total available-for-sale securities | **$12,092.8** | $ 9,875.9 | $ 9,856.4 |

The return on our portfolio is impacted by future interest rate changes. Factors that influence the earnings impact of the interest rate changes include, among others, the amount of invested funds and the overall portfolio mix between short-term and long-term investments. This mix varies during the year and is impacted by daily interest rate changes. A hypothetical change in both the short-term interest rates and the long-term interest rates of 25 basis points applied to the estimated average investment balances and any related borrowings for fiscal 2005 would result in approximately a $12.0 million impact to interest revenues on funds held for clients and approximately an $8.0 million impact to earnings before income taxes over the twelve-month period. A hypothetical change in only short-term interest rates of 25 basis points applied to the estimated average short-term investment balances and any related short-term borrowing for fiscal 2005 would result in approximately a $1.0 million impact to earnings before income taxes over the twelve-month period.

The Company is exposed to credit risk in connection with our available-for-sale securities through the possible inability of the borrowers to meet the terms of the bonds. The Company limits its credit risk by investing primarily in AAA and AA rated securities, as rated by Moody's and Standard & Poor's, and by limiting amounts that can be invested in any single issuer. At June 30, 2004, approximately 95% of our available-for-sale securities held a AAA or AA rating.

**Critical Accounting Policies**

Our Consolidated Financial Statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates, judgments and assumptions that affect reported amounts of assets, liabilities, revenues and expenses. We continually evaluate the accounting policies and estimates used to prepare the consolidated financial statements. The estimates are based on historical experience and assumptions believed to be reasonable under current facts and circumstances. Actual amounts and results could differ from these estimates made by management. Certain accounting policies that require significant management estimates and are deemed critical to our results of operations or financial position are discussed below.

*Revenue Recognition.* Our revenues are primarily attributable to fees for providing services (e.g., Employer Services' payroll processing fees and Brokerage Services' trade processing fees) as well as investment income on payroll funds, payroll tax filing funds and other Employer Services' client-related funds. We typically enter into agreements for a fixed fee per transaction (e.g., number of payees or number of trades). Fees associated with services are recognized in the period services are rendered and earned under service arrangements with clients where service fees are fixed or determinable and collectibility is reasonably assured. Interest income on collected but not yet remitted funds held for clients is recognized in revenues as earned, as the collection, holding and remittance of these funds are critical components of providing these services.

We also recognize revenues associated with the sale of software systems and associated software licenses. For a majority of our software sales arrangements, which provide hardware, software licenses, installation and post customer support, revenues are recognized ratably over the software license term as vendor-specific objective evidence of the fair values of the individual elements in the sales arrangement does not exist. Changes to the elements in an arrangement and the ability to establish vendor-specific objective evidence for those elements could affect the timing of the revenue recognition.

The majority of our revenues are generated from a fee for service model (e.g., fixed fee per transaction processed) in which revenue is recognized when the related services have been rendered under written price quotations or service agreements having stipulated terms and conditions which do not require management to make any significant judgments or assumptions regarding any potential uncertainties.

We assess collectibility of our revenues based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history. We do not believe that our assumptions utilized in the collectibility would result in a material change to revenues as no one customer accounts for a significant portion of our revenues.

*Goodwill.* We review the carrying value of all our goodwill in accordance with Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," by comparing the carrying value of our reporting units to their fair values. We are required to perform this comparison at least annually or more frequently if circumstances indicate possible impairment. When determining fair value, we utilize a discounted future cash flow approach using various assumptions, including projections of revenues, based on assumed long-term growth rates, estimated costs, and appropriate discount rates based on the particular businesses' weighted average cost of capital. Our estimates of long-term growth and costs are based on historical data, various internal estimates and a variety of external sources, and are developed as part of our routine long-range planning process. The estimated fair value of the Company's reporting units exceeds the carrying value of the reporting units. We had approximately $2.2 billion of goodwill as of June 30, 2004. Given the significance of our goodwill, an adverse change to the fair value could result in an impairment charge, which could be material to our consolidated earnings.

*Income Taxes.* We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which establishes financial accounting and reporting standards for the effect of income taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in addressing the future tax consequences of events that have been recognized in our financial statements or tax returns (e.g., realization of deferred tax assets, changes in tax laws or interpretations thereof). In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. A change in the assessment of the outcomes of such matters could materially impact our consolidated financial statements.

### Market Price, Dividend Data and Other

The market price of our common stock (symbol: ADP) based on New York Stock Exchange composite transactions and cash dividends per share declared during the past two years have been:

| | Price Per Share | | Dividends |
|---|---|---|---|
| | High | Low | Per Share |
| Fiscal 2004 quarter ended | | | |
| June 30 | **$47.31** | **$41.63** | **$.1400** |
| March 31 | **$44.68** | **$39.61** | **$.1400** |
| December 31 | **$39.88** | **$35.86** | **$.1400** |
| September 30 | **$40.70** | **$33.45** | **$.1200** |
| Fiscal 2003 quarter ended | | | |
| June 30 | $36.08 | $30.80 | $.1200 |
| March 31 | $40.81 | $27.24 | $.1200 |
| December 31 | $45.96 | $33.76 | $.1200 |
| September 30 | $43.75 | $31.15 | $.1150 |

As of June 30, 2004, there were approximately 37,547 holders of record of our common stock. As of such date, approximately 323,273 additional holders had their stock in "street name."

**Forward-looking Statements**

This report and other written or oral statements made from time to time by ADP may contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Statements that are not historical in nature and which may be identified by the use of words like "expects," "assumes," "projects," "anticipates," "estimates," "we believe," "could be" and other words of similar meaning, are forward-looking statements. These statements are based on management's expectations and assumptions and are subject to risks and uncertainties that may cause actual results to differ materially from those expressed. Factors that could cause actual results to differ materially from those contemplated by the forward-looking statements include: ADP's success in obtaining, retaining and selling additional services to clients; the pricing of products and services; changes in laws regulating payroll taxes, professional employer organizations and employee benefits; overall market and economic conditions, including interest rate and foreign currency trends; competitive conditions; stock market activity; auto sales and related industry changes; employment and wage levels; changes in technology; availability of skilled technical associates and the impact of new acquisitions and divestitures. ADP disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

# Statements of Consolidated Earnings

(In thousands, except per share amounts)

| Years ended June 30, | 2004 | 2003 | 2002 |
|---|---|---|---|
| Revenues other than interest on funds held for clients and PEO revenues | **$6,932,558** | $6,412,059 | $6,305,206 |
| Interest on funds held for clients | **355,410** | 368,727 | 431,236 |
| PEO revenues [(A)] | **466,974** | 366,231 | 267,821 |
| Total revenues | **7,754,942** | 7,147,017 | 7,004,263 |
| Operating expenses | **3,525,413** | 3,096,719 | 2,970,645 |
| Selling, general and administrative expenses | **1,903,356** | 1,758,353 | 1,606,690 |
| Systems development and programming costs | **581,165** | 499,192 | 474,843 |
| Depreciation and amortization | **306,772** | 274,682 | 279,077 |
| Other income, net | **(56,294)** | (127,129) | (113,962) |
| | **6,260,412** | 5,501,817 | 5,217,293 |
| Earnings before income taxes | **1,494,530** | 1,645,200 | 1,786,970 |
| Provision for income taxes | **558,960** | 627,050 | 686,200 |
| Net earnings | **$ 935,570** | $1,018,150 | $1,100,770 |
| Basic earnings per share | **$ 1.58** | $ 1.70 | $ 1.78 |
| Diluted earnings per share | **$ 1.56** | $ 1.68 | $ 1.75 |
| Basic average shares outstanding | **591,697** | 600,071 | 618,857 |
| Diluted average shares outstanding | **598,749** | 605,917 | 630,579 |

(A) Net of pass-through costs of $4,237,017, $3,462,783 and $2,648,321, respectively.

See notes to consolidated financial statements.

# Consolidated Balance Sheets

(In thousands, except per share amounts)

| June 30, | **2004** | 2003 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | **$ 712,998** | $ 1,410,218 |
| Short-term marketable securities | **416,077** | 595,166 |
| Accounts receivable, net | **1,057,938** | 1,005,833 |
| Other current assets | **574,576** | 664,284 |
| Total current assets | **2,761,589** | 3,675,501 |
| Long-term marketable securities | **963,501** | 338,959 |
| Long-term receivables | **196,828** | 180,354 |
| Property, plant and equipment: | | |
| Land and buildings | **518,134** | 477,682 |
| Data processing equipment | **778,388** | 780,044 |
| Furniture, leaseholds and other | **594,658** | 603,451 |
| | **1,891,180** | 1,861,177 |
| Less accumulated depreciation | **(1,248,827)** | (1,246,476) |
| | **642,353** | 614,701 |
| Other assets | **720,936** | 565,385 |
| Goodwill | **2,195,539** | 1,981,131 |
| Intangible assets, net | **736,281** | 669,891 |
| Total assets before funds held for clients | **8,217,027** | 8,025,922 |
| Funds held for clients | **12,903,532** | 11,807,749 |
| Total assets | **$21,120,559** | $19,833,671 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | **$ 175,175** | $ 173,988 |
| Accrued expenses and other current liabilities | **1,482,703** | 1,609,665 |
| Income taxes payable | **110,546** | 215,130 |
| Total current liabilities | **1,768,424** | 1,998,783 |
| Long-term debt | **76,200** | 84,674 |
| Other liabilities | **319,495** | 270,267 |
| Deferred income taxes | **283,781** | 320,796 |
| Deferred revenues | **414,764** | 338,763 |
| Total liabilities before client funds obligations | **2,862,664** | 3,013,283 |
| Client funds obligations | **12,840,225** | 11,448,915 |
| Total liabilities | **15,702,889** | 14,462,198 |
| Stockholders' equity: | | |
| Preferred stock, $1.00 par value: Authorized, 300 shares; issued, none | **—** | — |
| Common stock, $.10 par value: Authorized, 1,000,000 shares; issued, 638,702 shares at June 30, 2004 and 2003 | **63,870** | 63,870 |
| Capital in excess of par value | **79,646** | 211,339 |
| Retained earnings | **7,326,918** | 6,710,863 |
| Treasury stock – at cost: 51,587 and 43,863 shares, respectively | **(2,033,254)** | (1,773,418) |
| Accumulated other comprehensive (loss) income | **(19,510)** | 158,819 |
| Total stockholders' equity | **5,417,670** | 5,371,473 |
| Total liabilities and stockholders' equity | **$21,120,559** | $19,833,671 |

See notes to consolidated financial statements.

# Statements of Consolidated Stockholders' Equity

(In thousands, except per share amounts)

| | Common Stock | | Capital in Excess of Par Value | Retained Earnings | Treasury Stock | Comprehensive Income | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | | | | | |
| Balance at June 30, 2001 | 638,702 | $63,870 | $553,927 | $5,153,408 | $ (837,244) | | $(232,964) |
| Net earnings | — | — | — | 1,100,770 | — | $1,100,770 | — |
| Currency translation adjustments | | | | | | 73,504 | 73,504 |
| Unrealized net gain on securities, net of tax | | | | | | 41,147 | 41,147 |
| Comprehensive income | | | | | | $1,215,421 | |
| Employee stock plans and related tax benefits | — | — | (197,083) | — | 515,729 | | |
| Treasury stock acquired (17,412 shares) | — | — | — | — | (875,449) | | |
| Acquisitions (226 shares) | — | — | (423) | — | 12,848 | | |
| Debt conversion (705 shares) | — | — | (23,050) | — | 42,075 | | |
| Dividends ($.4475 per share) | — | — | — | (276,860) | — | | |
| Balance at June 30, 2002 | 638,702 | 63,870 | 333,371 | 5,977,318 | (1,142,041) | | (118,313) |
| Net earnings | — | — | — | 1,018,150 | — | $1,018,150 | — |
| Currency translation adjustments | | | | | | 174,046 | 174,046 |
| Unrealized net gain on securities, net of tax | | | | | | 108,562 | 108,562 |
| Minimum pension liability adjustment, net of tax | | | | | | (5,476) | (5,476) |
| Comprehensive income | | | | | | $1,295,282 | |
| Employee stock plans and related tax benefits | — | — | (103,593) | — | 268,938 | | |
| Treasury stock acquired (27,413 shares) | — | — | — | — | (938,545) | | |
| Acquisitions (294 shares) | — | — | (3,056) | — | 14,883 | | |
| Debt conversion (462 shares) | — | — | (15,383) | — | 23,347 | | |
| Dividends ($.4750 per share) | — | — | — | (284,605) | — | | |
| Balance at June 30, 2003 | 638,702 | 63,870 | 211,339 | 6,710,863 | (1,773,418) | | 158,819 |
| **Net earnings** | **—** | **—** | **—** | **935,570** | **—** | **$ 935,570** | **—** |
| **Currency translation adjustments** | | | | | | **17,127** | **17,127** |
| **Unrealized net loss on securities, net of tax** | | | | | | **(196,351)** | **(196,351)** |
| **Minimum pension liability adjustment, net of tax** | | | | | | **895** | **895** |
| **Comprehensive income** | | | | | | **$ 757,241** | |
| **Employee stock plans and related tax benefits** | **—** | **—** | **(124,950)** | **—** | **371,737** | | |
| **Treasury stock acquired (15,794 shares)** | **—** | **—** | **—** | **—** | **(648,889)** | | |
| **Acquisitions (12 shares)** | **—** | **—** | **3** | **—** | **502** | | |
| **Debt conversion (373 shares)** | **—** | **—** | **(6,746)** | **—** | **16,814** | | |
| **Dividends ($.5400 per share)** | **—** | **—** | **—** | **(319,515)** | **—** | | |
| **Balance at June 30, 2004** | **638,702** | **$63,870** | **$ 79,646** | **$7,326,918** | **$(2,033,254)** | | **$ (19,510)** |

See notes to consolidated financial statements.

# Statements of Consolidated Cash Flows

(In thousands)

| Years ended June 30, | 2004 | 2003 | 2002 |
|---|---|---|---|
| **Cash Flows From Operating Activities** | | | |
| Net earnings | **$ 935,570** | $ 1,018,150 | $ 1,100,770 |
| Adjustments to reconcile net earnings to net cash flows provided by operating activities: | | | |
| Depreciation and amortization | **306,772** | 274,682 | 279,077 |
| Deferred income taxes | **109,155** | (15,775) | 8,680 |
| Amortization of premiums and discounts on available-for-sale securities | **129,922** | 77,891 | 36,432 |
| Other | **86,988** | 95,280 | 78,547 |
| Changes in operating assets and liabilities, net of effects from acquisitions of businesses: | | | |
| Increase in receivables and other assets | **(233,836)** | (94,422) | (73,511) |
| Increase in accounts payable and accrued expenses | **57,364** | 209,283 | 101,709 |
| Net cash flows provided by operating activities | **1,391,935** | 1,565,089 | 1,531,704 |
| **Cash Flows From Investing Activities** | | | |
| Purchases of marketable securities | **(8,087,150)** | (3,451,554) | (6,243,228) |
| Proceeds from sale of marketable securities | **5,339,258** | 4,014,300 | 4,167,028 |
| Net proceeds from client fund money market securities | **663,783** | 1,501,286 | 1,645,908 |
| Net change in client funds obligations | **1,391,310** | (967,797) | (188,484) |
| Capital expenditures | **(204,085)** | (133,758) | (145,621) |
| Additions to intangibles | **(148,073)** | (144,728) | (109,799) |
| Acquisitions of businesses, net of cash acquired | **(295,220)** | (651,320) | (219,783) |
| Disposals of businesses | **26,907** | 4,035 | 7,200 |
| Other | **(5,511)** | 6,609 | 6,286 |
| Net cash flows (used in) provided by investing activities | **(1,318,781)** | 177,073 | (1,080,493) |
| **Cash Flows From Financing Activities** | | | |
| Payments of debt | **(1,475)** | (1,384) | (3,919) |
| Proceeds from issuance of notes | **433** | 964 | 358 |
| Repurchases of common stock | **(629,932)** | (938,545) | (875,449) |
| Proceeds from stock purchase plan and exercises of stock options | **169,208** | 92,816 | 228,113 |
| Dividends paid | **(308,608)** | (284,605) | (276,860) |
| Net cash flows used in financing activities | **(770,374)** | (1,130,754) | (927,757) |
| Net change in cash and cash equivalents | **(697,220)** | 611,408 | (476,546) |
| Cash and cash equivalents, at beginning of year | **1,410,218** | 798,810 | 1,275,356 |
| Cash and cash equivalents, at end of year | **$ 712,998** | $ 1,410,218 | $ 798,810 |

See notes to consolidated financial statements.

## NOTE 1 Summary of Significant Accounting Policies

**A. Consolidation and Basis of Preparation.** The consolidated financial statements include the financial results of Automatic Data Processing, Inc. and its majority-owned subsidiaries (the "Company" or "ADP"). Intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates.

**B. Description of Business.** The Company is a provider of technology-based outsourcing solutions to employers, the brokerage and financial services community, vehicle retailers and their manufacturers and the property and casualty insurance, auto collision repair and auto recycling industries. The Company classifies its operations into the following reportable segments: Employer Services, Brokerage Services, Dealer Services and Other. "Other" consists primarily of Claims Services, miscellaneous processing services, and corporate allocations and expenses.

**C. Revenue Recognition.** A majority of the Company's revenues are attributable to fees for providing services (e.g., Employer Services' payroll processing fees and Brokerage Services' trade processing fees) as well as interest income on payroll funds, tax filing funds and other Employer Services' client-related funds. The Company typically enters into agreements for a fixed fee per transaction (e.g., number of payees or number of trades). Fees associated with services are recognized in the period services are rendered and earned under service arrangements with clients where service fees are fixed or determinable and collectibility is reasonably assured.

Interest income on collected but not yet remitted funds held for clients is earned on funds that are collected from clients and are invested (funds held for clients) until remitted to the applicable tax agencies or client employees. The interest earned on these funds is included in revenues because the collection, holding and remittance of these funds are critical components of providing these services.

The Company also recognizes revenues associated with the sale of software systems and associated software licenses. For a majority of the Company's software sales arrangements, which provide hardware, software licenses, installation and post-contract customer support, revenues are recognized ratably over the software license term as vendor-specific objective evidence of the fair values of the individual elements in the sales arrangement does not exist. As part of the sale of software systems, the Company recognizes revenues from the sale of hardware, which is recorded net of the associated costs.

Postage fees for client mailings are included in revenues and the associated postage expenses are included in operating expenses. Professional Employer Organization (PEO) revenues are included in revenues and are reported net of direct costs billed and incurred for PEO worksite employees, which primarily include payroll wages and payroll taxes.

**D. Cash and Cash Equivalents.** Highly-liquid investments with a maturity of ninety days or less at the time of purchase are considered cash equivalents.

**E. Corporate Investments and Funds Held for Clients.** All of the Company's marketable securities are considered to be "available-for-sale" and, accordingly, are carried on the Consolidated Balance Sheets at fair value. Unrealized gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of accumulated other comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis and are included in other income, net.

If the market value of any available-for-sale security declines below cost and it is deemed to be other-than-temporary, an impairment charge is recorded to earnings for the difference between the carrying amount of the respective security and the fair value.

Premiums and discounts are amortized or accreted over the life of the related available-for-sale security as an adjustment to yield using the effective-interest method. Dividend and interest income are recognized when earned.

**F. Long-term Receivables.** Long-term receivables relate to notes receivable from the sale of computer systems, primarily to automobile and truck dealerships. Unearned income from finance receivables represents the excess of gross receivables over the sales price of the computer systems financed. Unearned income is amortized using the effective-interest method to maintain a constant rate of return on the net investment over the term of each contract. The allowance for doubtful accounts on long-term receivables is the Company's best estimate of the amount of probable credit losses in the Company's existing note receivables.

**G. Property, Plant and Equipment.** Property, plant and equipment is stated at cost and depreciated over the estimated useful lives of the assets using the straight-line method. Leasehold improvements are amortized over the shorter of the term of the lease or the estimated useful lives of the improvements. The estimated useful lives of assets are primarily as follows:

| | |
|---|---|
| Data processing equipment | 2 to 5 years |
| Buildings | 20 to 40 years |
| Furniture and fixtures | 3 to 7 years |

**H. Goodwill and Other Intangible Assets.** The Company accounts for goodwill and other intangible assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," which states that goodwill and intangible assets with indefinite useful lives should not be amortized, but instead tested for impairment at least annually at the reporting unit level. If an impairment exists, a write-down to fair value (normally measured by discounting estimated future cash flows) is recorded. Intangible assets with finite lives are amortized primarily on the straight-line basis over their estimated useful lives and are reviewed for impairment in accordance with SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets" (SFAS No. 144).

**I. Impairment of Long-lived Assets.** In accordance with SFAS No. 144, long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset.

**J. Foreign Currency Translation.** The net assets of the Company's foreign subsidiaries are translated into U.S. dollars based on exchange rates in effect at the end of each period, and revenues and expenses are translated at average exchange rates during the periods. Currency transaction gains or losses, which are included in the results of operations, are immaterial for all periods presented. Gains or losses from balance sheet translation are included in accumulated other comprehensive (loss) income on the balance sheet.

**K. Earnings Per Share (EPS).** The calculations of basic and diluted EPS are as follows:

| Years ended June 30, | Basic | Effect of Zero Coupon Subordinated Notes | Effect of Stock Options | Diluted |
|---|---|---|---|---|
| **2004** | | | | |
| **Net earnings** | **$ 935,570** | **$ 1,421** | **$ —** | **$ 936,991** |
| **Average shares** | **591,697** | **1,517** | **5,535** | **598,749** |
| **EPS** | **$ 1.58** | | | **$ 1.56** |
| 2003 | | | | |
| Net earnings | $1,018,150 | $ 1,207 | $ — | $1,019,357 |
| Average shares | 600,071 | 1,693 | 4,153 | 605,917 |
| EPS | $ 1.70 | | | $ 1.68 |
| 2002 | | | | |
| Net earnings | $1,100,770 | $ 1,611 | $ — | $1,102,381 |
| Average shares | 618,857 | 2,352 | 9,370 | 630,579 |
| EPS | $ 1.78 | | | $ 1.75 |

Options to purchase 36.9 million and 40.0 million shares of common stock for fiscal years ended June 30, 2004 and 2003, respectively, were excluded from the calculation of diluted earnings per share because their exercise prices exceeded the average market price of outstanding common shares for the year.

**L. Internal Use Software.** Expenditures for major software purchases and software developed or obtained for internal use are capitalized and amortized over a three- to five-year period on a straight-line basis. For software developed or obtained for internal use, the Company capitalizes costs in accordance with the provisions of Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." The Company's policy provides for the capitalization of external direct costs of materials and services associated with developing or obtaining internal use computer software. In addition, the Company also capitalizes certain payroll and payroll-related costs for employees who are directly associated with internal use computer software projects. The amount of capitalizable payroll costs with respect to these employees is limited to the time directly spent on such projects. Costs associated with preliminary project stage activities, training, maintenance and all other post-implementation stage activities are expensed as incurred. The Company also expenses internal costs related to minor upgrades and enhancements, as it is impractical to separate these costs from normal maintenance activities.

**M. Computer Software to be Sold, Leased or Otherwise Marketed.** The Company capitalizes certain costs of computer software to be sold, leased or otherwise marketed in accordance with the provisions of SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed." The Company's policy provides for the capitalization of all software production costs upon reaching technological feasibility for a specific product. Technological feasibility is attained when software products have a completed working model whose consistency with the overall product design has been confirmed by testing. Costs incurred prior to the establishment of technological feasibility are expensed as incurred. The establishment of technological feasibility requires considerable judgment by management and in many instances is only attained a short time prior to the general release of the software. Upon the general release of the software product to customers, capitalization ceases and such costs are amortized over a three-year period on a straight-line basis. Maintenance-related costs are expensed as incurred.

**N. Fair Value Accounting for Stock Plans.** The Company accounts for its stock options and employee stock purchase plans, using the intrinsic-value method, under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations, as permitted by SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123). No stock-based employee compensation expense related to the Company's stock option and stock purchase plans is reflected in net earnings, as all options granted under the stock option plans had an exercise price equal to the market value of the underlying common stock on the date of grant, and for the stock purchase plans the discount does not exceed fifteen percent.

The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

| Years ended June 30, | 2004 | 2003 | 2002 |
|---|---|---|---|
| Net earnings, as reported | **$ 935,570** | $1,018,150 | $1,100,770 |
| Add: Stock-based employee compensation expense included in reported net earnings, net of related tax effects | **7,861** | 6,784 | 6,592 |
| Deduct: Total stock-based employee compensation expense determined using the fair value-based method for all awards, net of related tax effects | **(120,393)** | (129,846) | (126,602) |
| Pro forma net earnings | **$ 823,038** | $ 895,088 | $ 980,760 |
| Earnings per share: | | | |
| Basic – as reported | **$1.58** | $1.70 | $1.78 |
| Basic – pro forma | **$1.39** | $1.49 | $1.58 |
| Diluted – as reported | **$1.56** | $1.68 | $1.75 |
| Diluted – pro forma | **$1.38** | $1.48 | $1.56 |

The fair value for these instruments was estimated at the date of grant using a Black-Scholes valuation model with the following assumptions:

| Years ended June 30, | 2004 | 2003 | 2002 |
|---|---|---|---|
| Risk-free interest rate | **3.9%-4.5%** | 3.2%-4.1% | 4.3%-5.2% |
| Dividend yield | **1.0%-1.1%** | .8%-.9% | .7%-.8% |
| Volatility factor | **29.0%-29.3%** | 29.5%-31.7% | 25.9%-27.9% |
| Expected life (in years): | | | |
| Options | **6.5** | 6.4 | 6.3 |
| Stock purchase plans | **2.0** | 2.0 | 2.0 |
| Weighted average fair value (in dollars): | | | |
| Options | **$13.96** | $12.85 | $16.54 |
| Stock purchase plans | **$11.95** | $12.94 | $21.55 |

See Note 10, Employee Benefit Plans, for additional information relating to the Company's stock plans.

**O. Reclassification of Prior Financial Statements.** Certain reclassifications have been made to previous years' financial statements to conform to the 2004 presentation.

**P. Income Taxes.** The provisions for income taxes, income taxes payable and deferred income taxes are determined using the liability method. Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured by applying enacted tax rates and laws to taxable years in which such differences are expected to reverse. A valuation allowance is provided when the Company determines that it is more likely than not that a portion of the deferred tax asset balance will not be realized.

**Q. Adoption of New Accounting Pronouncements.** In November 2003, the Emerging Issues Task Force (EITF) published Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (EITF 03-1). EITF 03-1 reached a consensus that certain quantitative and qualitative disclosures are required for debt and marketable equity securities classified as available-for-sale or held-to-maturity that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. The disclosure requirements of EITF 03-1 are effective for fiscal periods ending after December 15, 2003 and are included in Note 4, herein.

In December 2003, the Financial Accounting Standards Board (FASB) revised Interpretation No. 46R, "Consolidation of Variable Interest Entities," with certain modifications and clarifications. Application of this guidance was effective for interests in certain variable interest entities commonly referred to as special purpose entities as of December 31, 2003. Application for all other types of variable interest entities created prior to February 1, 2003 is required for the period ended after March 15, 2004 unless previously applied. The adoption of the revised interpretation did not impact the Company's consolidated financial statements as the Company does not have investments in unconsolidated special purpose or variable interest entities.

In December 2003, the FASB revised SFAS No. 132, "Employer's Disclosures about Pensions and Other Post-retirement Benefits" (SFAS No. 132). SFAS No. 132 (revised) retains the disclosure requirements of the original statement and requires additional disclosures about the assets, obligations, cash flows and net periodic benefit cost of defined benefit plans and other defined benefit post-retirement plans. The annual financial statement disclosures required by SFAS No. 132 are effective for the Company for fiscal 2004 and are included in Note 10, herein.

In March 2003, the EITF published Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables" (EITF 00-21). EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it performs multiple revenue-generating activities and how to determine whether such an arrangement involving multiple deliverables contains more than one unit of accounting for purposes of revenue recognition. The guidance in EITF 00-21 is effective for revenue arrangements entered in fiscal periods beginning after June 15, 2003. The adoption of EITF 00-21, effective July 1, 2003, did not have a material impact on the consolidated financial statements.

## NOTE 2 Other Income, Net, Consists of the Following:

| Years ended June 30, | 2004 | 2003 | 2002 |
|---|---|---|---|
| Interest income on corporate funds | **$ (79,941)** | $(119,413) | $(118,672) |
| Interest expense | **15,993** | 21,838 | 21,164 |
| Realized gains on available-for-sale securities | **(9,665)** | (34,491) | (22,657) |
| Realized losses on available-for-sale securities | **17,319** | 4,937 | 6,203 |
| Total other income, net | **$ (56,294)** | $(127,129) | $(113,962) |

Proceeds from the sale of available-for-sale securities were $5.3 billion, $4.0 billion, and $4.2 billion for the years ended June 30, 2004, 2003 and 2002, respectively.

## NOTE 3 Acquisitions and Divestitures

Assets acquired and liabilities assumed in business combinations were recorded on the Company's Consolidated Balance Sheets as of the respective acquisition dates based upon their estimated fair values at such dates. The results of operations of businesses acquired by the Company have been included in the Company's Statements of Consolidated Earnings since their respective dates of acquisition. The excess of the purchase price over the estimated fair values of the underlying assets acquired and liabilities assumed was allocated to goodwill. In certain circumstances, the allocations of the excess purchase price are based upon preliminary estimates and assumptions. Accordingly, the allocations are subject to revision when the Company receives final information, including appraisals and other analyses.

The Company acquired six businesses in fiscal 2004 for approximately $270 million, net of cash acquired. These acquisitions resulted in approximately $186 million of goodwill. Intangible assets acquired, which total approximately $88 million, consisted primarily of software and customer contracts and lists that are being amortized over a weighted average life of 9 years.

In addition to goodwill recognized in the transactions noted above, the Company made contingent payments totaling $26 million (including $1 million in common stock), relating to previously consummated acquisitions. As of June 30, 2004, the Company had contingent consideration remaining for all transactions of approximately $80 million, which is payable over the next four years, subject to the acquired entity's achievement of specified revenue, earnings and/or development targets.

On June 20, 2003, the Company acquired all of the outstanding common and preferred stock of ProBusiness Services, Inc. (ProBusiness) for $17 per common share and $26 per preferred share. The transaction was consummated in cash of approximately $517 million, net of cash acquired. ProBusiness was a leading provider of comprehensive payroll and human resource processing solutions to larger employers within the United States. During fiscal 2004, the allocation of the purchase price was finalized and adjustments were made to increase goodwill by $5 million. The adjustments primarily related to the final fair value adjustments to certain assets and liabilities in the preliminary purchase price allocation. The acquisition resulted in approximately $422 million of goodwill. Intangible assets acquired, which totaled approximately $80 million, consisted of software, customer contracts and lists, and other intangible assets that are being amortized over a weighted average life of 8 years.

In addition to the acquisition of ProBusiness in fiscal 2003, the Company also acquired ten other businesses for approximately $118 million, net of cash acquired. These acquisitions resulted in approximately $90 million of goodwill. Intangible assets acquired of $28 million, which consist of software, customer contracts and lists, and other intangible assets, are being amortized over a weighted average life of 5 years.

The Company purchased several businesses in fiscal 2002 in the amount of $232 million (including $12 million in common stock), net of cash acquired.

The acquisitions discussed above for fiscal 2004, 2003 and 2002 were not material to the Company's operations, financial position or cash flows.

The Company divested of five small businesses in fiscal 2004 for $26 million. The divestitures of these businesses were not material to the Company's operations, financial position or cash flows in fiscal 2004, 2003 and 2002.

## NOTE 4 Corporate Investments and Funds Held for Clients

Corporate investments and funds held for clients at June 30, 2004 and 2003 are as follows:

| | 2004 | | 2003 | |
|---|---|---|---|---|
| | **Cost** | **Fair Value** | Cost | Fair Value |
| Type of issue: | | | | |
| Money market securities and other cash equivalents | **$ 2,903,284** | **$ 2,903,284** | $ 4,276,175 | $ 4,276,175 |
| Available-for-sale securities: | | | | |
| U.S. Treasury and direct obligations of U.S. government agencies | **5,449,694** | **5,485,632** | 4,145,995 | 4,349,052 |
| Asset backed securities | **2,570,424** | **2,580,609** | 2,420,233 | 2,489,521 |
| Corporate bonds | **2,342,017** | **2,341,015** | 1,568,195 | 1,620,621 |
| Canadian government obligations and Canadian government agency obligations | **765,908** | **774,877** | 492,581 | 513,366 |
| Other debt securities | **899,216** | **900,550** | 867,284 | 887,548 |
| Other equity securities | **5,696** | **10,141** | 5,696 | 15,809 |
| Total available-for-sale securities | **12,032,955** | **12,092,824** | 9,499,984 | 9,875,917 |
| Total corporate investments and funds held for clients | **$14,936,239** | **$14,996,108** | $13,776,159 | $14,152,092 |
| Classification of investments on the Consolidated Balance Sheets | | | | |
| Corporate investments | **$ 2,096,014** | **$ 2,092,576** | $ 2,327,244 | $ 2,344,343 |
| Funds held for clients | **12,840,225** | **12,903,532** | 11,448,915 | 11,807,749 |
| Total corporate investments and funds held for clients | **$14,936,239** | **$14,996,108** | $13,776,159 | $14,152,092 |

At June 30, 2004, approximately 95% of our available-for-sale securities held a AAA or AA rating, as rated by Moody's and Standard & Poor's.

Gross unrealized gains and losses on the available-for-sale securities are as follows:

| As of June 30, | Gross unrealized gains | Gross unrealized losses | Unrealized gains, net |
|---|---|---|---|
| **2004** | **$125,585** | **$(65,716)** | **$ 59,869** |
| 2003 | $376,494 | $ (561) | $ 375,933 |

Available-for-sale securities that have been in an unrealized loss position for a period of less than and greater than 12 months as of June 30, 2004 are as follows:

| | Unrealized losses less than 12 months | Fair market value— less than 12 months | Unrealized losses greater than 12 months | Fair market value— greater than 12 months | Total gross unrealized losses | Total fair market value |
|---|---|---|---|---|---|---|
| U.S. Treasury and direct obligations of U.S. government agencies | $(29,133) | $2,614,784 | — | — | $(29,133) | $2,614,784 |
| Asset backed securities | (11,745) | 1,200,598 | $(124) | $15,571 | (11,869) | 1,216,169 |
| Corporate bonds | (15,998) | 1,413,116 | (54) | 3,256 | (16,052) | 1,416,372 |
| Canadian government obligations and Canadian government agency obligations | (2,894) | 355,748 | — | — | (2,894) | 355,748 |
| Other debt securities | (5,768) | 467,819 | — | — | (5,768) | 467,819 |
| | $(65,538) | $6,052,065 | $(178) | $18,827 | $(65,716) | $6,070,892 |

The Company believes that the available-for-sale securities which have fair values that are below cost are not other-than-temporarily impaired since it is probable that principal and interest will be collected in accordance with the applicable contractual terms and the Company has the ability to hold the available-for-sale securities until maturity.

Expected maturities of available-for-sale securities at June 30, 2004 are as follows:

| | |
|---|---|
| Maturity Dates: | |
| Due in one year or less | $ 3,241,891 |
| Due after one year through two years | 3,834,349 |
| Due after two years through three years | 3,153,773 |
| Due after three years through four years | 932,779 |
| Due after four years through ten years | 930,032 |
| Total available-for-sale securities | $12,092,824 |

## NOTE 5 Receivables

Accounts receivable is net of an allowance for doubtful accounts of $51 million and $55 million at June 30, 2004 and 2003, respectively.

The Company's receivables for the financing of the sale of computer systems, most of which are due from automobile and truck dealerships, are reflected in the Consolidated Balance Sheets as follows:

| June 30, | 2004 | | 2003 | |
|---|---|---|---|---|
| | **Current** | **Long-term** | Current | Long-term |
| Receivables | **$151,774** | **$222,073** | $167,328 | $209,177 |
| Less: | | | | |
| Allowance for doubtful accounts | **(5,303)** | **(8,578)** | (7,337) | (11,103) |
| Unearned income | **(18,093)** | **(16,667)** | (20,563) | (17,720) |
| | **$128,378** | **$196,828** | $139,428 | $180,354 |

Long-term receivables at June 30, 2004 mature as follows:

| | |
|---|---|
| 2006 | $108,284 |
| 2007 | 67,731 |
| 2008 | 33,926 |
| 2009 | 11,822 |
| 2010 | 283 |
| Thereafter | 27 |
| | $222,073 |

## NOTE 6 Goodwill and Intangible Assets, Net

Changes in goodwill for the year ended June 30, 2004 are as follows:

| | Employer Services | Brokerage Services | Dealer Services | Other | Total |
|---|---|---|---|---|---|
| Balance as of June 30, 2003 | $1,287,128 | $366,775 | $215,134 | $112,094 | $1,981,131 |
| Additions | 19,221 | 6,948 | 109,080 | 81,124 | 216,373 |
| Other | 1,646 | (6,455) | — | — | (4,809) |
| Sale of businesses | (1,315) | (2,152) | — | (1,088) | (4,555) |
| Cumulative translation adjustments | 7,899 | 1,183 | (103) | (1,580) | 7,399 |
| **Balance as of June 30, 2004** | **$1,314,579** | **$366,299** | **$324,111** | **$190,550** | **$2,195,539** |

No impairment losses were recognized during the year. During fiscal 2004, 2003 and 2002, the Company performed the required impairment tests of goodwill and determined that there was no impairment.

Components of intangible assets are as follows:

| June 30, | 2004 | 2003 |
|---|---|---|
| Intangibles | | |
| Software and software licenses | **$ 729,399** | $ 578,261 |
| Customer contracts and lists | **594,841** | 545,978 |
| Other | **391,906** | 405,860 |
| | **1,716,146** | 1,530,099 |
| Less accumulated amortization | **(979,865)** | (860,208) |
| Intangible assets, net | **$ 736,281** | $ 669,891 |

Other intangibles consist primarily of purchased rights, covenants, patents and trademarks (acquired directly or through acquisitions). All of the intangible assets have finite lives and as such are subject to amortization. The weighted average remaining useful life of the intangible assets is 9 years (3 years for software and software licenses, 13 years for customer contracts and lists, and 12 years for other). Amortization of intangibles totaled $145 million for fiscal 2004, $114 million for fiscal 2003 and $115 million for fiscal 2002. Estimated amortization expense of the Company's existing intangible assets for the next five fiscal years are as follows:

| | |
|---|---|
| 2005 | $140,239 |
| 2006 | $116,681 |
| 2007 | $ 96,269 |
| 2008 | $ 75,001 |
| 2009 | $ 46,287 |

## NOTE 7 Short-term Financing

In June 2004, the Company entered into two new unsecured revolving credit agreements, each for $2.25 billion, with certain financial institutions, replacing an existing $4.5 billion credit agreement which was due to expire in September 2004. The interest rate applicable to the borrowings is tied to LIBOR or prime rate depending on the notification provided by the Company to the syndicated financial institutions prior to borrowing. The Company is also required to pay facility fees on the credit agreements. The primary uses of the credit facilities are to provide liquidity to the unsecured commercial paper program and to provide funding for general corporate purposes, if necessary. The Company had no borrowings through June 30, 2004 under the new credit agreements or the credit agreement that was replaced. The two new unsecured revolving credit agreements expire in June 2005 and June 2009, respectively.

In April 2002, we initiated a U.S. short-term commercial paper program providing for the issuance of up to $4.0 billion in aggregate maturity value of commercial paper at our discretion. In November 2003, the Company increased the aggregate maturity value of commercial paper available under the program to $4.5 billion. Our commercial paper program is rated A-1+ by Standard & Poor's and Prime 1 by Moody's. These ratings denote the highest quality commercial paper securities. Maturities of commercial paper can range from overnight to 270 days. At June 30, 2004 and 2003, there was no commercial paper outstanding. For fiscal 2004 and 2003, the Company's average borrowings were $1.0 billion and $0.9 billion, respectively, at a weighted average interest rate of 1.0% and 1.5%, respectively. The weighted average maturity of the Company's commercial paper during fiscal 2004 and 2003 was less than two days for both periods.

The Company's U.S. and Canadian short-term funding requirements related to client funds obligations are sometimes obtained on a secured basis through the use of repurchase agreements, which are collateralized principally by government and government agency securities. These agreements generally have terms ranging from overnight up to five business days. At June 30, 2004 and 2003, there were no outstanding repurchase agreements. For the years ended June 30, 2004 and 2003, the Company had an average outstanding balance of $32.0 million and $6.1 million, respectively, at a weighted average interest rate of 1.8% and 3.0%, respectively.

## NOTE 8 Debt

Components of long-term debt are as follows:

| June 30, | 2004 | 2003 |
|---|---|---|
| Zero coupon convertible subordinated notes (5.25% yield) | **$31,863** | $39,661 |
| Industrial revenue bonds (with variable interest rates from 1.15% to 1.58%) | **36,525** | 36,500 |
| Other | **8,327** | 9,338 |
| | **76,715** | 85,499 |
| Less current portion | **(515)** | (825) |
| | **$76,200** | $84,674 |

The zero coupon convertible subordinated notes had a face value of approximately $48 million at June 30, 2004 and mature February 20, 2012, unless converted or redeemed earlier. At June 30, 2004, the notes were convertible into approximately 1.2 million shares of the Company's common stock. The notes are callable at the option of the Company, and the holders of the notes can convert into common stock at any time or require redemption in fiscal 2007. During fiscal 2004 and 2003, approximately $14 million and $18 million face value of notes were converted, respectively. As of June 30, 2004 and 2003, the quoted market prices for the zero coupon notes were approximately $52 million and $55 million, respectively. The fair value of the other debt, included above, approximates its carrying value.

Long-term debt repayments at June 30, 2004 are due as follows:

| | |
|---|---|
| 2006 | $ 402 |
| 2007 | 344 |
| 2008 | 169 |
| 2009 | 16,366 |
| 2010 | — |
| Thereafter | 58,919 |
| | $76,200 |

Cash payments relating to interest were approximately $14 million in fiscal 2004, $20 million in fiscal 2003 and $18 million in fiscal 2002.

**NOTE 9 Funds Held for Clients and Client Funds Obligations**

As part of its integrated payroll and payroll tax filing services, the Company impounds funds for federal, state and local employment taxes from approximately 379,000 clients; handles regulatory payroll tax filings, correspondence, amendments, and penalty and interest disputes; remits the funds to the appropriate tax agencies; and handles other employer-related services. In addition to fees paid by clients for these services, the Company receives interest during the interval between the receipt and disbursement of these funds by investing the funds primarily in fixed-income instruments. The amount of collected but not yet remitted funds for the Company's payroll and payroll tax filing and other services varies significantly during the year, and averaged approximately $11.1 billion in fiscal 2004, $8.9 billion in fiscal 2003 and $8.4 billion in fiscal 2002.

**NOTE 10 Employee Benefit Plans**

**A. Stock Plans.** The Company has stock option plans which provide for the issuance, to eligible employees, of incentive and non-qualified stock options, which may expire as much as 10 years from the date of grant, at prices not less than the fair market value on the date of grant. At June 30, 2004, there were 9,096 participants in the plans. The aggregate purchase price for options outstanding at June 30, 2004 was approximately $2.9 billion. The options expire at various points beginning in fiscal 2005 through fiscal 2014.

A summary of changes in the stock option plans for the three years ended June 30, 2004, is as follows:

| | Number of Options (In thousands) | | | Weighted Average Price (In dollars) | | |
|---|---|---|---|---|---|---|
| Years ended June 30, | **2004** | 2003 | 2002 | **2004** | 2003 | 2002 |
| Options outstanding, beginning of year | **60,958** | 50,843 | 47,496 | **$41** | $41 | $37 |
| Options granted | **18,080** | 15,867 | 12,325 | **$41** | $37 | $49 |
| Options exercised | **(4,557)** | (2,588) | (6,481) | **$24** | $19 | $22 |
| Options canceled | **(4,322)** | (3,164) | (2,497) | **$46** | $48 | $47 |
| Options outstanding, end of year | **70,159** | 60,958 | 50,843 | **$42** | $41 | $41 |
| Options exercisable, end of year | **32,140** | 27,617 | 21,626 | **$40** | $36 | $31 |
| Shares available for future grants, end of year | **22,431** | 1,189 | 13,892 | | | |
| Shares reserved for issuance under stock option plans | **92,590** | 62,147 | 64,735 | | | |

Summarized information about stock options outstanding as of June 30, 2004 is as follows:

| | Outstanding | | | Exercisable | |
|---|---|---|---|---|---|
| Exercise Price Range | Number of Options (In thousands) | Remaining Life (In years) | Weighted Average Price (In dollars) | Number of Options (In thousands) | Weighted Average Price (In dollars) |
| **Under $15** | **589** | **0.5** | **$14** | **589** | **$14** |
| **$15 to $25** | **4,243** | **2.0** | **$20** | **4,227** | **$20** |
| **$25 to $35** | **11,757** | **6.6** | **$32** | **6,741** | **$30** |
| **$35 to $45** | **29,411** | **7.6** | **$41** | **10,745** | **$42** |
| **$45 to $55** | **18,942** | **7.8** | **$49** | **6,867** | **$51** |
| **Over $55** | **5,217** | **6.2** | **$60** | **2,971** | **$60** |

The Company has stock purchase plans under which eligible employees have the ability to purchase shares of common stock at 85% of the lower of market value as of the date of purchase election or as of the end of the plans. Approximately 3.3 million and 3.0 million shares are scheduled for issuance on December 31, 2005 and 2004, respectively. Approximately 1.9 million and 1.5 million shares were issued during the years ended June 30, 2004 and 2003, respectively. At June 30, 2004 and 2003, there were approximately 8.0 million and 0.6 million shares, respectively, reserved for purchase under the plans. As of June 30, 2004 and 2003, employee stock purchase plan withholdings of $63 million and $60 million, respectively, were included in accrued expenses and other current liabilities, and $26 million and $27 million, respectively, were included in other non-current liabilities on our Consolidated Balance Sheets.

The Company has a restricted stock plan under which shares of common stock have been sold for nominal consideration to certain key employees. These shares are restricted as to transfer and in certain circumstances must be resold to the Company at the original purchase price. The Company records stock compensation expense relating to the issuance of restricted stock over the period during which the transfer restrictions exist, which is up to six years. During the fiscal years ended June 30, 2004, 2003 and 2002, the Company issued 393 thousand, 221 thousand and 144 thousand restricted shares, respectively.

**B. Pension Plans.** The Company has a defined benefit cash balance pension plan covering substantially all U.S. employees, under which employees are credited with a percentage of base pay plus interest. The plan interest credit rate will vary from year-to-year based on the ten-year U.S. Treasury rate. Employees are fully vested on completion of five years of service. The Company's policy is to make contributions within the range determined by generally accepted actuarial principles. In addition, the Company has various retirement plans for its non-U.S. employees and maintains a Supplemental Officer Retirement Plan ("SORP"). The SORP is a defined benefit plan pursuant to which the Company will pay supplemental pension benefits to certain key officers upon retirement based upon the officer's years of service and compensation.

A June 30 measurement date was used in determining the majority of the Company's benefit obligations and fair value of plan assets.

The Company's pension plans' funded status as of June 30, 2004 and 2003 follows:

| June 30, | **2004** | 2003 |
|---|---|---|
| Change in plan assets: | | |
| Fair value of plan assets at beginning of year | **$553,200** | $444,500 |
| Actual return on plan assets | **81,800** | 20,400 |
| Employer contributions | **59,500** | 99,700 |
| Benefits paid | **(16,500)** | (11,400) |
| Fair value of plan assets at end of year | **$678,000** | $553,200 |
| Change in benefit obligation: | | |
| Benefit obligation at beginning of year | **$593,400** | $484,600 |
| Service cost | **23,000** | 25,600 |
| Interest cost | **33,700** | 31,200 |
| Actuarial and other losses | **3,100** | 63,400 |
| Benefits paid | **(16,500)** | (11,400) |
| Projected benefit obligation at end of year | **$636,700** | $593,400 |
| Funded status — plan assets less benefit obligation | **$ 41,300** | $ (40,200) |
| Unrecognized net actuarial loss due to different experience than assumed | **240,700** | 279,800 |
| Prepaid pension cost | **$282,000** | $239,600 |

The accumulated benefit obligation for all defined benefit pension plans was $629,000 and $582,700 at June 30, 2004 and 2003, respectively.

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the Company's pension plans with accumulated benefit obligations in excess of plan assets were $70 million, $65 million and $23 million, respectively, as of June 30, 2004, and $67 million, $59 million and $19 million, respectively, as of June 30, 2003.

The components of net pension expense were as follows:

| Years ended June 30, | **2004** | 2003 | 2002 |
|---|---|---|---|
| Service cost — benefits earned during the period | **$ 23,000** | $ 25,600 | $ 17,400 |
| Interest cost on projected benefits | **33,700** | 31,200 | 29,100 |
| Expected return on plan assets | **(50,500)** | (50,500) | (46,300) |
| Net amortization and deferral | **10,200** | 1,100 | (500) |
| | **$16,400** | $ 7,400 | $ (300) |

Assumptions used to determine the actuarial present value of benefit obligations generally were:

| Years ended June 30, | **2004** | 2003 |
|---|---|---|
| Discount rate | **6.00%** | 5.75% |
| Increase in compensation levels | **6.00%** | 6.00% |

Assumptions used to determine the net periodic benefit cost generally were:

| Years ended June 30, | **2004** | 2003 |
|---|---|---|
| Discount rate | **5.75%** | 6.75% |
| Expected long-term rate of return on assets | **7.25%** | 8.50% |
| Increase in compensation levels | **6.00%** | 6.00% |

The long-term expected rate of return on assets assumption is 7.25%. This percentage has been determined based on historical and expected future rates of return on plan assets considering the target asset mix and the long-term investment strategy.

### Plan Assets

The Company's pension plans' weighted average asset allocations at June 30, 2004 and 2003, by asset category were as follows:

| | 2004 | 2003 |
|---|---|---|
| United States Fixed Income Securities | **31%** | 41% |
| United States Equity Securities | **54%** | 46% |
| International Equity Securities | **15%** | 13% |
| Total | **100%** | 100% |

The Company's pension plans' asset investment strategy is designed to ensure prudent management of assets, consistent with long-term return objectives and the prompt fulfillment of all pension plan obligations. The investment strategy and asset mix were developed in coordination with an asset liability study conducted by external consultants to maximize the funded ratio with the least amount of volatility.

The pension plans' assets are currently invested in various asset classes with differing expected rates of return, correlations and volatilities including large capitalization and small capitalization U.S. equities, international equities, and U.S. fixed income securities and cash.

The target asset allocation ranges are as follows:

| | |
|---|---|
| United States Fixed Income Securities | 30 – 40% |
| United States Equity Securities | 45 – 55% |
| International Equity Securities | 12 – 20% |
| Total Equities | 60 – 70% |

The pension plans' fixed income portfolio is designed to match the duration and liquidity characteristics of the pension plans' liabilities. In addition, the pension plans invest only in investment-grade debt securities to ensure preservation of capital. The pension plans' equity portfolios are subject to diversification guidelines to reduce the impact of losses in single investments. Investment managers are prohibited from buying or selling commodities, futures or option contracts, and from short selling of securities.

None of the assets of the pension plans are directly invested in the Company's stock, although the pension plans may hold a minimal amount of Company stock to the extent of the Company's participation in the S&P 500 Index.

### Contributions

The minimum required contributions to the Company's pension plans is $0 in fiscal 2005; however, the Company expects to contribute approximately $25 million.

### Estimated Future Benefit Payments

The benefits expected to be paid in each year from fiscal 2005 to 2009 are $17 million, $18 million, $24 million, $26 million and $32 million, respectively. The aggregate benefits expected to be paid in the five fiscal years from 2010 to 2014 are $276 million. The expected benefits to be paid are based on the same assumptions used to measure the Company's pension plans' benefit obligation at June 30, 2004 and include estimated future employee service.

**C. Retirement and Savings Plan.** The Company has a 401(k) retirement and savings plan, which allows eligible employees to contribute up to 20% of their compensation annually and allows highly compensated employees to contribute up to 10% of their compensation annually. The Company matches a portion of employee contributions, which amounted to approximately $35 million, $34 million and $35 million for calendar years 2003, 2002 and 2001, respectively.

## NOTE 11 Income Taxes

Earnings before income taxes shown below are based on the geographic location to which such earnings are attributable.

| Years ended June 30, | 2004 | 2003 | 2002 |
|---|---|---|---|
| Earnings before income taxes: | | | |
| United States | **$1,307,465** | $1,474,915 | $1,618,885 |
| Foreign | **187,065** | 170,285 | 168,085 |
| | **$1,494,530** | $1,645,200 | $1,786,970 |

The provision for income taxes consists of the following components:

| Years ended June 30, | 2004 | 2003 | 2002 |
|---|---|---|---|
| Current: | | | |
| Federal | **$350,265** | $496,920 | $542,980 |
| Foreign | **78,450** | 84,180 | 67,380 |
| State | **21,090** | 61,725 | 67,160 |
| Total current | **449,805** | 642,825 | 677,520 |
| Deferred: | | | |
| Federal | **100,125** | 430 | 6,525 |
| Foreign | **(13,720)** | (16,350) | (20) |
| State | **22,750** | 145 | 2,175 |
| Total deferred | **109,155** | (15,775) | 8,680 |
| Total provision | **$558,960** | $627,050 | $686,200 |

A reconciliation between the Company's effective tax rate and the U.S. federal statutory rate is as follows:

| Years ended June 30, | 2004 | % | 2003 | % | 2002 | % |
|---|---|---|---|---|---|---|
| Provision for taxes at U.S. statutory rate | **$523,086** | **35.0** | $575,820 | 35.0 | $625,415 | 35.0 |
| Increase (decrease) in provision from: | | | | | | |
| State taxes, net of federal tax benefit | **28,495** | **1.9** | 40,215 | 2.4 | 45,070 | 2.5 |
| Other | **7,379** | **0.5** | 11,015 | 0.7 | 15,715 | 0.9 |
| | **$558,960** | **37.4** | $627,050 | 38.1 | $686,200 | 38.4 |

The significant components of deferred income tax assets and liabilities and their balance sheet classifications are as follows:

| June 30, | 2004 | 2003 |
|---|---|---|
| Deferred tax assets: | | |
| Accrued expenses not currently deductible | **$190,541** | $178,893 |
| Net operating losses | **45,916** | 58,178 |
| Other | **30,168** | 29,023 |
| | **266,625** | 266,094 |
| Less: Valuation allowances | **(25,858)** | (32,220) |
| Deferred tax assets—net | **$240,767** | $233,874 |
| Deferred tax liabilities: | | |
| Unrealized investment gains, net | **$ 22,390** | $142,102 |
| Accrued retirement benefits | **112,323** | 90,730 |
| Depreciation and amortization | **275,806** | 188,943 |
| Other | **47,305** | 49,244 |
| Deferred tax liabilities | **$457,824** | $471,019 |
| Net deferred tax liabilities | **$217,057** | $237,145 |

There are $84.0 million and $104.7 million current deferred tax assets included in other current assets in the balance sheets at June 30, 2004 and June 30, 2003, respectively. There are $17.3 million and $21.0 million current deferred tax liabilities included in accrued expenses and other current liabilities in the balance sheets at June 30, 2004 and June 30, 2003, respectively.

Income taxes have not been provided on undistributed earnings of foreign subsidiaries as the Company considers such earnings to be permanently reinvested as of June 30, 2004 and June 30, 2003.

The Company has estimated domestic and foreign net operating loss carry forwards of approximately $55.5 million and $70.1 million, respectively, at June 30, 2004 and approximately $103.2 and $66.9 million, respectively, at June 30, 2003.

The Company has recorded valuation allowances of $25.8 million and $32.2 million at June 30, 2004 and June 30, 2003, respectively, to reflect the estimated amount of foreign deferred tax assets that may not be realized. A portion of the valuation allowances in the amounts of approximately $3.4 million and $11.6 million at June 30, 2004 and June 30, 2003, respectively, relate to net deferred tax assets which were recorded in purchase accounting. Any recognition of such amounts in future years will be a reduction to goodwill.

Income tax payments were approximately $539 million in 2004, $686 million in 2003 and $518 million in 2002.

### NOTE 12 Contractual Commitments, Contingencies and Off-Balance Sheet Arrangements

The Company has obligations under various facilities and equipment leases and software license agreements. Total expense under these agreements was approximately $317 million in 2004, $319 million in 2003 and $272 million in 2002, with minimum commitments at June 30, 2004 as follows:

| Years ending June 30, | |
|---|---|
| 2005 | $290,901 |
| 2006 | 215,412 |
| 2007 | 148,606 |
| 2008 | 102,264 |
| 2009 | 55,965 |
| Thereafter | 117,617 |
| | $930,765 |

In addition to fixed rentals, certain leases require payment of maintenance and real estate taxes and contain escalation provisions based on future adjustments in price indices.

As of June 30, 2004, the Company has purchase commitments of approximately $89 million relating to software and equipment maintenance contracts, of which $46 million relates to fiscal 2005 and the remaining $43 million relates to fiscal years 2006 through 2009.

The Company is subject to various claims and litigation in the normal course of business. The Company does not believe that the resolution of these matters will have a material impact on the consolidated financial statements.

It is not the Company's business practice to enter into off-balance sheet arrangements. However, in the normal course of business, the Company does enter into contracts in which it makes representations and warranties that guarantee the performance of the Company's products and services. Historically, there have been no material losses related to such guarantees. The Company also has provisions within certain contracts that require the Company to make future payments if specific conditions occur. The maximum potential payments under these contracts is not material to the consolidated financial statements.

### NOTE 13 Accumulated Other Comprehensive (Loss) Income

Comprehensive income is a measure of income which includes both net income and other comprehensive (loss) income. Other comprehensive (loss) income results from items deferred on the balance sheet in stockholders' equity. Other comprehensive (loss) income was $(178) million, $277 million and $115 million in 2004, 2003 and 2002, respectively. The accumulated balances for each component of other comprehensive (loss) income are as follows:

| June 30, | 2004 | 2003 | 2002 |
|---|---|---|---|
| Currency translation adjustments | **$(52,408)** | $(69,535) | $(243,581) |
| Unrealized gain on available-for-sale securities, net of tax | **37,479** | 233,830 | 125,268 |
| Minimum pension liability adjustment, net of tax | **(4,581)** | (5,476) | — |
| Accumulated other comprehensive (loss) income | **$(19,510)** | $158,819 | $(118,313) |

### NOTE 14 Financial Data By Segment

Employer Services, Brokerage Services and Dealer Services are the Company's largest business units. The primary components of "Other" are Claims Services, miscellaneous processing services, and corporate allocations and expenses. The Company evaluates performance of its business units based on operating results before interest on corporate funds, foreign currency gains and losses, and income taxes. Certain revenues and expenses are charged to business units at a standard rate for management reasons. Other costs are recorded based on management responsibility. The 2003 and 2002 business unit revenues and earnings before income taxes have been adjusted to reflect updated fiscal year 2004 budgeted foreign exchange rates. In addition, Employer Services' prior year's revenues and earnings before income taxes were adjusted to include interest income earned on funds held for clients at a standard rate of 4.5%. Prior to fiscal year 2004, Employer Services was credited with interest earned on client funds at 6.0%. Given the decline in interest rates over recent years, the standard rate has been changed to 4.5%. The business unit results also include a cost of capital charge related to the funding of acquisitions and other investments. All of these adjustments/charges are eliminated in consolidation and as such represent a reconciling item to earnings before income taxes. Business unit assets include funds held for clients but exclude corporate cash, marketable securities and goodwill.

| | | | | | Reconciling Items | | | |
|---|---|---|---|---|---|---|---|---|
| (In millions) | Employer Services | Brokerage Services | Dealer Services | Other | Foreign Exchange | Client Fund Interest | Cost of Capital Charge | Total |
| **Year ended June 30, 2004** | | | | | | | | |
| **Revenues** | **$ 4,809** | **$1,665** | **$ 890** | **$ 476** | **$ 55** | **$ (140)** | **—** | **$ 7,755** |
| **Earnings before income taxes** | **$ 993** | **$ 245** | **$ 144** | **$ 112** | **$ 7** | **$ (140)** | **$ 134** | **$ 1,495** |
| **Assets** | **$ 14,429** | **$ 611** | **$ 434** | **$ 5,647** | **—** | **—** | **—** | **$21,121** |
| **Capital expenditures** | **$ 97** | **$ 36** | **$ 34** | **$ 37** | **—** | **—** | **—** | **$ 204** |
| **Depreciation and amortization** | **$ 248** | **$ 86** | **$ 51** | **$ 56** | **—** | **—** | **$ (134)** | **$ 307** |
| Year ended June 30, 2003 | | | | | | | | |
| Revenues | $ 4,390 | $1,610 | $ 813 | $ 462 | $ (87) | $ (41) | — | $ 7,147 |
| Earnings before income taxes | $ 1,070 | $ 232 | $ 137 | $ 153 | $ (15) | $ (41) | $ 109 | $ 1,645 |
| Assets | $ 13,278 | $ 556 | $ 351 | $ 5,649 | — | — | — | $19,834 |
| Capital expenditures | $ 66 | $ 24 | $ 26 | $ 18 | — | — | — | $ 134 |
| Depreciation and amortization | $ 193 | $ 95 | $ 50 | $ 46 | — | — | $ (109) | $ 275 |
| Year ended June 30, 2002 | | | | | | | | |
| Revenues | $ 4,176 | $1,777 | $ 732 | $ 464 | $ (195) | $ 50 | — | $ 7,004 |
| Earnings before income taxes | $ 995 | $ 358 | $ 120 | $ 169 | $ (27) | $ 50 | $ 122 | $ 1,787 |
| Assets | $ 12,244 | $ 566 | $ 181 | $ 5,286 | — | — | — | $18,277 |
| Capital expenditures | $ 71 | $ 33 | $ 21 | $ 21 | — | — | — | $ 146 |
| Depreciation and amortization | $ 208 | $ 108 | $ 40 | $ 45 | — | — | $ (122) | $ 279 |

Revenues and assets by geographic area are as follows:

| (In millions) | United States | Europe | Canada | Other | Total |
|---|---|---|---|---|---|
| **Year ended June 30, 2004** | | | | | |
| **Revenues** | **$ 6,449** | **$ 881** | **$ 354** | **$ 71** | **$ 7,755** |
| **Assets** | **$17,591** | **$1,662** | **$1,719** | **$ 149** | **$21,121** |
| Year ended June 30, 2003 | | | | | |
| Revenues | $ 6,016 | $ 775 | $ 292 | $ 64 | $ 7,147 |
| Assets | $16,841 | $1,476 | $1,391 | $ 126 | $19,834 |
| Year ended June 30, 2002 | | | | | |
| Revenues | $ 5,978 | $ 673 | $ 270 | $ 83 | $ 7,004 |
| Assets | $16,055 | $1,214 | $ 843 | $ 165 | $18,277 |

## NOTE 15 Quarterly Financial Results (Unaudited)

Summarized quarterly results of operations for the two years ended June 30, 2004 are as follows:

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| **Year ended June 30, 2004** | | | | |
| **Revenues** | **$1,720,277** | **$1,827,400** | **$2,121,435** | **$2,085,830** |
| **Net earnings** | **$ 194,850** | **$ 228,580** | **$ 300,250** | **$ 211,890** |
| **Basic earnings per share** | **$ .33** | **$ .39** | **$ .51** | **$ .36** |
| **Diluted earnings per share** | **$ .32** | **$ .38** | **$ .50** | **$ .36** |
| Year ended June 30, 2003 | | | | |
| Revenues | $1,646,685 | $1,682,995 | $1,905,778 | $1,911,559 |
| Net earnings | $ 210,400 | $ 261,690 | $ 329,390 | $ 216,670 |
| Basic earnings per share | $ .35 | $ .44 | $ .55 | $ .36 |
| Diluted earnings per share | $ .34 | $ .43 | $ .54 | $ .36 |

**Report of Management**

Management is responsible for the preparation of the accompanying financial statements. The financial statements, which include amounts based on the application of business judgments, have been prepared in conformity with accounting principles generally accepted in the United States of America. Deloitte & Touche LLP, an independent registered public accounting firm, has audited our consolidated financial statements as described in their report.

The Company maintains financial control systems designed to provide reasonable assurance that assets are safeguarded and that transactions are executed and recorded in accordance with management authorization. The control systems are supported by written policies and the control environment is regularly evaluated by both the Company's internal auditors and Deloitte & Touche LLP.

The Board of Directors has an Audit Committee comprised of four outside directors. The Audit Committee meets with both Deloitte & Touche LLP and the internal auditors with and without management's presence. It monitors and reviews the Company's financial statements and internal controls, and the scope of the internal auditors' and Deloitte & Touche LLP's audits. Deloitte & Touche LLP and the internal auditors have free access to the Audit Committee.

Arthur F. Weinbach
Chairman and Chief Executive Officer

Karen E. Dykstra
Chief Financial Officer

Roseland, New Jersey
August 11, 2004

**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders of
Automatic Data Processing, Inc.
Roseland, New Jersey

We have audited the accompanying consolidated balance sheets of Automatic Data Processing, Inc. and subsidiaries ("the Company") as of June 30, 2004 and 2003, and the related consolidated statements of earnings, stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with 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 the Company at June 30, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2004, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

New York, New York
August 11, 2004

# Directors and Corporate Officers

**Directors**

Gregory D. Brenneman [(1)*, (2), (3)]
*CEO, Burger King Corporation*
*Chairman, ADP Compensation Committee*

Leslie A. Brun [(2), (4)]
*Chairman, Hamilton Lane*

Gary C. Butler
*President and Chief Operating Officer*

Joseph A. Califano, Jr. [(1), (2)]
*Chairman of the Board and President,*
*The National Center on Addiction and Substance Abuse*
*at Columbia University (CASA)*

Leon G. Cooperman [(1)*, (3), (4)]
*Chairman and Chief Executive Officer,*
*Omega Advisors, Inc.*
*Chairman, ADP Audit Committee*

R. Glenn Hubbard
*Dean of The Graduate School of Business at Columbia University*

Ann Dibble Jordan [(1), (4)]
*Consultant*
*Member of various boards*

Harvey M. Krueger [(3)]
*Vice Chairman, Lehman Brothers*
*Chairman, ADP Executive Committee*

Frederic V. Malek [(2), (3), (4)]
*Chairman, Thayer Capital Partners*
*Chairman, ADP Nominating/Corporate Governance Committee*

Henry Taub [(3)]
*Honorary Chairman of the Board*

Arthur F. Weinbach [(3)]
*Chairman and Chief Executive Officer*

Josh S. Weston [(3)]
*Honorary Chairman of the Board*

(1) Audit Committee
 * a designated "audit committee financial expert"
(2) Compensation Committee
(3) Executive Committee
(4) Nominating/Corporate Governance Committee

**Corporate Officers**

Arthur F. Weinbach
*Chairman and Chief Executive Officer*

Gary C. Butler
*President and Chief Operating Officer*

**Group Presidents**

Richard J. Daly
John Hogan
S. Michael Martone

**Corporate Vice Presidents**

Steven J. Anenen
James B. Benson
Richard C. Berke
Marianne C. Brown
Janice M. Colby
Raymond L. Colotti
Vincent R. Coppola
J. Russ DeLoach
Vincent R. De Palma
G. Harry Durity
Karen E. Dykstra, *Chief Financial Officer*
Campbell B. Langdon
Peter H. Op de Beeck
Jay C. Rising
Carlos Rodriguez
Michael P. Rooney
Robert Schifellite
Dan Sheldon
George I. Stoeckert
Dante F. Terzo
Thomas J. Tremba

**Staff Vice Presidents**

Stephen A. Doherty
Steven J. Kyono
Gary E. Tarino
Daniel A. Zaccardo

**Corporate Headquarters**

Automatic Data Processing, Inc.
One ADP Boulevard
Roseland, New Jersey 07068-1728
973.974.5000

**Annual Report, Form 10-K and Other Reports**

This 2004 Annual Report is also available online under "Investor Information" on ADP's Web site at www.adp.com. Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statement, statements of change in beneficial ownership and other SEC filings, and amendments to those reports, statements and filings, are available, without charge, on ADP's Web site as soon as reasonably practicable after they are filed electronically with the SEC. Copies also are available, without charge, from ADP Investor Relations at: One ADP Boulevard, Roseland, New Jersey 07068-1728. Phone: 973.974.5858.

**Product Information**

For information about ADP's products and services, visit us at www.adp.com.

**Corporate Governance**

Visit ADP's Web site, at www.adp.com, to see its key corporate governance documents, including its Corporate Philosophy, Code of Business Conduct & Ethics, Code of Ethics for Principal Executive Officer and Senior Financial Officers, Corporate Governance Principles, Audit Committee Charter, Compensation Committee Charter, Nominating/Corporate Governance Committee Charter and Executive Committee Charter.

**Contact ADP's Audit Committee or Board of Directors**

To report complaints about ADP's accounting, internal accounting controls or auditing matters, or other concerns, to the Audit Committee or the Board of Directors, send a detailed note, with relevant documents, to P.O. Box 34, Roseland, New Jersey 07068, leave a message for a return call at 973.974.5770 or send an email to adp_audit_committee@adp.com.

**Annual Meeting**

This year's stockholders' meeting will be held at Automatic Data Processing, Inc., One ADP Boulevard, Roseland, New Jersey, on November 9, 2004 at 10:00 a.m. A notice of the meeting, proxy statement, and proxy voting card will be mailed to stockholders starting on or about September 22, 2004.



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